

BRASIL TELECOM SA  
Form 20-F  
June 30, 2006

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**SECURITIES AND EXCHANGE COMMISSION**  
Washington, DC 20549

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**FORM 20-F**

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**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005**

Commission file number: 1-15256

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**BRASIL TELECOM S.A.**  
(F/K/A TELECOMUNICAÇÕES DO PARANÁ S.A. - TELEPAR)

(Exact Name of Registrant as Specified in Its Charter)

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**Brazil Telecom Company**  
(Translation of Registrant's Name into English)

**The Federative Republic of Brazil**  
(Jurisdiction of Incorporation or Organization)

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**SIA/Sul, ASP, Lote D, Bloco B**  
**71215-000 Setor de Indústria, Brasília, DF, Brazil**

(Address of Principal Executive Offices)

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**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Each Exchange On Which Registered</b>
Preferred Shares, without par value, represented by American Depositary Shares*	New York Stock Exchange

\* American Depositary Shares issuable upon deposit of Preferred Shares were registered under a separate registration statement on Form F-6.

**Securities registered or to be registered pursuant to Section 12(g) of the Act: None**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None**

**Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by this Annual Report:**

At December 31, 2005 there were outstanding:  
249,597,049,542 Common Shares, without par value  
305,701,231,289 Preferred Shares, without par value

**Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.**

**Yes      No**

**Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.**

**Yes      No**

**Indicate by check mark whether the registrant is a large accelerated, an accelerated filer, or a non-accelerated filer.**

**See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.**

**Large Accelerated Filer      Accelerated Filer      Non-Accelerated Filer**

**Indicate by check mark which financial statement item the Registrant has elected to follow.**

**Item 17      Item 18**

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## PRESENTATION OF FINANCIAL INFORMATION

In this Annual Report, Brasil Telecom S.A., a corporation organized under the laws of the Federative Republic of Brazil and its subsidiaries are referred to collectively as "Brasil Telecom," "our company," "we," "us" or the "Registrant." References to our company's businesses and operations are references to the businesses and operations of our company on a consolidated basis for the years 2003, 2004 and 2005.

References to (i) the "*real*," "*reais*" or "R\$" are to Brazilian *reais* (plural) and the Brazilian *real* (singular) and (ii) "dollars" or "US\$" are to United States dollars. All amounts in Brazilian currencies that existed prior to the adoption of the *real* as the Brazilian currency on July 1, 1994 have been restated in *reais*. On May 31, 2006, the Commercial Market selling rate (as defined in Item 3 "Key Information Selected Financial Data Exchange Rates") was R\$2.3005 to US\$1.00 as published by the Brazilian Central Bank. The exchange rate information in this Annual Report should not be construed as a representation that any such amounts have been, would have been or could be converted at this or any other exchange rate.

Our audited consolidated financial statements were prepared in conformity with generally accepted accounting principles in Brazil ("Brazilian GAAP") which are similar to the Brazilian Corporation Law (Law 6.404/76, as amended by Law 10.303/01), except for the effects of the recognition of inflationary effects from January 1, 1996 to December 31, 2000, and are consistent with the rules and regulations of the Brazilian Securities and Exchange Commission (CVM *Comissão de Valores Mobiliários*), and the accounting standards issued by the Brazilian Institute of Independent Auditors (*Instituto dos Auditores Independentes do Brasil* or "IBRACON"). Investors should note that financial statements prepared in accordance with Brazilian GAAP differ from financial statements prepared in accordance with Brazilian Corporation Law in the methodology used for the recognition of inflation, among other things. See Notes 2a and 2b to our audited consolidated financial statements for (i) a summary of the principal differences between Brazilian GAAP and Brazilian Corporation Law as they relate to us and (ii) a reconciliation from Brazilian Corporation Law to Brazilian GAAP of shareholders' equity as of December 31, 2003, 2004 and 2005 and net income (loss) for each of the years ended December 31, 2003, 2004 and 2005. Brazilian GAAP when applied to us differs in certain important respects from generally accepted accounting principles in the United States ("US GAAP"). See Note 33 to our audited consolidated financial statements for (i) a summary of the principal differences between Brazilian GAAP and US GAAP as they relate to us and (ii) a reconciliation to US GAAP of shareholders' equity as of December 31, 2004 and 2005 and net income (loss) for each of the years ended December 31, 2003, 2004 and 2005. These audited consolidated financial statements are referred to herein as the "Financial Statements."

Our audited annual consolidated financial statements as of December 31, 2003, 2004 and 2005, and for each of the three years ended December 31, 2003, 2004 and 2005 prepared in accordance with Brazilian GAAP with reconciliation of shareholders' equity and income statements to US GAAP, included in this Annual Report, have been audited by KPMG Auditores Independentes, in accordance with the standards of the Public Company Accounting Oversight Board as stated in their report appearing in this Annual Report.

The "Index of Defined Terms" that begins on page 161 lists the page where each defined term is defined within this document. Technical terms are defined in the Technical Glossary on page 163.

Certain figures included in this Annual Report have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

## **FORWARD-LOOKING INFORMATION CONTAINED IN THIS ANNUAL REPORT**

This Annual Report contains forward-looking statements. We may also make forward-looking statements in press releases and oral statements. Forward-looking statements are not statements of historical fact and involve known and unknown risks and uncertainties. The words "anticipates," "believes," "estimates," "expects," "forecasts," "intends," "plans," "predicts," "projects," "targets" and similar words are intended to identify these forward-looking statements.

In this Annual Report, we have made forward-looking statements with respect to, but not limited to:

- our marketing strategy;
- our ability to meet our network expansion, service quality and modernization obligations;
- our market share in general and the growth in our internet service offerings in particular;
- our compliance with radiation standards;
- the reduction of our labor force;
- the payment of our debt;
- the material adverse financial effect of any labor, civil or tax claims arising out of acts committed by Telebrás prior to the effective date of the breakup of Telebrás;
- the retroactive application of state value-added taxes to certain services, including installation services, rendered during the five years preceding June 30, 1998;
- the growth in the customer base and products offered by cable television services providers in our region;
- our projected capital expenditures; and
- our liquidity.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Our future results and shareholder values may differ materially from those expressed in or suggested by these forward-looking statements. Many of the factors that will determine these results and values are beyond our ability to control or predict.

Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements. These factors include:

- the performance of the Brazilian economy generally;
- the levels of exchange rates between Brazilian and foreign currencies;
- the telecommunications policy of Brazil's federal government;

- the growth of the Brazilian telecommunications industry as a whole;
- the introduction of competition to the Brazilian telecommunications industry in general and in our region in particular;

- the receipt of additional, and/or the revocation of our existing, governmental approvals and licenses;
- the availability of financing;
- the resolution of disputes among certain of our controlling shareholders;
- changes in the rates that we may charge under government regulations;
- the emergence of new technologies and the response of our customer base to those technologies;
- our ability to grow our business, in particular our mobile telephone business;
- acquisitions by us of other companies; and
- other factors discussed under "Item 3. Key Information - Risk Factors."

The reader should not place undue reliance on any forward-looking statement. Forward-looking statements speak only as of the date they are made, and we do not undertake any obligation to update them in light of new information or future developments. Neither our independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures, with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with the prospective financial information.

Information included in this Annual Report concerning Brazil, Telecom Italia International N.V. ("TII"), Techold Participações S.A. ("Techold") and Timepart Participações Ltda. ("Timepart") and other direct and indirect shareholders has been included herein based on public filings or other sources we assume to be correct but we have not independently verified such information.

**PART I****ITEM 3. KEY INFORMATION****Selected Financial Data*****Background***

The selected financial information presented herein should be read in conjunction with our Financial Statements and notes, which appear elsewhere in this Annual Report. Our selected financial information is presented on a consolidated basis for all years presented.

The following paragraphs discuss some important features of the presentation of the selected financial information and our Financial Statements. These features should be considered when evaluating the selected financial information and our Financial Statements and Notes.

***Brazilian GAAP and US GAAP***

The consolidated financial statements have been prepared in accordance with Brazilian GAAP, which differ in certain significant respects from US GAAP.

See Note 33 to our Financial Statements for (i) a summary of the principal differences between Brazilian GAAP and US GAAP as they relate to us, and (ii) a reconciliation to US GAAP of shareholders' equity as of December 31, 2004 and 2005 and net income (loss) for each of the years ended December 31, 2003, 2004 and 2005.

***Change in Accounting Methodology***

For a discussion of recent changes in accounting methodology regarding depreciation, see Item 4. Information on the Company "Property, Plant and Equipment" and Item 5. Operating and Financial Review and Prospects "Operating Results Results of Operations for the Years Ended December 31, 2003, 2004 and 2005 Cost of Services Depreciation and Amortization."

***Difference from Financial Statements Published in Brazil***

Our statutory financial statements prepared in accordance with the Brazilian Corporation Law (the "Statutory Financial Statements") are the basis for dividend and tax determinations. See Notes 2a and 2b to our Financial Statements for (i) a summary of the principal differences between Brazilian GAAP and Brazilian Corporation Law as they relate to us and (ii) a reconciliation from Brazilian Corporation Law to Brazilian GAAP of shareholders' equity as of December 31, 2004 and 2005 and net income (loss) for each of the years ended December 31, 2003, 2004 and 2005. Our Statutory Financial Statements also differ from our Financial Statements in respect of certain reclassifications, and presentation of comparative information.

**Selected Financial Information**

<b>Income Statement Data:</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b><i>Brazilian GAAP:</i></b>					
Net operating revenue	6,158,408	7,071,368	7,915,194	9,064,855	10,138,684
Cost of services	4,798,434	5,163,861	5,472,142	6,142,645	6,525,898
Gross profit	1,359,974	1,907,507	2,443,052	2,922,210	3,612,786
Operating expenses:					
Selling expenses	724,570	763,375	821,656	1,086,946	1,656,242
General and administrative expenses	604,890	661,060	847,074	998,592	1,264,741
Other net operating expenses (income)	56,769	(118,496)	214,953	61,198	626,306
Operating income (loss) before net financial expenses	(26,255)	601,568	559,369	775,474	65,497
Net financial expenses	236,357	618,899	844,802	579,514	596,239
Operating income (loss)	(262,612)	17,331	(285,433)	195,960	(530,742)
Net non-operating expenses (income)	93,071	64,497	541,691	112,073	(149,024)
Employee's profit share	50,834	41,387	1,076	53,783	0
Income (loss) before taxes and minority interests	(406,517)	(123,215)	(828,200)	30,104	(679,766)
Income and social contribution tax benefits	199,039	111,596	320,751	75,012	389,066
Income (loss) before minority interests	(207,478)	(11,619)	(507,449)	105,116	(290,700)
Minority interests	---	---	14	(6,276)	(12,971)
Net income (loss)	(207,478)	(11,619)	(507,435)	98,840	(303,671)
Number of Common Shares (millions) <sup>(1)</sup>	237,165	243,564	249,597	249,597	249,597
Number of Preferred Shares millions) <sup>(1)</sup>	293,218	292,020	289,850	292,011	305,701
Net income (loss) per thousand Common Shares ( <i>reais</i> ) <sup>(1)</sup>	(0.87)	(0.05)	(2.03)	0.40	(1.22)
Dividends per thousand Common Shares ( <i>reais</i> ) <sup>(1)</sup>	0.37	0.51	0.39	0.70	0.98
Dividends per thousand Common Shares (dollars) <sup>(1)(2)</sup>	0.16	0.14	0.14	0.26	0.42
Dividends per thousand Preferred Shares ( <i>reais</i> ) <sup>(1)</sup>	0.37	0.51	0.39	0.70	0.98
Dividends per thousand Preferred					

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Shares (dollars) <sup>(1)(2)</sup>	0.16	0.14	0.14	0.26	0.42
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(1) See Note 3s to our Financial Statements.

(2) Dividends per thousand shares were converted into dollars at the Commercial Market selling rate of R\$2.3200 per dollar on December 31, 2001, of R\$3.5333 per dollar on December 31, 2002, of R\$2.8892 per dollar on December 31, 2003, of R\$2.6544 per dollar on December 31, 2004, and of R\$2.3407 per dollar on December 31, 2005, respectively.

**Selected Financial Information (continued)**

<b>Income Statement Data (continued)</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>U.S. GAAP:</b>					
Net income (loss)	(169,716)	317,280	(287,739)	284,907	168,790
Net income (loss) per thousand shares ( <i>reais</i> ) <sup>(3)</sup> :					
Common Shares Basic	(0.32)	0.59	(0.54)	0.53	0.30
Common Shares Diluted	(0.32)	0.59	(0.54)	0.53	0.30
Preferred Shares Basic	(0.32)	0.59	(0.54)	0.53	0.30
Preferred Shares Diluted	(0.32)	0.59	(0.54)	0.53	0.30

<sup>(3)</sup> In accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share," or SFAS 128, basic and diluted earnings per share have been calculated, for US GAAP purposes, using the "two class method." See Note 33e to our Consolidated Financial Statements.

	<b>At December 31</b>				
	2001	2002	2003	2004	2005
	(Thousands of <i>reais</i> )				
<b>Balance Sheet Data:</b>					
<b>Brazilian GAAP:</b>					
Intangibles <sup>(1)</sup>	372,537	470,544	531,556	863,929	649,949
Property, plant and equipment, net	12,240,270	11,260,625	9,567,243	9,370,091	8,687,607
Total assets	15,772,551	16,432,198	15,622,803	17,402,504	16,728,089
Loans and financing current portion	530,661	683,276	1,990,274	1,103,133	1,489,384
Loans and financing non-current portion	3,504,489	4,398,532	2,645,563	4,178,365	3,418,841
Total liabilities (including funds for capitalization and minority interests)	7,796,249	8,808,409	8,781,841	10,921,139	11,231,482
Shareholders' equity	7,976,302	7,623,789	6,840,962	6,481,365	5,496,607
<b>US GAAP:</b>					
Intangibles <sup>(2)</sup>	873,559	830,328	978,414	1,419,363	1,410,004

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Property, plant and equipment, net	12,139,658	11,670,826	10,035,667	9,795,888	9,224,017
Total assets	16,546,508	17,202,182	16,538,085	18,383,735	18,100,528
Loans and financing current portion	525,137	480,666	1,737,494	834,321	1,198,051
Loans and financing non-current portion	3,504,489	4,252,221	2,455,897	3,990,371	3,254,622
Total liabilities (including funds for capitalization and minority interests)	8,711,767	9,390,158	9,281,644	11,311,615	11,542,343
Shareholders' equity	7,834,741	7,812,024	7,256,440	7,072,120	6,558,186

- (1) Includes the goodwill from our acquisition of a controlling stake in CRT, which was calculated based on book value.
- (2) Intangibles under US GAAP include the goodwill from our merger with Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR and our merger with CRT at December 31, 2001, 2002, 2003, 2004 and 2005, and amounts relating to our personal communication system ( PCS ) licenses at December 31, 2002, 2003, 2004 and 2005. See Note 33o to our Consolidated Financial Statements.

## Exchange Rates

Until March 14, 2005, there were two principal foreign exchange markets in Brazil: the commercial rate exchange market (the "Commercial Market") and the floating rate exchange market (the "Floating Market"). Most foreign trade and financial foreign currency exchange transactions were carried out on the Commercial Market. Purchases of foreign exchange in the Commercial Market could be carried out only through a financial institution authorized to buy and sell currency in that market. The Floating Market rate generally applied to specific transactions for which the approval of the Brazilian Central Bank (or the Central Bank ) was not required.

On March 4, 2005, the National Monetary Council ( CMN ) enacted new rules with respect to the foreign exchange market in Brazil. Resolution 3.265 unified the Commercial Market and the Floating Market in a single market (the Foreign Exchange Market ). The new rules also eliminated previous restrictions thereby allowing more flexibility for the purchase and sale of foreign currency. The unified Foreign Exchange Market is intended to simplify both inbound and out bound exchange transactions by permitting exchange contracts to be executed by the local institutions authorized to deal in foreign exchange. Foreign currencies may only be purchased through a Brazilian financial institution authorized to operate in the market. Furthermore, under the Foreign Exchange Market, Brazilian entities and individuals may purchase and sell foreign currency in transactions of any nature and without any limitations on the amounts involved, subject to the legality of the transaction and in accordance with the economic basis of the transactions and obligations set forth in the respective documentation. Rates are freely negotiated but the Central Bank may, in limited circumstances, intervene in the Foreign Exchange Market to curb excessive volatility.

Under the *Real Plan* ("Real Plan"), adopted on July 1, 1994, the *real* was introduced as the official unit of Brazilian currency, with each *real* having an exchange rate of R\$1.00 to US\$1.00. The issuance of *reais* was initially subject to quantitative limits backed by a corresponding amount of dollars in reserves, but the government subsequently expanded those quantitative limits and allowed the *real* to float, with parity between the *real*/dollar (R\$1.00 to US\$1.00) as a ceiling.

Since January 15, 1999 the *real* has been allowed to float freely. In 2000, the *real* devalued by 9.3% against the dollar to R\$1.9554. Further deterioration in the political and economic environment in 2001, in addition to the Brazilian energy crisis, resulted in the *real* devaluing by 18.7% against the dollar in that year. In 2002, as a reaction to political and economic uncertainties, the global economic downturn, the crisis in Argentina and the Brazilian presidential elections, the dollar appreciated by 52.3% against the *real* to R\$3.5333 per US\$1.00 at December 31, 2002. The *real* recovered in 2003, appreciating by 18.2% to R\$2.8892 per US\$1.00, at December 31, 2003. In 2004, the *real* appreciated by 8.1% against the dollar, quoted at R\$2.6544 per US\$1.00 on December 31, 2004. In 2005, the *real* appreciated by 13.4% against the dollar, quoted at R\$2.3407 per US\$1.00 on December 31, 2005. We cannot guarantee that the *real* will not substantially devalue again in the future. See " Risk Factors Risks Relating to Brazil."

***Selling Rate for Dollars***

As of May 31, 2006, the selling rate published by the Brazilian Central Bank was R\$2.3005 per US\$1.00. The following table sets forth the reported high and low selling rates for dollars for the months indicated.

	<b>High</b>	<b>Low</b>
December 2005	2.3735	2.1800
January 2006	2.3460	2.2116
February 2006	2.2217	2.1177
March 2006	2.2238	2.1067
April 2006	2.1534	2.0884
May 2006	2.3235	2.0586

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Source: Brazilian Central Bank

The following table sets forth the reported high and low, average and period-end selling rates for dollars for the annual periods indicated. The average selling rates represent the average of the month-end commercial market selling rates (R\$/US\$) during the relevant period.

<b>For the Year Ended December 31,</b>	<b>High</b>	<b>Low</b>	<b>Average</b>	<b>Period End</b>
2001	2.801	1.936	2.352	2.320
2002	3.955	2.271	2.915	3.533
2003	3.662	2.822	3.060	2.889
2004	3.205	2.654	2.926	2.654
2005	2.762	2.163	2.434	2.340

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Source: Brazilian Central Bank

Brazilian law provides that whenever there is a serious imbalance in Brazil's balance of payments or reliable information to foresee such an imbalance temporary restrictions may be imposed on remittances of foreign capital abroad. We cannot guarantee that these restrictive measures will not be taken by the Brazilian government in the future. See " Risk Factors Risks Related to Operations In Brazil."

## **RISK FACTORS**

The following are risk factors that relate materially to our company and to an investment in our Preferred Shares or ADSs. Our business, results of operations or financial condition could be harmed if any of these risks materialize and, as a result, the trading price of our Preferred Shares or ADSs could decline and a holder of those securities could lose a substantial portion or all of his investment.

### ***Risks Related to Our Business***

***Regulatory developments could affect our services, including placing restrictions on the rates we charge for our services, which could adversely impact our business.***

Our main activities, as well as the main activities of our competitors, are subject to regulation and inspection by the Agência Nacional de Telecomunicações ("Anatel"). The regulations enacted by Anatel and applicable to our activities include provisions regarding charges, fees, universalization, quality of services, net expansion, licenses, competition, changes in our corporate control (including participation by foreign investors), interconnection and other operational issues related to the functioning of our telecommunications net.

Any changes in the laws, regulations or governmental policies applicable to the telecommunications sector or in the interpretation of such laws and regulations may have material adverse effects on our financial condition and results of operations.

Moreover, it is not possible to predict which policies for the telecommunications sector will be adopted by the government in the future or the consequences of such policies to our business and the business of our competitors.

The new concession contracts contain sections regarding the new Plano Geral de Metas de Qualidade (*General Plan for Quality Targets*; the PGMQ ) and the new Plano Geral de Metas de Universalização (*General Plan for Universalization Targets*; the PGMU ) related to (i) new targets for the universalization of services; (ii) change in the criteria for the charging of local calls, substituting pulses for minutes in the calculation of charges; (iii) new parameters for the adjustment of rates (the Telecommunications Industry Index ( IST ) became the official index to measure the sector inflation and adjust rates, although private-regime companies that compete with us do not require Anatel approval when setting their rates and may unilaterally determine the prices they charge for their services) and interconnection rates; and (iv) portability of fixed line telephone numbers.

These changes may affect the financial balance of our concession contract and adversely affect our business and financial conditions. We are currently discussing certain terms of the new concession contract with Anatel to reconcile the fact that such terms do not contemplate investments made by us to reach the previous targets determined by our old concession contract, the fact that we are to bear the costs associated with the new universalization targets and the fact that the IST may not accurately reflect inflation in a given period. We can not assure that we will be able to successfully challenge such provisions.

### ***Termination of Concession Contracts***

According to the General Telecommunications Law, as well as according to the Concession Contracts, the concessions are revocable in the following situations:

- non-renewal upon the expiration of the concessions;

- an extraordinary situation in which the public interest is in jeopardy, during which time the Brazilian government may operate our company. In such cases, the Brazilian government must be legislatively authorized to terminate the concession and our company must be indemnified;
- contractual, legal or free-will termination by us when an act or omission of the Brazilian government makes rendering services excessively burdensome to us, or:

- the occurrence of:
  - (a) a split-up, spin-off, amalgamation, merger, capital reduction or transfer of our corporate power without Anatel's authorization;
  - (b) the transfer of the concessions without Anatel's authorization;
  - (c) our dissolution or bankruptcy; or
  - (d) an extraordinary situation where Brazilian government intervention, although legally possible, is not undertaken since such intervention would prove to be inconvenient, unnecessary or would result in unfair benefits for us.

***A proposed bill of law terminating monthly subscription fees may adversely affect our business and financial conditions.***

On May 12, 2004, the Consumer Defense Committee of the House of Representatives approved a bill of law proposing the termination of the monthly subscription fees charged for fixed-line services by Brazilian telephone concessionaires, including our company. The bill is still under consideration before the House of Representatives, where a special committee was created on June 3, 2005 to discuss and to make a report regarding the bill. The bill will be subject to the approval of the House of Representatives, the Senate and the President. In 2005 the revenue of monthly subscription fees charged for fixed-line was R\$3.5 billion. Should this bill be approved, it may have an impact on our current rate structure and, as a result, our operations and competitive position could be adversely affected.

***We are subject to financial covenants and other contractual provisions under our existing indebtedness. Failure to comply with these provisions could adversely affect our business and financial condition.***

The agreements that govern our debt, including our credit facilities with National Bank for Social and Economic Development (*Banco Nacional de Desenvolvimento Econômico e Social* - BNDES), contain a number of significant covenants, the failure to comply with which could adversely impact our business. In particular, the terms of these agreements restrict our ability, and the ability of our subsidiaries, to incur additional debt, make capital expenditures, grant liens, pledge assets, sell or dispose of assets and make certain acquisitions, mergers and consolidations. Furthermore, in accordance with a number of our debt agreements, including our credit facilities with BNDES, we are required to comply with these covenants and maintain certain specified financial ratios in order to maintain the current maturity dates for these debt agreements. As a general rule, the occurrence of an event of default under a credit facility with BNDES may trigger the acceleration of other agreements representing our indebtedness.

During December 2004, we initiated a process of adjusting the covenants related to certain agreements with BNDES, in order to fit them to the new reality of the telecommunications sector and our company. As part of this adjustment process, we and BNDES introduced a new mechanism in the credit facility agreements. In the event of a failure by us to comply with semi-annual financial covenants, instead of the right to accelerate the entire amount of the debt, which may trigger cross-defaults in our debt instruments, BNDES may request the retention of funds in a blocked account in an amount equivalent to three times the highest installment of principal plus interest due under such agreement. If we, after the creation of such a blocked account, we again fail to comply with the financial covenants, then BNDES will have the right, but not the obligation, to declare the acceleration of the debt. The adjustment process extended these remedies to all BNDES agreements to which we are a party, effective as of December 31, 2004. Any failure by us to comply with the financial covenants of our debt instruments, and subsequent acceleration of our debt by BNDES, would have a material adverse effect on our ability to conduct our operations.

On January 5, 2006, we announced that we intended to book provisions in our financial statements for the year ended December 31, 2005, in the amount of R\$622 million (see description in PART II of this report in our Financial Statements). Such provisions, if booked, could affect our results and, accordingly, jeopardize the compliance in the fiscal year ended on December 31, 2005 until and including the third quarter of 2006 of financial covenants set forth in certain debt agreements, including the credit facilities with BNDES, and the *Escritura de Emissão*,

relating to the Debentures of the 4<sup>th</sup> issuance, being the 3<sup>rd</sup> public, the loan agreements entered into with Japan Bank of International Cooperation ( JBIC ) and with Sumitomo Mitsui Banking Corporation. Therefore, prior to making the decision to book the provisions, we initiated negotiations with our creditors to adjust the affected financial covenants, in particular the ratio between EBTIDA and the financial expenses.

On January 6, 2006, we entered into negotiations with BNDES and the financial institutions acting as its agents under the credit facilities. In view of our failure to comply with certain financial covenants, BNDES decided to retain funds in a blocked account equivalent to the highest installment plus interest due under agreement in an amount of approximately R\$250 million. In February 2005, the agreements were amended to determine that the funds to be retained shall be equivalent to the highest installment plus interest, instead of three times such figure, as provided for in the initial amendment to the credit facilities.

On January 30, 2006, the holders of our outstanding debentures of the 4<sup>th</sup> issuance approved an adjustment to the financial covenant relating to the ratio between Consolidated EBITDA and Consolidated Financial Expenses, contained in Section 4.19.1(e)(i) *Escritura de Emissão* from equal or higher than 2.25, to equal or higher than 1.5, as of the fourth quarter of 2005, until and including the third quarter of 2006. If we had not obtained this amendment, we would not have been in compliance with this financial covenant for the fourth quarter of 2005, when we reached a ratio of 2.17. See Item 10. Additional Information Material Contracts Debentures Escritura de Emissão.

On February 17, 2006, we signed the First Amendment to the Loan Agreement entered into with JBIC, dated March 18, 2004, and the First Amendment to the Loan Agreement entered into with Sumitomo Mitsui Banking Corporation, dated March 24, 2004. These amendments adjusted the financial covenants in each respective loan agreement relating to EBTIDA and the financial expenses from equal or higher than 2.25, to equal or higher than 1.5, as of the fourth quarter until and including the third quarter of 2006. For the fourth quarter of 2005 we achieved a Consolidated EBITDA over Consolidated Financial Expenses ratio of 2.17. See Item 10. Additional Information Material Contracts JBIC Guaranteed Loan.

Regarding the loan agreements with BNDES we failed to comply with the financial covenant of Brasil Telecom Participações consolidated results. The Consolidated EBITDA over Consolidated Financial Expenses ratio was supposed to remain above or equal to 2.50, but we reached 2.17 in the fourth quarter of 2006. Following the provisions established in the agreements, BNDES is running retention up to R\$250 million of our cash investments, without penalties concerning interest or fees, which will be valid until we achieve the 2.50 ratio.

On February 3, 2006, we obtained a waiver from BNDES in order to avoid the acceleration of the agreements in view of a potential failure to comply with the financial covenants in the first semester of 2006. See Item 10. Additional Information Material Contracts JBIC BNDES Loan Agreements.

Compliance with these covenants in future periods will depend upon our financial and operating performance, which may be affected by adverse business, market and economic conditions. If we are unable to comply with these covenants, or to obtain waivers from our lenders, our debt agreements may be accelerated and the terms of our debt agreements may be otherwise amended adversely. If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to restructure or refinance our indebtedness, seek additional equity capital or sell assets. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Indebtedness."

***Certain beneficial owners directly or indirectly control a large percentage of our voting shares, and their interests may conflict with the interests of our other shareholders, including minority shareholders. Disputes among our controlling shareholders and entities that manage our controlling shareholders have had and could in the future have a material adverse effect on our management and operations.***

We are controlled by Brasil Telecom Participações S.A., which is in turn controlled by Solpart Participações S.A. ("Solpart"), whose stockholders are Timepart, Techold and TII. As the controlling shareholder of Brasil Telecom Participações S.A., Solpart has the power to modify our business plan, modify our dividend plan and sell our material assets. As of the date of this annual report, control of Solpart, as well as certain actions taken by Solpart's shareholders and their affiliates are the subject of a number of judicial and arbitration proceedings.

On March 9, 2005, International Equity Investments, Inc. as the sole shareholder of CVC/Opportunity Equity Partners LP (since renamed Citigroup Venture Capital International Brazil, LP) ("CVC LP") which holds a direct stake in Brasil Telecom Participações S.A. and a substantial indirect stake in Zain Participações S.A. ( Zain ), a company that indirectly owns a majority of the voting interests in Solpart, and therefore indirectly owns a majority of the voting shares of Brasil Telecom Participações S.A. and our company, publicly announced the ouster of CVC/Opportunity Equity Partners, Ltd ("CVC Ltd"), currently named Opportunity Equity Partners, Ltd., ( Opportunity Ltd. ) from the management of CVC LP. Opportunity Ltd. was replaced by a new company incorporated abroad, Citigroup Venture Capital International Brazil LLC ("CVC International Brazil").

On March 9, 2005, CVC LP, in compliance with CVM/SEP/GEA-2 Written Notice 225/05 and the terms of CVM Instruction 358, announced that International Equity Investments, Inc. and CVC International Brazil had entered into certain agreements with Investidores Institucionais Fundo de Investimento em Ações ( Investidores Institucionais FIA ), Caixa de Previdência dos Funcionários do Banco do Brasil Previ ( Previ ), Fundação dos Economistas Federais Funcef ( Funcef ) and Fundação Petrobras de Seguridade Social Petros ( Petros ), including a voting agreement with respect to their shares of Zain (collectively, the Agreements ).

Under the Agreements, CVC LP and Investidores Institucionais FIA, with combined holdings of approximately 90% of the voting shares of Zain, will jointly exercise the corporate control of Zain and Invitel S.A. ( Invitel ), a company controlled by Zain with approximately 68% of its voting shares, and in which Previ, Funcef, Petros and other Brazilian pension entities hold nearly all of the remaining shares. The Agreements also establish that the parties are to attempt to disinvest, under identical terms, jointly and in an organized manner, their shareholdings in Zain and Invitel, companies which control, among other companies, us, our Parent, and our subsidiary, 14 Brasil Telecom Celular S.A. ( BrT Celular ).

In connection with the execution of the Agreements, Previ, Funcef and Petros signed the Put Option on Shares Issued by Zain granting CVC LP a put option on its Zain shares, which may be exercised under certain circumstances during a limited period of time, but not before November 2007. CVC LP's right to exercise the put option is conditioned on the occurrence of certain future events, some of which are beyond the control of CVC LP, Investidores Institucionais FIA, Previ, Funcef and Petros. If CVC LP exercises its put option, the exercise price is set at R\$1,045,941,692.43, adjusted by the variation of the IGP-DI Index + 5% p.a. The fulfillment of the conditions to the exercise of such put option granted by Previ, Funcef and Petros does not depend and is not tied to the occurrence of any operation or business involving, directly or indirectly, property or other assets owned by Zain, Invitel or any of their controlled companies, including us, our Parent and BrT Celular.

On April 12, 2005, Anatel issued a decision approving among other things: (i) the replacement of Opportunity Ltd. by CVC International Brazil as the general partner of CVC LP; (ii) the replacement of CVC/Opportunity Equity Partners Administradora de Recursos Ltda. by Angra Partners Consultoria Empresarial e Participações Ltda. as the new manager of Investidores Institucionais FIA, an indirect shareholder of Brasil Telecom Participações S.A. and Brasil Telecom S.A.; and (iii) certain changes resulting from the Agreements entered into by CVC LP and Investidores Institucionais. This decision was published in the Federal Gazette (*Diário Oficial*) on April 14, 2005. After reviewing our appeal filed by prior management related to Opportunity Ltd., Anatel upheld its April 12, 2005 decision.

On October 6, 2003, Fundação 14 de Previdência Privada ( Fundação 14 ), successor to Fundação Sistel de Seguridade Social, was prevented by the other shareholders of Investidores Institucionais FIA from exercising its voting rights at the Investidores Institucionais FIA's Unitholders Meeting. At such meeting, Banco Opportunity S.A. was ousted from the administration of Investidores Institucionais FIA. Consequently, Fundação 14 brought an ordinary action before the 5th Federal Court of Rio de Janeiro against Previ and several investors in Investidores Institucionais FIA, seeking a declaration that the resolutions adopted at the Investidores Institucionais FIA's

Unitholders Meeting held on October 6, 2003 were invalid. On May 18, 2005, an injunction granted on May 17, 2005 in favor of Fundação 14 by a federal tribunal in Rio de Janeiro, which would have allowed Banco Opportunity S.A. to return to the management of Investidores Institucionais FIA s was revoked by a decision granted by Superior Tribunal de Justiça ( STJ ), the highest Brazilian court for non-constitutional matters; in the proceeding SLS 128. On July 12, 2005, Fundação 14 filed before the 5th Federal Court of Rio de Janeiro a motion to abandon this lawsuit. To the best of our knowledge, this STJ decision is being challenged by Banco Opportunity S.A.

On July 27, 2005, at an Extraordinary General Shareholders Meeting of our Parent, the shareholders removed and replaced the members of the board. The new board members assumed their board positions on August 25, 2005, and at their first formal meeting replaced the officers of our Parent.

At an Extraordinary General Shareholders Meeting held on September 30, 2005, our shareholders removed and replaced the prior members of our Board of Directors (except for Mr. Antonio Cardoso dos Santos, who was elected by the holders of our preferred stock and remains a director). Also on September 30, 2005, our newly constituted Board of Directors replaced all of the senior officers with a new management team, including Mr. Ricardo Knoepfmacher, as Chief Executive Officer, Charles Lagana Putz, as Chief Financial Officer and Investor Relations Officer, Luiz Francisco Tenorio Perrone as Human Resources Officer, and Francisco Aurelio Sampaio Santiago as Network Officer. Subsequently, at an Extraordinary General Shareholders Meetings held on November 17, 2005 and January 12, 2006, our shareholders removed and replaced the members of our fiscal council (which functions as our audit committee for purposes of SEC and NYSE rules and regulations).

The process of replacing the directors and officers of Brasil Telecom Participações S.A. and Brasil Telecom S.A. was litigious, as evidenced by various lawsuits filed by our former managers and their affiliates in an attempt to resume their former management roles. While we cannot predict the cumulative effect of this ongoing litigation on our business and results of operations, extensive litigation regarding ownership of our company creates uncertainty with respect to the identity of our current and future management, which may impair our ability to carry out our business plan.

#### ASSESSMENT OF THE ACTIONS OF OUR FORMER MANAGERS UNDER THE MANAGEMENT OF OPPORTUNITY LTD.

In observance of their fiduciary duties, under the terms of the applicable legislation, the current management of Brasil Telecom Participações S.A. and the current management of Brasil Telecom S.A. have performed and continue to perform internal investigations of the businesses and operations conducted by the former managers appointed by Opportunity, Ltd. In the course of such investigations, the current managers identified management acts indicating abuse of controlling power, breach of fiduciary duties, and conflict of interest, as well as various violations of Brazilian law and Companies Bylaws.

Therefore, in accordance with a notice to shareholders released on December 12, 2005, we filed a formal complaint with the CVM - the Brazilian Securities and Exchange Commission, against our former management, Opportunity Fund and other individuals and companies, both domestic and foreign, linked to our former management, who have been involved with, or participated in any way, or benefited from the actions which are the object of the formal complaint. On March 21, 2006, a second formal complaint, as an amendment to the first complaint, was submitted to CVM, in light of new management actions identified.

We intend to pursue all appropriate legal measures to recover potential losses and damages suffered, consistent with our best interests and fiduciary obligations. On April 28, 2006, at Ordinary and Extraordinary Meetings of Shareholders of Brasil Telecom S.A. and Brasil Telecom Participações S.A., the shareholders of each company approved the filing of damages lawsuits against prior management.

Despite the potentially misleading actions of our prior management as described above, to the knowledge of our management, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report.

#### ISSUES ARISING OUT OF OVERLAPPING OF LICENSES WITH A TELECOM ITALIA AFFILIATE

When we received the certification of achievement of universalization targets for 2003, established by Anatel, we were already providing fixed telephone services ( PSTN ) at domestic local and long distance modalities ( DLD ) intra-regional in Region II of the General Concession Plan ( PGO ).

After the achievement of such targets, Anatel, in January 2004, issued authorizations enlarging our potential areas of operations: PSTN local and LDN in Regions I and III of PGO (and in a few sectors of Region II); International Long Distance Call (ILD) in Regions I, II and III of PGO; mobile telephone, by means of our subsidiary BrT Celular, in Region II of Personal Mobile Service (SMP). Our existing concession agreements were also expanded, allowing LDN calls to any Brazilian territory. If TII acquires an indirect controlling interest in our Parent, TII and TIM could be viewed as affiliated companies under the Brazilian telecommunications law. As a result, our ability to render domestic (NLD) and international (ILD) fixed telephone services, as well as mobile telephone services, in the same regions as TIM, would be at risk of partial restriction or revocation by Anatel.

On January 16, 2004, Anatel issued Act 41,780, establishing a period of 18 months during which TII could reacquire an indirect controlling interest in our company, as long as TII neither participated nor voted on any issues related to the overlapping services offered by us and TIM, including domestic and international long distance calls and mobile telephone services. On June 30, 2004, the Administrative Council for Economic Defense CADE, in the records of Writ of Prevention 08700.000018/2004 -68, set forth restrictions on the exercise of control rights by TII and its representatives over the Boards of Directors of Solpart, our Parent and our company.

On April 28, 2005, certain TII affiliates and BrT Celular purported to enter into various corporate agreements, including an instrument called Merger Agreement and a Protocol related thereto. The April 28, 2005 agreements alleged that the proposed merger was justified as a possible solution to the overlapping regulatory licenses and authorizations with TIM, and to avoid sanctions and penalties which could be imposed by Anatel. Certain actions contemplated by these agreements have since been forbidden by injunctions issued by the US and Brazilian courts. The agreements are also subject to legal challenges by our indirect shareholders. Regardless of whether the validity of the April 28, 2005 agreements is confirmed, there is the possibility that assets related to our fixed and mobile segments (see Note 43) will eventually lose their value as a result of overlapping operations or sanctions issued by Anatel. It is possible that these agreements will be declared null and void by courts or in arbitration proceedings, which would remove TII from the control block of that group, eliminating the overlapping concessions and consequently, the regulatory risks. Nevertheless, it is not possible at this time to anticipate such legal developments and their future effects on our operations or financial statements.

On July 7, 2005, Anatel declared, by means of Act 51,450, that the counting of an 18 month term to solve the overlapping of licenses would start on the date of the effective return of TII to our control group. On July 26, 2005, Anatel, by means of Order 576/2005, declared that the counting of term would start on April 28, 2005. Therefore, according to Anatel, the interested companies shall adopt the measures necessary to eliminate the overlapping of licenses until the end of the 18 month term, October 2006, under the penalty of legal sanctions, which may affect either companies or both of them.

Depending on the final decision of Anatel, the threatened sanctions could have a material adverse effect on the business and operations of us and our subsidiary, BrT Celular.

On March 15, 2006, we and our subsidiary, BrT Celular, began an arbitration against TIM International N.V. (TIMINT) and TIM Brasil Serviços e Participações S.A. (TIMB), seeking to annul the Merger Agreement. We disclosed such arbitration in a material fact on March 16, 2006.

On May 2, 2006, TIMINT and TIMB announced their decision to terminate the Merger Agreement. In the same letter, TIMINT and TIMB reserved their alleged rights under sections 10.3 and 11.1 of the Merger Agreement. The arbitration that we brought against the Merger Agreement continues.

## **LAWSUITS AND INJUNCTIONS AFFECTING OUR OPERATIONS**

*Disputes among controlling shareholders*

We are unable to predict the outcome of the disputes related to the overlap of licenses and whether such disputes will be resolved without the issuance by Anatel of any sanctions or penalties. In addition, the disputes among the shareholders of Solpart, including the dispute over the ownership structure of Solpart, and management

of entities which hold a stake in Brasil Telecom Participações S.A. and Zain may result in changes to our board and/or senior management.

***Delays in payment or defaults of our clients for long periods may adversely affect our business.***

On March 31, 2006, we accounted losses related to accrued receivables in the amount of R\$112.8 million, as a result of the default of subscribers, which correspond to 3.1% of our consolidated net earnings during the period ended on that date.

Subscribers in default are those who fail to pay their bills within 30 days of their maturity date. Anatel requires us to render our services to all consumers, notwithstanding their credit history. Therefore, we may not select our subscribers or refuse to provide our services to certain subscribers, except if such subscriber has failed to pay past debts with us. High levels of default for long periods may adversely affect our business, our financial health and operational results.

***Problems with billing, invoicing and collection services may adversely affect our earnings.***

On July 2003, users were given the option to use our code to complete calls from mobile handsets. By Resolution No. 343, dated as of July 17, 2003, Anatel established that carriers shall render invoicing and collection services to other carriers with which they had entered into traffic agreements. Upon the certification that we had achieved the then established universalization targets, we were authorized to complete long distance national and international calls. We have entered into agreements with several carriers to include on our telephone bills the long distance services rendered by such carriers, as well as the long distance services rendered by other collective interest carriers. Any problems with the execution of invoicing and collection services by other carriers may adversely affect our levels of bad debts.

***Any reduction in the offer of products by suppliers may adversely affect us.***

We rely on several technology, equipment and services suppliers. Any difficulty in obtaining these products, due to, for example, a decrease in supply, excessive demand by global telecommunication players (causing product price pressure), discontinuity in the operations of one or more relevant suppliers (including bankruptcy or production problems), problems with the transfer or any other factor which affects the supplying of goods, may jeopardize either our expansion plans or the continuity of our services.

***We sponsor employee social security plans and any changes in the regulations regarding mortality rates may require us to book additional provisions on our financial statements.***

The amount, frequency and duration of our contributions to employee social security employees plans is directly related to the mortality rate, which represents the average life span of employees, among other factors.

Any change in these criteria may result in the need to contribute for longer periods in comparison to those initially provided. Consequently, we may be compelled to book additional provisions on our financial statements, which may adversely affect our results.

***We may need to enter financing agreements with third parties in order to conclude potential strategic acquisitions carry on new transactions, effect regulatory investments, and maintain wireless and fixed telephone line plants.***

We may not be able to bear financing demands through funds arising out of ordinary cash flow and may need to enter into financing agreements with third parties in the future. Such financing may not be available to us in

acceptable and competitive conditions or indeed in market conditions. If we are unable to obtain financings on terms favorable to us or at all, our transactions and operations may be materially and adversely affected.

***Problems with sophisticated information and processing systems may cause significant adverse effects on our financial status and operational results.***

Our sophisticated information and processing systems are vital for our growth and our ability to monitor costs, collect debts, detect frauds, provide services to consumers, reach operational efficiency and accomplish service targets, particularly in view of the increase in competition in our region. The updating and modernization of our systems may not be sufficient to avoid future flaws in each of these systems, which may have a significant adverse effect on our financial status and operational results.

***We may be required to obtain certain environmental licenses or fines may be levied against us for the failure to obtain such licenses.***

In Brazil, environmental licenses are regulated specially by Resolution No. 237/97, enacted by the National Environmental Council ( CONAMA ). This resolution lists those activities that require an environmental license and also establishes compulsory licensing for certain activities which may produce significant potential environmental impacts.

In Brazil, federal, state and local governments each have the authority to determine whether an activity may potentially result in significant environmental effects and, consequently, demand and award environmental permissions for the implementation of these activities. Our regular operations include the installation and maintenance of cables, wires and transmission antenna towers in our operating region. The installation and maintenance of cables, wires and transmission antenna towers are not referred to in CONAMA Resolution No. 237/97 as activities that require previous compulsory licenses. We cannot be assured, though, that a jurisdiction will not interpret installation and maintenance as activities that may potentially cause environmental impacts and therefore require us to obtain an environmental license for the implementation of these activities. If we are compelled to obtain environmental licenses in some jurisdictions and we fail to obtain these licenses, we may be subject to the imposition of fines, which may vary from R\$500 to R\$10 million, total or partial suspension of those activities, and/or civil and criminal sanctions. According to environmental crimes law (Law n° 9.605/98), the criteria for the imposition of fines include the degree of the violation, taking into account the motivation for the violation, the consequences for public health and for the environment, and the criminal precedents of the agent regarding the accomplishment of environmental law and its economic capacity. The imposition of fines or the compliance with these environmental regulations may have a significant adverse effect on our business or results of operations.

***Risks Related to the Brazilian Telecommunications Industry***

***We face increasing competition in all segments of the Brazilian telecommunications industry, and the telecommunications industry may not continue to grow or may grow at a slower rate than in the past. This may have a material adverse effect on our market share, margins, results of operations and financial condition.***

The telecommunications industry in Brazil is becoming increasingly competitive. Our public-regime fixed-line concessions are not exclusive, and Anatel could grant additional private-regime authorizations in our region. Our fixed-line services are also subject to competition from wireless service providers. However such competition is still limited by the fact that rates for wireless calls are currently much higher than rates for calls on our fixed-line network. We also face competition from wireless service providers in the low end of the market through the offer of prepaid plans by such wireless providers. To date, Telemar Norte Leste S.A. ("Telemar"), Empresa Brasileira de Telecomunicações S.A. ("Embratel"), Intelig Telecomunicações Ltda ("Intelig"), Telecomunicações de São Paulo S.A. ("Telesp"), Global Village Telecom ("GVT"), Telmex do Brasil Ltda ("Telmex"), Fonet Brasil Ltda ("Fonet"), and Novação Telecomunicações Ltda ("Novação") have been granted permission by Anatel to provide local fixed telecommunications services in the totality of our Region.

Additionally, to date, TNL PCS S.A. ("Oi"), Embratel, Intelig, Telesp, GVT, Albra Telecomunicações Ltda ("Albra"), TIM Celular S.A. ("TIM Cellular"), and Easytone Telecomunicações Ltda ("Easytone") have been granted permission by Anatel to provide long distance telecommunications services in the totality of our Region. Now we also have to compete in our region against competitors from outside of our region that offer fixed-line, mobile, data local and/or long distance telecommunications services throughout Brazil. Increased competition could have a material adverse effect on our market share, margins, results of operations and financial condition. Since

January 2004, we have developed the ability to counteract losses in our market share in the local fixed-line market by providing interregional and international long-distance telecommunications services.

In September 2004, we commenced offering wireless services. Wireless services are equally competitive and we face competition in Region II from (i) a joint venture between Telefônica and Portugal Telecom (marketed under the brand name "Vivo"), (ii) Telmex, which competes against us in our region through América Móviles (marketed under the brand name "Claro"), (iii) TIM Cellular, (iv) Sercomtel Celular, and (v) CTBC Celular. Competition for wireless telecommunications customers may require us to increase our costs and marketing expenses or provide services at lower rates than those we currently expect to charge for such services. Competition in data transmission services is not subject to regulatory restrictions. The market is open to a great number of competitors. Increased competition in data transmission services may require us to reduce the rates we charge for data transmission services.

In addition, the Brazilian telecommunications industry is consolidating, which results in larger competitors with greater resources. There can be no assurance that increased competition in all segments of the Brazilian telecommunications industry will not have a material adverse effect on our market share, margins, results of operations and financial condition.

Our ability to continue to compete successfully will depend on the success of our marketing, financial and other resources (including our access to capital) in comparison to our competitors and on our ability to anticipate and respond to competitive factors affecting the industry, including the introduction of new services, changes in consumer preferences, changes in regulation, demographic trends, economic conditions, discount pricing strategies by competitors as well as further industry consolidation. Currently, we compete with our competitors primarily on the basis of features, pricing and customer service. However, we cannot predict exactly which factors in the future will be important in maintaining our competitive position, such as the increasing need to offer promotions, discounts and other marketing initiatives, or what expenditures will be required to develop and provide the necessary technologies, products and services to remain competitive. An inability to compete in any of these factors may adversely affect our market share, margins, results of operations and financial condition.

In addition, we may also face increased competition due to unbundling regulations. On May 13, 2004, Anatel issued Order (*Despacho*) 172, which establishes rules for partial unbundling of local telephone networks, which we refer to as "line sharing", and full unbundling of local telephone networks, and requires us to make our networks available to other telecommunications service providers. This legislation limits the rate we can charge for line sharing per line for broadband speeds of up to 512 kbps. Additional charges, such as co-location charges, are applied over the line sharing base price, increasing the total cost of the unbundled line. Anatel has not yet fixed rates for full unbundling, although we expect that these rates will be lower than the rates we currently are permitted to charge. This regulation was designed to increase competition in the local fixed-line and broadband internet access markets by making it easier for new telephone companies operating under either the public or private regime to enter these markets and for existing providers to provide new services or enter new regions, since the networks of all telecommunications service providers, including fixed-line operators such as us, will be made available at lower rates. Similarly, this legislation makes it easier for us to provide new services and enter into new regions in competition with other operators. However, operational rules for the implementation of unbundling have not yet been agreed to among Brazilian telecommunications operators. These regulations are recent, and as of December 31, 2005 no unbundled lines had been used by competitors in our region. We cannot assure that we can compete without suffering an adverse impact on market share, margins, and results of operations or financial condition based on the implementation of unbundling.

Moreover, cable television services companies offer telecommunication services, and there are other alternatives to render telecommunication services, such as satellite transmission and VoIP. Another example is the conversion of fixed-line telephone users to wireless telephone users. These changes may lead to the migration of some of our

subscribers, resulting in a reduction in earnings, which may adversely affect our company.

Any economic, technological or other developments resulting in a slowdown in growth or a reduction in demand for our fixed-line or other services may harm our business and revenues. To remain competitive we must diversify further our services, and there can be no assurance that we will be successful in doing so.

***We depend on other telecommunications services providers. We may not be able to enter into favorable interconnection and unbundling agreements.***

In order to receive or send calls from or to customers of other fixed-line and wireless Brazilian networks and international networks, we must interconnect with the networks of our competitors. The Brazilian General Telecommunications Law requires all telecommunications service providers to interconnect their networks with those of other providers on a non-discriminatory basis. The rates to be paid by one fixed-line network operator to the other for the use of each other's fixed-line network are currently regulated by Anatel.

The current interconnection model is asymmetric, with higher rates in effect for mobile interconnection than fixed-line interconnection. As a result, mobile operators generally retain more than 80% of net revenues from fixed-to-mobile calls, while fixed-line carriers, like us, usually offer this service incurring negative margins. In light of such imbalance, Anatel established that from July 2004 on, interconnection rates for wireless networks (the VU-M) would be freely negotiated. The companies agreed to establish a provisional readjustment and submit the final decision to Anatel's arbitration under the telecommunication sector legislation. We can not assume that Anatel's arbitration regarding the interconnection tariffs will be favorable to us. If Anatel's decision is unfavorable to us, our operating and financial results may be adversely affected.

***The failure to implement the technology necessary to assess and combat fraud on our network could adversely affect our results of operations.***

The fraudulent use of telecommunications networks imposes a significant cost upon service providers, who must bear the cost of services provided to fraudulent users. We suffer loss of revenue as a result of fraudulent use, and also cash costs due to our obligation to reimburse carriers for the cost of services provided to fraudulent users. During 2004, we installed a Fraud Management System to detect and prevent fraud. In addition to a system to monitor customers' usage based on their traffic behavior, we implemented a system to keep subscribers under close surveillance. The fraud system is based on a signaling network and has an interface to the call-blocking platform in order to limit revenue loss once fraudulent use has been identified. We cannot guarantee that our Fraud Management System will effectively detect and prevent fraud.

In addition, there can be no assurance that all operators with which our network is interconnected have appropriate anti-fraud treatment in their networks. In 2001, we created a fraud management department to provide specialized customer service to customers affected by fraud. During fiscal year 2002, several automated procedures were created and placed in various parts of our operations to detect and control possible abnormalities that could represent fraudulent activities. These controls have a preventive function, and work both pro-actively and, should a fraud occur, reactively. In 2003, we implemented controls to capture fraud events automatically, such as a non-billing mechanism for fraud-blocked terminals, a cut-off limit system for service usage, and a webpage to gather any fraud claims from the community. At the end of 2003, we created the IT Revenue Assurance Group, which develops systems to assist the revenue assurance department in fraud combating. During 2004, the Group implemented a significant number of applications to monitor and detect fraud in different areas including public telephone, bad debt, revenue chain, key performance indicators and others. These actions achieved a better level of control and mitigated the risk of loss from fraud as compared to previous years. We cannot guarantee that these fraud control measures will continue to be accurate and effective to reach the desired level of fraud control. We continue to deploy and implement the technology necessary to assess the accuracy and effectiveness of our fraud combative procedures. Should we not be able to correctly quantify and combat fraud on our network, our results of operations could be adversely affected.

***Developments in the global telecommunications industry and technology are difficult to predict, and a failure by us to respond to such developments may have a material adverse effect on our financial condition and results of operations.***

All companies in the global telecommunications industry must adapt to rapid and significant changes in technology that are often difficult to anticipate. While we have been upgrading our network with technologically advanced fiber optic cable with a microwave overlay, it is possible that our network will be challenged by competition from improved or new technologies in the future. Technological changes may adversely affect our competitive position, require substantial new capital expenditures and/or require write-offs of obsolete technology.

If we fail to implement technological advances, we may be unable to continue to compete in the global telecommunications industry.

The mobile telephone sector, in particular, requires considerable technological developments, constant capacity, quality and digital technology data transmission speed improvements, shorter development periods of new cycles and changes due to users' needs and preferences. New technologies, superior to the ones used by BrT GSM may be developed. Furthermore, it is expected that Anatel will promote 3G (Third Generation) mobile telephone auctions in the near future, which will allow eventual buyers of such licenses to adopt technological platforms which allow the offer of more advanced mobile telephone services than those allowed by our current mobile platform. Thus, it cannot be assured that we will remain competitive due to the adoption, in due time, of the new technologies, as they are developed.

***In the event of a natural disaster, war, significant public disturbance or for economic reasons, the Brazilian government could temporarily seize or permanently expropriate our assets, which could have a material adverse effect on our financial condition and results of operations.***

The Brazilian government has the authority to temporarily seize all assets related to telecommunications concessions in the event of natural disaster, war, significant public disturbance, threats to internal peace, or for economic reasons and other reasons related to national security. In addition, the Brazilian government has the statutory right to permanently expropriate any telecommunications concession and claim any related assets for reasons of public interest. Brazilian law provides for compensation in connection with losses and damages related to temporary seizure or expropriation. However, in the event of a temporary seizure or expropriation of any of our assets there can be no assurance that the actual compensation paid would be adequate or that such payment would be timely. An inadequate or untimely payment would have a material adverse effect on our financial condition and results of operations.

***Restructuring of Governmental Regulatory Agencies may adversely affect the transactions of our company.***

A bill of law subject to the approval of National Congress provides for the administration, organization and social controlling of Governmental Regulatory Agencies, such as Anatel. The purpose of this bill of law is to change the structure, functioning and competence of those agencies, by, among other measures: (i) implementing administration agreements to be entered into by and between the agencies and the correspondent related ministries; (ii) creating public hearings on the agencies, with the purpose of controlling the services rendered and monitoring the internal process of adjudication of accusations and complaints by citizens, either against the agencies' activities or the entities subject to their control; (iii) changing the mandates of managers, including presidents and directors, to four years; and (iv) transferring the authority to award concession licenses for rendering public services to ministries, leaving for the agencies the task of regulating, inspecting, monitoring bid proceedings and awarding authorizations for the operation of services under private-regime.

Considering the level of political influence over the ministries, the agencies may be subject to further instability in their administration, which may trigger unexpected changes on regulation and policies affecting public services concessionary companies, such as our company. We cannot foresee the impact of the approval of the referred bill of law on our transactions and our competitive position.

***The failure to accomplish Anatel's targets may result in the imposition of sanctions and penalties on our company.***

We are required to accomplish targets established by the Federal Government and Anatel. Due to the public nature of the services rendered by our company, according to the terms of the Concession Contracts and of the applicable regulation, we must cover a geographic area and comply with targets on the execution of the services rendered.

In this regard, the PGMU and the PGMQ also provide for targets that we must achieve. Potential consequences of our failure to comply with such targets include the imposition of fines and/or other penalties and

the termination of our concession contract, which may cause significant financial loss to business, financial condition and results of operations.

### ***Risks Related to Operations in Brazil***

#### ***Brazilian political and economic conditions have a direct impact on our business and the market price of the Preferred Shares underlying our ADSs.***

Substantially all of our operations and customers are located in Brazil. Accordingly, our financial condition and results of operations are substantially dependent on Brazil's economy, which has been characterized by frequent and occasionally drastic intervention by the Brazilian government and volatile economic cycles in the past.

The Central Bank reduced the base interest rate ( SELIC ) from 17.75% in December 2004 to 15.75% in April 2006. Facing the economic, political and inflation indicators during 2005, the Central Bank increased the SELIC to 19.75% between June and September 2005. In 2002, as a reaction to political and economic uncertainties, the global economic downturn, the crisis in Argentina and the Brazilian presidential elections, the dollar appreciated by 52.3% against the *real* to R\$3.5333 per US\$1.00 at December 31, 2002. The *real* recovered in 2003, appreciating by 18.2% to R\$2.8892 per US\$1.00, at December 31, 2003. In 2004, the *real* appreciated by 8.1% against the dollar, quoted at R\$2.6544 per US\$1.00 on December 31, 2004. In 2005, the *real* appreciated by 13.4% against the dollar, quoted at R\$2.3407 per US\$1.00 on December 31, 2005. We cannot guarantee that the *real* will not substantially devalue again in the future.

In the past, the Brazilian government has often changed monetary, fiscal, taxation and other policies to influence the course of Brazil's economy. We have no control over and cannot predict what measures or policies the Brazilian government may take in response to the current Brazilian economic situation or how Brazilian government intervention and government policies will affect the Brazilian economy and, both directly and indirectly, our operations and revenues.

Our operations, financial condition and the market price of our Preferred Shares and ADSs may be adversely affected by changes in policy involving exchange controls, tax and other matters, as well as factors such as:

- fluctuations in exchange rates;
- base interest rate fluctuations;
- fiscal and taxation legislation changes;
- inflation; and
- other political, diplomatic, social and economic developments within and outside Brazil that affect the country.

On January 1, 2003, Luiz Inácio Lula da Silva from the Labor Party took office as the new President of Brazil. Although the government has not departed significantly from the economic policies of the former administration, the *real* appreciated 13.4% against the dollar during 2005 and concerns remain about the future policies of the Brazilian government. While the current administration's policies to date have not been adverse to the telecommunications industry, uncertainty over the future economic policies of the Brazilian government may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian international securities markets, which may have a material adverse effect on our business and results of operations.

Additionally the Presidential Election is expected to occur in October 2006 in Brazil. The President of Brazil has considerable power to change the future economic policies of the Brazilian government. The election may change government political policies and the elected administration may implement new policies. We cannot

predict what policies will be adopted and we cannot predict their effect on the economy, our business or our results of operations.

***If Brazil experiences substantial inflation in the future, our revenues and the market price of the Preferred Shares and ADSs may be reduced.***

Brazil has in the past experienced extremely high rates of inflation, with annual rates of inflation reaching as high as 2,489.1% in 1993 (according to the Brazilian National Consumer Price Index (*Índice Nacional de Preços ao Consumidor* published by the *Instituto Brasileiro de Geografia e Estatística* ( IBGE ). Inflation and governmental measures to combat inflation have both in the past had significant negative effects on the Brazilian economy. In 1994 the Brazilian Government introduced the *Plano Real* ( Real Plan ) with the objective of reducing inflation and building a base to sustainable economic growth.

Since the introduction of Plano Real, inflation has remained at stable levels, substantially below prior periods. However recent international events like the emerging markets crisis, the US terrorist attacks, and the subsequent military conflicts, have caused and may continue to cause destabilization in international markets. These events may affect the Brazilian economy in the form of fluctuations in the exchange rate between the US dollar and the Plano Real, interest rate increases, oil price increases, and, consequently, increases in the rate of inflation.

In 2003, the inflation rate measured by the Extensive Consumer Price Index ( IPCA ) was 9.3% above the established initial target of 4% with 2 percentage points of tolerance above and below the target. In 2004 the established target was 5.5% with 2.5 percentage points of tolerance above and below the target. For 2005 and 2006 the established target was/is 4.5% with 2.5 percentage points of tolerance. The measured inflation by IPCA in 2005 was 5.7% and until March 31, 2006 the cumulative inflation was 1.4%.

Actions taken to combat inflation and public speculation about possible future actions have also contributed to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets. If Brazil experiences substantial inflation in the future, our costs may increase, and our gross profit may be affected to the extent that our rate increases and our net operating revenues do not keep up with the rate of inflation. Additionally, our service debt and the cost of new financial funding may increase. We cannot predict the effect that an inflation increase would have on our financial condition, our capacity, our cash generation, or our operational results.

***Devaluation of the real may lead to substantial losses on our liabilities denominated in or indexed to foreign currencies and a reduction in our revenues.***

During the last four decades, the Brazilian Central Bank has periodically devalued the Brazilian currency. The exchange rate between the *real* and the dollar has varied significantly in recent years. For example, the *real*/dollar exchange rate fell from R\$1.9554 per dollar at December 31, 2000 to R\$3.5333 at December 31, 2002. In 2003, the *real* appreciated in value by 18.1% to R\$2.8892 per dollar. In 2004 the *real* appreciated in value by 8.1% to R\$2.6544 per dollar. In 2005 the *real* appreciated in value by 13.4% to R\$2.3407 per dollar.

A significant amount of our financial assets and liabilities are denominated in or indexed to foreign currencies, primarily dollars. As of December 31, 2005, R\$1,064.1 million or 21.7% of our financial indebtedness was denominated in a foreign currency. When the Brazilian currency is devalued, we incur losses on our liabilities denominated in or indexed to foreign currencies, such as our dollar-denominated long-term debt and foreign currency loans, and experience gains on our monetary assets denominated in or indexed to foreign currencies, as the liabilities and assets are translated into *reais*. If devaluation occurs when the value of such liabilities significantly exceeds the value of such assets, including any financial instruments entered into for hedging purposes, we could incur significant reduction in our revenues, even if their value has not changed in their original currency. This could adversely affect

our ability to meet certain of our payment obligations. A failure to meet certain of our payment obligations could trigger a default in certain financial covenants in our loan and credit facilities, which would have a material adverse effect on our business and results of operations.

*We are subject to delays and delinquency on our accounts receivable.*

Our business is affected by customers' ability to pay their bills. If the Brazilian economy worsens because of, among other factors:

- the level of economic activity;
- inflation;
- devaluation of the *real*; or
- an increase in domestic interest rates,

a greater portion of our customers may not be able to pay their bills, which would increase our bad debts and provisions for doubtful accounts. Strict regulation from Anatel prevents us from implementing certain policies that could have the effect of reducing delinquency, such as service restrictions or limitations on the types of services provided based on a subscriber's credit record. Losses from accounts receivable reached R\$449.3 million in 2005, against R\$411.3 million in 2004 and R\$298.0 million in 2003, increasing in percentage of gross revenues terms, from 2.7% in 2003 to 3.2% in 2004 and 3.1% in 2005. However, if economic conditions worsen in Brazil or if we are unable to implement policies to limit subscriber delinquencies or otherwise select our customers, persistent subscriber delinquencies and bad debt can adversely affect our financial results. See "Item 5. Operating and Financial Review and Prospects Critical Accounting Policies and Estimates Provision for Doubtful Accounts."

***Any increase in taxes levied on the telecommunications sector in connection with tax reforms expected to be implemented in the future could affect the results of our operations.***

Increases in Brazil's already high level of taxation could adversely affect our profitability. Increases in taxes for the telecommunications sector usually result in higher tariffs for our customers. High tariff levels generally result in lower levels of usage of our services and, therefore, lower net sales. Lower net sales result in lower margins because a significant portion of our costs are fixed and thus do not vary substantially based on the level of usage of our network or our services. Although mobile and fixed services are equally taxed, there can be no assurance that the Brazilian government will not increase current tax levels, at state and/or federal levels, and that this will not adversely impact our business.

In December 2003, the Federal Senate approved part of a tax reform bill, the text of which was consolidated in Constitutional Amendment 42, enacted on December 19, 2003. Constitutional Amendment 42 provides for an extension on the assessment of the Provisional Contribution of Financial Transfers (*Contribuição Provisória sobre Movimentação Financeira - "CPMF"*), the assessment of *Programa de Integração Social ("PIS")*; and *Contribuição para Financiamento da Seguridade Social ("COFINS")* taxes on import transactions, and the assessment of COFINS under a non-cumulative regime. Certain issues that were under discussion in 2003, related to taxes on the commercialization of goods and rendering of services, were not included in Constitutional Amendment 42 and may be discussed again in 2007.

Some important issues originally provided for in the tax reform bill relate to: (i) harmonization of ICMS tax rules, which would be governed by a single federal legislation applicable to all states; (ii) equalization of ICMS rates; and (iii) limitations on granting tax incentives. If approved, such measures will be gradually adopted in 2007. Additionally, the Federal Senate has discussed the merger of the ICMS and IPI into a single federal tax assessed upon the commercialization of goods and rendering of interstate and intermunicipal transportation and communication services. We cannot guarantee that, if the merger of the ICMS and IPI is accomplished, certain tax incentives granted to us in the past will continue to be granted, and cannot determine the effect that a cessation of such tax incentives may have on our results of operations. See "Item 10. Additional Information Taxation."

***Proposed changes in Brazilian labor law may affect our labor relations.***

In April 2003, the Lower House reopened discussions regarding changes in the Brazilian Labor Law (*Consolidação das Leis do Trabalho*, or CLT). A further revision of union relations in Brazil is also under discussion in the Lower House. Although the progress of these proposed modifications has slowed during the last

year as political forces have showed some resistance, we cannot predict the effect on any such modifications on our labor relations, which could have a negative effect on our business.

***It may be difficult to effect service of process upon, or to enforce foreign judgments upon us, our directors and our officers.***

We are organized under the laws of Brazil, and all of our directors and officers reside outside the United States. In addition, a substantial portion of our assets, and most or all of the assets of our directors and officers, are located in Brazil. As a result, it may be difficult for an ADS holder to effect service of process within the United States or other jurisdictions outside of Brazil upon us or such persons. In addition, because substantially all of our assets and all of our directors and officers reside outside the United States, and judgment obtained in the United States against us or any of our directors or officers may not be collectible within the United States. There is a doubt as to the enforceability of civil liabilities under the U.S. Securities Act of 1933, as amended (the "Securities Act") or the U.S. Exchange Act of 1934, as amended (the "Exchange Act") pursuant to original actions instituted in Brazil.

### **Risks Related to Our Preferred Shares and American Depositary Shares**

***Our ADS holders may not have the same rights with respect to voting, dividends, distributions, and preemptive rights, among others, that may expose our ADS holders to greater risk than holders of our Preferred Shares.***

Our ADS holder may not have the same voting rights as holders of our Preferred Shares. Under our Bylaws and Brazilian Corporation law, in the limited circumstances where holders of our Preferred Shares are able to vote, an ADS holder will be able to exercise voting rights with respect to the Preferred Shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs. There are practical limitations upon an the ability of holders of our ADSs to exercise voting rights due to the additional procedural steps involved in communicating with such holders. See "Item 7. Major Shareholders and Related Party Transactions Major Shareholders" and "Item 10. Additional Information Memorandum and Articles of Association Voting Rights."

An ADS holder that is a resident of the United States may not be able to exercise preemptive rights or certain other rights with respect to our Preferred Shares. A holder of our ADSs may not be able to exercise preemptive rights with respect to the ADSs unless a registration statement is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not required to file a registration statement relating to preemptive rights with respect to our Preferred Shares, and there can be no assurance that we will file any such registration statement. If a registration statement is not filed and an exemption from registration does not exist, Citibank, N.A., as depositary (the "Depositary"), will attempt to sell the preemptive rights, and our ADS holders will be entitled to receive their share of the proceeds of the sale. However, the preemptive rights will expire if the Depositary cannot sell them, and therefore we cannot guarantee that our ADS holders will be able to either exercise their preemptive rights or receive the proceeds from their sale. For a more complete description of preemptive rights with respect to our Preferred Shares, see "Item 10. Additional Information Memorandum and Articles of Association."

Pursuant to our deposit agreement with the Depositary, any payments of cash dividends and distributions that we may make will be made in Brazilian currency to *Banco Bradesco S.A.*, as custodian for the Preferred Shares underlying our ADSs, on behalf of the Depositary. The Depositary will then convert such proceeds into dollars and cause such dollars to be delivered to the Depositary for distribution to our ADS holders. Holders of ADSs could be adversely affected by devaluations of the Brazilian currency that may occur due to delays in, or a refusal to grant, any required government approval for conversions of Brazilian currency payments and remittances abroad in connection with the Preferred Shares underlying our ADSs. See "Item 10. Additional Information Memorandum and Articles of Association Dividends."

We may agree with the Depositary to modify the deposit agreement at any time without the consent of the holders of our ADSs. We will give holders of our ADSs 30 days' prior notice of any modifications that would materially prejudice any of their substantial rights under the deposit agreement. After receipt of such notice, our ADS holders will be bound by the modifications to the deposit agreement if such holders continue to hold ADSs after the modifications to the deposit agreement become effective.

***Holder of ADSs may have fewer and less well-defined shareholders' rights than in the United States.***

Our corporate affairs are governed by our Bylaws and Brazilian Corporation Law, which may differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States. Under Brazilian Corporation Law, the holders of our Preferred Shares and our ADSs may have fewer and less well-defined rights to protect their interests relative to actions taken by our board of directors or the holders of our Common Shares than under the laws of other jurisdictions outside Brazil.

Restrictions on insider trading and price manipulation, rules and policies against self-dealing and regarding the preservation of shareholder interests may not be as detailed, well-established and enforced in Brazil as in the United States, which may potentially disadvantage the holders of our Preferred Shares and/or ADSs. For example, when compared to Delaware corporation law, Brazilian Corporation Law and practice has less detailed and well-established rules, and fewer judicial precedents relating to the review of management decisions involving duty of care and duty of loyalty standards in the context of corporate restructurings, transactions with related parties and sale-of-business transactions. In addition, shareholders in Brazilian companies must hold at least 5.0% of the outstanding share capital of a corporation in order to have standing to bring shareholders' derivative suits. Furthermore, shareholders in Brazilian companies ordinarily do not have standing to bring class action suits.

***The relative volatility and illiquidity of the Brazilian securities markets may substantially limit an ADS holder's ability to sell the Preferred Shares underlying the ADSs at the price and time desired.***

Brazilian investments, such as investments in our securities, are subject to economic and political risks that may affect the ability of investors to receive payment, in whole or in part, in respect of their investments, including, among others:

- changes in the regulatory, tax, economic and political environment; and
- restrictions on foreign investment and on repatriation of capital invested.

The Brazilian securities markets are substantially smaller, less liquid, more concentrated and more volatile than major U.S. and European securities markets, and are not as highly regulated or supervised as those markets. As a consequence, the trading volume of our ADSs has traditionally been relatively low. Even if the trading volume of our ADSs increases, we can give no assurance that it will be maintained or will result in a desirable stock price. As a result of this relatively low trading volume, it may be difficult to identify buyers to whom our ADS holders can sell their ADSs, and the ability of our ADS holders to sell the Preferred Shares underlying the ADSs may be substantially limited. Furthermore, the trading price of our ADSs representing Preferred Shares is likely to be highly volatile and subject to wide fluctuations in price in response to various factors, many of which are beyond our control.

***Developments in other countries may affect the Brazilian economy and the market price of our Preferred Shares and our ADSs.***

The securities of Brazilian issuers have been influenced by economic and market conditions in other countries, especially other emerging market countries. Since the end of 1997, and in particular during 2001 and 2002, the international financial markets have experienced significant volatility as a result of economic problems in various emerging market countries. Investors subsequently have had a heightened risk perception for investments in such markets. As a result, in some periods, Brazil has experienced a significant outflow of dollars and Brazilian companies have faced higher costs for raising funds, both domestically and abroad and have been impeded from accessing international capital markets. We cannot assure investors that international capital markets will remain open to Brazilian companies, including our company, or that prevailing interest rates in these markets will be advantageous to

us or that we will be able to obtain additional financing on acceptable terms or at all. As a consequence, the market value of our securities may be adversely affected by these or other events outside of Brazil. See "Item 9. The Offer and Listing - Offer and Listing Details." There can be no assurances that future events elsewhere, especially in emerging market countries, will not have an adverse effect on the market value of our Preferred Shares and our ADSs.

***Changes in Brazilian tax laws may have an impact on the taxes applicable to the disposition of the ADSs.***

According to Law 10,833, enacted on December 29, 2003, capital gains earned by a non-Brazilian resident upon the sale of assets located in Brazil to a Brazilian resident or to another non-Brazilian resident are subject to Brazilian withholding tax. Considering the general and unclear scope of Law 10,833 and the absence of judicial guidance in respect thereof, we cannot predict the exact scope of Law 10,833 or the effect that Law 10,833 will have on holders of our ADSs or Preferred Shares.

**ITEM 4. INFORMATION ON THE COMPANY****History and Development of the Company**

Brasil Telecom S.A. is a corporation organized under the laws of the Federative Republic of Brazil. We are one of the fixed-line telecommunications companies that resulted from the breakup and privatization of Telebrás by the Brazilian Federal Government in 1998. We are an amalgamation of the following operating companies formerly controlled by *Telebrás: Telecomunicações de Santa Catarina S.A. Telesc* ("Telesc"), *Telecomunicações de Goiás S.A. Telegoiás* ("Telegoiás"), *Telecomunicações de Brasília S.A. Telebrásília* ("Telebrásília"), *Telecomunicações do Mato Grosso S.A. Telemat* ("Telemat"), *Telecomunicações do Mato Grosso do Sul S.A. Telems* ("Telems"), *Telecomunicações de Rondônia S.A. Teleron* ("Teleron"), *Telecomunicações do Acre S.A. Teleacre* ("Teleacre"), *Companhia Telefônica Melhoramento e Resistência CTMR* ("CTMR"), and our predecessor, *Telecomunicações do Paraná S.A. Telepar* ("Telepar") and CRT, a company acquired by us from Telefônica S.A. in July 2000.

Our principal executive office is located at SIA/Sul, ASP, Lote D, Bloco B 71215-000 *Setor de Indústria e Abastecimento*, Brasília, DF, Brazil, and our telephone number is (55-61) 3415-1140. Our agent in the United States is CT Corporation System, located at 111 Eighth Avenue, 13th floor, New York, New York 10011.

***Historical Background***

Prior to the incorporation of Telebrás in 1972, there were more than 900 telecommunications companies operating throughout Brazil. Between 1972 and 1975, Telebrás acquired almost all of the other telephone companies in Brazil and thus came to have a monopoly over the provision of public telecommunications services in almost all areas of the country. Beginning in 1995, the Federal Government undertook a comprehensive reform of Brazil's telecommunications regulatory system. In July 1997, Brazil's National Congress approved the *Lei Geral de Telecomunicações* (the "General Telecommunications Law," and together with the regulations, decrees, orders and plans on telecommunications issued by Brazil's Executive Branch, the "Telecommunications Regulations"), which provided for the establishment of a new regulatory framework, the introduction of competition and the privatization of Telebrás.

The General Telecommunications Law established Anatel as the regulator of the telecommunications industry in Brazil. Anatel is administratively independent from the Brazilian Government and financially autonomous. Anatel is required to report on its activities to the Ministry of Communications and to the Brazilian Congress on an annual basis. In addition, any proposed regulation of Anatel is subject to a period of public comment, including public hearings. Anatel's decisions may be challenged in the Brazilian courts. Among its functions are the following:

- to propose the implementation or elimination of services in the public regime;
- to manage the spectrum of radio frequency and the use of orbits;
- to approve tariff readjustment;

- to settle conflicts of interest among the companies that render telecommunications services;
- to protect and defend the rights of users of the telecommunications services;

- to prevent, control and impose economic penalties in the telecommunications industry;
- to impose restrictions, limits or conditions on corporate groups in obtaining or transferring the concessions, permissions and authorizations, in order to ensure a competitive environment; and
- to establish the rate structure for each kind of service rendered in the public regime.

On January 30, 1998, in preparation for the restructuring and privatization of Telebrás, the cellular telecommunications operations of Telebrás' operating subsidiaries were spun off into separate companies. On May 22, 1998, Telebrás was restructured to form, in addition to Telebrás, 12 new holding companies by means of a procedure under Brazilian Corporation Law called *cisão*, or split-up. These new holding companies were allocated virtually all the assets and liabilities of Telebrás, including the shares held by Telebrás in its operating companies. The split-up of Telebrás into 12 new holding companies is referred to herein as the "breakup of Telebrás."

These holding companies, together with their respective subsidiaries, consisted of (i) eight cellular service providers, each operating in one of the regions into which Brazil has been divided for purposes of cellular telecommunications services in the frequency range formerly used by each of the former operating companies of Telebrás, (ii) three regional fixed-line service providers, each providing local and intra-state long-distance service in one of the three regions into which Brazil has been divided for purposes of fixed-line telecommunications, and (iii) Embratel, providing domestic (including intraregional and interregional) long-distance telephone service and international telephone service throughout Brazil.

Set forth below are maps of Brazil showing the locations of the fixed-line, long-distance regions and cellular regions into which the country was split-up following the breakup of Telebrás:

*Brasil Telecom Participações S.A.* (formerly known as Tele Centro Sul Participações S.A.) is our parent company, and is one of the three holding companies providing local, interregional and international long-distance telecommunications services in Brazil. See Item 7 Major Shareholders and Related Party Transactions Major Shareholders." In the breakup of Telebrás, Brasil Telecom Participações S.A. was allocated all the share capital held by Telebrás in Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre, CTMR and Telepar, our predecessor; companies which provided fixed-line telecommunications service in the northern, western, central and southern regions of Brazil. See " Business Overview Our Region." In July 1998, the Federal Government sold all of its voting shares in these holding companies, including the shares it held in Brasil Telecom Participações S.A., to private sector buyers. The sale of all of the Federal Government's voting shares in the holding companies to private sector buyers is referred to herein as the "privatization of Telebrás." As a result of the merger of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre, CTMR and CRT, ultimately turning into Brasil Telecom S.A., we became the leading local and intraregional fixed-line telecommunications service provider in our region. The principal other relevant fixed-line telecommunications service provider in our region is Global Village Telecom (Sercomtel and CTBC also operate partially in our region but we do not service the same cities). For intraregional long-distance telecommunications services, Intelig and Embratel, among others, are providers that are authorized to provide long-distance services in our region.

The other major telecommunications operators which were created as a result of the privatization of Telebrás are: Telemar which is our mirror telecommunications service provider in Region I, Telesp which is our mirror telecommunications service provider in Region III, and, Embratel which provides domestic and international long-distance service throughout Brazil. Brasil Telecom, Telemar, Telesp and Embratel all operate pursuant to public concessions granted by Anatel.

Since the privatization of Telebrás, Anatel has continued to implement regulations in order to promote competition and quality of service in the Brazilian telecommunications marketplace. As part of this policy initiative, Anatel has allowed new private competitors into the Brazilian market to compete directly against us. In addition, Anatel has required us and the other public concession service providers to meet certain quality and universalization

targets before we could compete in other service providers' market areas. On January 19, 2004, we received certification by Anatel that we had accomplished our universalization targets, and accordingly we are authorized to offer local fixed and domestic and international long-distance telephone services originated inside or outside our region as well as mobile services in our region. The certification of other service providers' compliance with universalization and expansion targets permits other service providers, including Telemar, Telesp and Embratel, to operate in our region. Any other service provider can get Anatel's authorization to provide service and compete with us. We cannot, however, confirm the identity of the service providers that will be so authorized, the timing of such authorizations, or the extent of the authorized services, should any service providers be so authorized.

### ***History of Our Company***

The following bullet points briefly illustrate our history:

- November 27, 1963: Telepar was incorporated as a corporation under the laws of Brazil.
- June 5, 1975: The control of our company was transferred to the Brazilian government and we became a subsidiary of Telebrás.
- May 22, 1998: Restructuring of Telebrás System, with the creation of *Tele Centro Sul Participações S.A.* (currently *Brasil Telecom Participações S.A.*), a holding company of Telesc, Telepar, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR.
- July 29, 1998: Solpart acquired our parent, *Tele Centro Sul Participações S.A.* (currently *Brasil Telecom Participações S.A.*), from the Brazilian government in the privatization process of Telebrás.
- February 28, 2000: The concessionaires Telesc, Telepar, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR, controlled by *Tele Centro Sul Participações S.A.*, currently *Brasil Telecom Participações S.A.*, were reorganized and merged into Telepar and became a single company.
- April 28, 2000: In accordance with our strategy of becoming a national telecommunications company, we changed our corporate name from *Telecomunicações do Paraná S.A.-Telepar* to *Brasil Telecom S.A.*
- July 31, 2000: We acquired 98.8% of the corporate capital of *TBS Participações S.A.* ("TBS"), a company controlled by *Telefônica*, which held 85.2% of the voting capital of CRT, representing 31.6% of the total share capital of CRT, for approximately R\$1,446.3 million. CRT was the leading fixed-line telecommunications service company in the state of Rio Grande do Sul. The acquisition of CRT was financed partly through the use of our own cash reserves, as well as through the domestic placement of commercial paper of approximately R\$900.0 million.
- December 28, 2000: TBS was merged into CRT, and immediately afterwards CRT was merged with and into us. Pursuant to our merger with CRT, minority shareholders of CRT were given the right to exchange their CRT shares for Preferred Shares and Common Shares of us. The exchange of shares was made based on the market value of our shares compared to those of CRT.
- November 1, 2001: *BrT Serviços de Internet S.A.* ("BrTSi"), our wholly-owned subsidiary, acquired 15.4% of the total capital stock of *iBest Holding Corporation*, which controls *iBest S.A.*, a free internet service provider, for approximately R\$10.0 million.
- November 16, 2001: We listed ADSs evidencing our Preferred Shares on the New York Stock Exchange.

- December 5, 2001: We acquired 19.9% of the capital stock of Vant, a leading corporate data solutions provider, for R\$3.9 million from AESCOM Sul Ltda. and Luiz Cruz Schneider together with an option to purchase the remaining 80.1% after certification by Anatel of compliance with the 2003 targets stipulated in our concession contracts.

- May 9, 2002: We joined the Special Corporate Governance Level 1 of the *São Paulo Stock Exchange* ("BOVESPA"). See Item 9. The Offer and Listing Markets The Special Corporate Governance Levels of the São Paulo Stock Exchange.
- June 3, 2002: Our shares listed on BOVESPA started trading under new symbols: "BRTO3" for Common Shares and "BRTO4" for Preferred Shares.
- December 18, 2002: We acquired licenses for the PCS for R\$191.5 million through the auction held on November 19, 2002. The minimum price was R\$182.9 million and we paid a premium of 3.6%.
- February 18, 2003: We acquired 19.9% of the capital of *MTH Ventures do Brasil Ltda.* ("MTH"), a company that holds 99.99% of the capital of *Brasil Telecom Comunicação Multimídia*, a leading local fiber optic network provider, for US\$17.0 million together with an option to purchase the remaining 80.1% of the capital of MTH for US\$51.0 million after certification by Anatel of compliance with the 2003 targets stipulated in our concession contracts.
- June 11, 2003: We acquired, through BrTSi, the entire submarine fiber-optic cable system from *GlobeNet Communications Group Ltd.* for U.S. \$ 46.8 million. A total of U.S. \$ 27.6 million was paid on June 11, 2003, with the remaining US\$19.2 million payable within 18 months of the first installment.
- June 26, 2003: We acquired the remaining capital of *iBest Holding Corporation* for U.S. \$ 36.0 million.
- January 19, 2004: Anatel certified that we had met our universalization targets and authorized us to provide interregional long-distance services throughout Brazil and international long-distance services, also from any point in the country. We also received authorization to offer local services outside our original concession area and to offer wireless services in our region.
- May 13, 2004: We purchased the remaining 80.1% of the capital of MTH for US\$51.0 million.
- May 13, 2004: We purchased the remaining 80.1% capital of Vant for R\$15.6 million.
- September 27, 2004: We began offering wireless telecommunications services through our subsidiary *14 Brasil Telecom Celular S.A.* (hereinafter referred to as "Brasil Telecom GSM.")
- November 24, 2004: We acquired approximately 63% of the capital stock from *Internet Group (Cayman), Ltd.* ("iG"), for U.S. \$ 104.9 million. Considering that *Brasil Telecom Participações S.A.* already held, indirectly, 10% of iG's total capital, both companies at the moment held approximately 73% of the total capital of iG.
- July 2005: We acquired 25.6% of the capital stock of *Internet Group (Cayman) Ltd.* ( iG ) for approximately US\$ 27.9 million. Considering that *Brasil Telecom Participações S.A.* and *Brasil Telecom S.A.* already held, indirectly, 73% of iG's total capital, both companies now hold approximately 98.2% of the total capital of iG. iG is the leading dial-up internet service provider in Brazil. The acquisition of iG made us the largest internet company in Latin America. Among the sellers of IG Cayman stock, there was an Opportunity Group affiliate. Under our current management, we filed a complaint with the Brazilian Securities Commission questioning pricing and disclosure issues related to this IG Cayman transaction.

***Organizational structure***

We are structured as a consolidated operational company, and currently have five subsidiaries through which we conduct substantially all of our operations: BrT Serviços de Internet S.A., Brasil Telecom GSM, Vant Telecomunicações S.A., MTH Ventures do Brasil Ltda., and Brasil Telecom Comunicação Multimídia.

At the Brasil Telecom S.A. level, we are subdivided into eleven operational branches: Tocantins, Goiás, Acre, Rondônia, Mato Grosso, Mato Grosso do Sul, Paraná, Santa Catarina, Rio Grande do Sul, Pelotas and the Federal District. For information on our shareholding structure, please see Item 7. Major Shareholders and Related Party Transactions Major Shareholders."

The following chart sets forth a summary of our organizational structure, including the percentage of total capital held in each of our significant subsidiaries as of December 31, 2005. All of our significant subsidiaries are organized and existing under the laws of the Federative Republic of Brazil, except for Brasil Telecom Subsea Cable Systems (Bermuda) Ltd., which is incorporated under the laws of Bermuda, Brasil Telecom of America Inc., which is incorporated under the laws of the United States of America, Brasil Telecom de Venezuela S.A., which is incorporated under the laws of Venezuela, and Internet Group (Cayman) Limited and iBest Holding Corporation, which are incorporated under the laws of the Cayman Islands.



*BrT Serviços de Internet S.A.*

We formed BrTSi in October 2001. Through BrTSi, we provide broadband internet services through our internet service provider ("ISP") BrTurbo and data center services.

Through BrTurbo, a broadband Region II leader, iBest, the largest internet service provider in Region II for dial-up internet access, and iG, the first dial-up access provider and one of the largest content providers with a broadband presence outside Region II, we compete in all territories in Brazil, in all internet segments. The following is a description of iBest and iG.

*iBest*

In November 2001, we acquired 15.4% of iBest Holding Corporation for approximately US\$10.0 million. iBest Holding Corporation controls iBest S.A. ("iBest"), a free internet service provider and important brand name. On June 26, 2003, we acquired through our wholly owned subsidiary, BrTSi, the remaining capital of iBest Holding Corporation for US\$36.0 million, consolidating our 100% ownership of iBest. The iBest Group is composed by the following main entities: iBest Holding Corporation and Freelance S.A. Freelance S.A. became the owner of iBest's trademark, and is now the operating company of the Group.

*iG*

In July 2005, we acquired 25.6% of the capital stock of Internet Group (Cayman) Ltd. ( iG ). With this acquisition, combined with previous holdings of 73% of iG s total capital by Brasil Telecom Participações S.A. and Brasil Telecom S.A., we hold 98.6% of the total capital of iG. iG is the leading dial-up internet service provider in Brazil. Through the acquisition of iG, we became the largest internet service provider in Latin America.

*Grupo BrT Cabos Submarinos (Submarine Fiber-Optic Cable System)*

On June 11, 2003, we acquired a submarine fiber-optic cable system from GlobeNet Communications Group Ltd., which we now refer to as Grupo BrT Cabos Submarinos, for US\$46.8 million. A total of US\$27.6 million was paid on June 11, 2003, with the remaining US\$19.2 million payable within 18 months of the first installment. We signed a final agreement on April 20, 2005, when we paid US\$16.2 million. US\$3.0 million was retained to cover contingences discovered after the acquisition. Grupo BrT Cabos Submarinos is composed of five operating subsidiaries: Brasil Telecom Cabos Submarinos (Holding) Ltda., Brasil Telecom Cabos Submarinos Ltda., Brasil Telecom of America, Inc., Brasil Telecom Subsea Cable Systems (Bermuda) Ltd. and Brasil Telecom de Venezuela, S.A. These companies own and operate the Grupo BrT Cabos Submarinos fiber optic cable system that connects the United States, Bermuda, Brazil and Venezuela. Brasil Telecom of America, Inc. is headquartered in Boca Raton, Florida, and coordinates all activities and supports the commercial activities of the group in the international market. Grupo BrT Cabos Submarinos is also the parent company of iG, our internet service provider.

*14 Brasil Telecom Celular S.A*

14 Brasil Telecom Celular S.A. ("Brasil Telecom GSM") is our mobile telephone services subsidiary, which became operational on September 27, 2004. Brasil Telecom Mobile offers wireless telecommunications services using Global System for Mobile Communications ("GSM") technology under the brand name "Brasil Telecom GSM." See " Business Overview Wireless Services."

*Vant Telecomunicações S.A.*

On May 13, 2004, we exercised our option to purchase for R\$15.6 million the remaining 80.1% of the capital of Vant, giving us 99.99% of the capital of Vant. Vant offers internet protocol as well as other products to the corporate market throughout Brazil.

*Brasil Telecom Comunicação Multimidia*

On May 13, 2004, we exercised our option to purchase for US\$ 51.0 million the remaining 80.1% of the capital of MTH, giving us 99.9% of the capital of MTH. Brasil Telecom Comunicação Multimidia is a leading local fiber optic network provider, with 343 kilometers of local network in São Paulo, Rio de Janeiro and Belo Horizonte, and a 1,600 kilometer long-distance network linking these three metropolitan areas. Brasil Telecom Comunicação Multimidia also has an internet solutions data center in São Paulo which provides internet support to our customers. As part of the acquisition, we also integrated a management team with expertise in these markets.

**Capital Expenditures**

The following table sets forth our capital expenditures on plant expansion and modernization for each of the years ended December 31, 2003, 2004 and 2005.

	<b>Year ended December 31,</b>		
	( millions of reais)		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Conventional Telephone	302.8	179.7	256.5
Data Network	264.9	300.0	411.5
Network Operation	251.6	270.2	292.2
Information Technology	210.1	216.1	180.8
Other <sup>(1)</sup>	655.4	725.2	395.4
Total Fixed Telephone	1,684.8	1,691.2	1,536.4
Total mobile Telephone	109.2	1,175.7	441.3
Total capital expenditures	1,794.0	2,866.9	1,977.7

(1) These investments include the acquisition of PCS licenses, the acquisition of Grupo BrT Cabos Submarinos, Brasil Telecom Comunicação Multimidia, iBest, Vant and iG, and investments in transmission backbone, special platforms, technical and operational support such as telecommunications management network systems besides regulatory and interconnection projects.

Our capital expenditures decreased by approximately 31.0% to R\$1,977.7 million in the year ended December 31, 2005, from R\$2,866.9 million for the corresponding period in 2004. Of our total 2005 capital expenditures, R\$1,490.2 million related to fixed-line telephone and internet operations, R\$441.3 million to mobile telephone operations and R\$46.6 million to acquisitions. The capital expenditures on the expansion and modernization of our fixed-line telephone operations related primarily to upgrading the capacity of our transmission backbone and implementation of regulatory projects to meet Anatel's requirements.

*Expected Capital Expenditures on Expansion and Modernization*

We currently expect to invest approximately R\$2,161.3 million in the expansion and modernization of our network during the fiscal year 2006, which includes investments of approximately R\$464.3 million in our mobile telephone network. See Risk Factors - Risks Related to Our Business for a discussion of current obstacles to these transactions. Of our total expected capital expenditures, R\$616.7 million relates to targets established by Anatel and required under the terms and conditions of our concessions. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Capital Expenditures."

*Acquisition of PCS Licenses*

As part of our strategy of providing integrated solutions to our clients, we acquired PCS licenses for R\$191.5 million at an auction held on November 19, 2002.

On December 18, 2002, we paid the equivalent of 10.0% and in December 18, 2005 we paid the equivalent of 15.0% of the total bid amount at auction. The remaining 75.0% will be paid in five equal installments annually,

each respectively due 12, 24, 36, 48 and 60 months after the last payment date (December 18, 2005). The amount of the installments will be adjusted monthly by the IGP-DI index plus 1.0% interest rate over the indexed amount calculated from the execution date.

## **Business Overview**

We provide fixed-line telecommunications services in Region II under concessions which we assumed from each of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre, CTMR and CRT for each of the states in our region. These concessions were granted by the Brazilian government to us and to each of these companies as a result of the privatization process. Until January 2004, these concessions authorized us to provide local and intra-regional fixed-line telecommunications services in nine states located in the northern, western, central and southern regions of Brazil and in the Federal District. These concession areas constitute our region. See " Our Region." As a result of these original concessions, we are the leading provider of local fixed-line telecommunications services and intraregional fixed-line telecommunications services in our region. Local fixed-line telecommunications services include all calls that originate and terminate within a single local area, as well as, installation, monthly subscription, public telephones and supplemental local services. Intra-regional fixed-line telecommunications services include all calls between states within a concession area. We also offer broadband services to our customers that allow them to access the internet and represent an important new source of revenue.

Since January 2004, we have been able to offer interregional and international long-distance telecommunications services. We also provide a variety of data transmission services through various technologies and means of access. Since 1999, we have invested in data transmission capacity in response to the growing demand in Brazil for data, images and text transmission services, mainly for corporate networks and corporate and residential Internet access.

Our business, including the service we provide and the rates we charge, is subject to comprehensive regulation by Anatel, an independent regulatory agency, under the General Telecommunications Law and various administrative enactments thereunder. The licenses and concessions under which we operate our fixed-line services imposed certain universalization, expansion and modernization targets on us. On January 19, 2004, we received certification by Anatel that we had accomplished our universalization targets established for December 31, 2003. Accordingly, we were authorized to offer local fixed and domestic and international long-distance telephone services, whether originated inside or outside our region. We also acquired a license to provide mobile telephone services in our region.

Our main competitors in the fixed-line telecommunications area are Embratel, Intelig, Global Village Telecom, Telesp, Telemar, Companhia de Telecomunicações do Brasil Central ("CTBC Telecom") and Sercomtel Telecomunicações S.A. ("Sercomtel"). The mobile telephone business is a highly competitive one, and Region II has the highest penetration rate in the country by outsider service providers. Our main competitors in the mobile telecommunications area are TIM, Claro and Vivo.

In 2004 we obtained authorization from the Anatel to provide wireless services through our Brasil Telecom GSM arm, for the acquisition and installation of network equipment and the integration of mobile telephone with other products of the Brasil Telecom Group. Our license to provide wireless service is valid for fifteen years and may be renewed for another fifteen years.

### ***Strategic Results for 2005***

As our strategic priorities for 2005, we resolved to expand our mobile telephone business, increase our broadband subscriber base, grow the range of alternative rate plans offered and increase our market share in the inter-regional and international segments.

As of December 31, 2005, Brasil Telecom GSM had a market share of 8.7%, despite fact that Region II had a 41% penetration rate at the time Brasil Telecom GSM launched mobile operations. In addition, Brasil Telecom GSM was able to obtain the best percentage of monthly paying (post-paid) customers in its operational region.

We ended the year with a total of 1,013,893 broadband subscribers, up 89.3% compared to the previous year, maintaining our leadership in the market, with the best ratio of broadband accesses to lines in service.

We also launched various different alternative rate plans to adapt our service to the socio-economic profile of the population in our region, reducing the amount of disconnected fixed-line terminals. As of December 31, 2005, 8.2% of lines in service were serviced by alternative rate plans.

In the data communications market, we created solutions focused on various sectors of the economy, such as the automotive and agribusiness segments, as well as municipal authorities. Based on analysis and understanding of the inter-relationships of our clients with their suppliers, customers and external agents, we were able to launch a number of segmented promotions, adding security, efficiency, state-of-the-art technology and greater value to our clients participating in these promotions.

### ***Strategy for 2006***

In 2006, the telecommunications sector is likely to undergo significant transformation, with repercussions on the business model of all the operating companies. New technologies are making the use of broadband access, both for fixed-line and mobile telephones, as well as enlarging the range of converging solutions, based mainly on Internet protocol.

It is already possible to see a trend of replacing fixed-lines by mobile accesses, with an immediate impact on traffic generated by the former and the switching over, still incipient, from conventional voice traffic to VoIP (Voice over Internet Protocol). The result of this process is a reduction in revenue from fixed-line voice traffic.

This reduction would have already been evident in the past few years, if it had not been for tariff increases. Adding to the complexity of this scenario is that the new revenues coming from IP world, for example, are still low and therefore do not compensate for the loss which is being seen in fixed-line voice revenues.

To align our planning with the realities of the market, we have selected the following priorities for 2006:

- (1) To defend our main business, that of fixed-line voice traffic;
- (2) To expand our mobile telephone service, seeking to achieve a satisfactory balance between scale and profitability;
- (3) To exploit growth opportunities in data and internet, ensuring profitability;
- (4) To build a portfolio of converging promotions in the customer environment voice, data and images to reduce client turnover and increase the average customer bill;

(5) To increase operational efficiency, applying the necessary rigorous controls in terms of cash allocation; and

(6) To create value for our shareholders, in an ethical and transparent manner, through our relationships with our partners.

*Offer interregional and international long-distance services*

We intend to increase our market share in our business of providing long-distance service. Since January 22, 2004 we have offered interregional and international long distance services and started competing directly with other regional operators that currently provide such services. By offering interregional and international long-distance services, we expect to be able to offer our existing corporate and residential clients more competitive and integrated plans and capture additional market share. We intend to leverage the strength of the "Brasil Telecom" brand in Region II and to consolidate Brasil Telecom as the carrier of choice through advertising campaigns that promote the use of our carrier selection code "14" and the synergies across our growing portfolio of integrated services, including wireless, data and long-distance services nationwide. However, our ability to offer national and international fixed-line services and/or mobile services could be adversely affected by the issues involved in our relationship with TIM. See "Risk Factors Risks Related to Our Business" for a further discussion.

*Strengthen our wireless telecommunications services*

Since September 2004 we have offered wireless telecommunications services using Global System for Mobile Communications ("GSM") technology through our subsidiary, Brasil Telecom GSM. With the introduction of wireless services, we are the only company in Region II to offer both wireline and wireless services and we expect to leverage this to increase our brand awareness and overall market share. We are able to offer competitive wireless service plans due, among other things, to the attractive prices paid for our licenses and the favorable terms available to us from our equipment vendors. We also intend to realize the synergies between our wireline and wireless operations by marketing to our existing client database, using our existing wireline sales channels, providing integrated packages and sharing infrastructure and operational systems. We also intend to develop new mobile products and services for the corporate market.

*Continue to integrate and acquire high technology network infrastructure in order to position ourselves as a market leader in the Brazilian corporate market*

Our acquisition in June 2003 of Grupo BrT Cabos Submarinos, our submarine fiber optic cable system, and our acquisition in May 2004 of Brasil Telecom Comunicação Multimídia, our local fiber-optic network, and Vant, our internet protocol provider, provided us with a state-of-the-art broadband infrastructure as well as local network capacity. These networks consist of a 22,000 kilometer submarine fiber optic system connecting us to Latin America and the United States, as well as 343 kilometers of local and 1,600 kilometers of long-distance fiber-optic lines in Brazil, allowing us to expand geographically to three principal corporate markets outside our region São Paulo, Rio de Janeiro and Belo Horizonte.

In addition, through Brasil Telecom Comunicação Multimídia we obtained an internet data center in São Paulo that will host various internet services. We have integrated these networks and this center into our existing network and business and intend to use this capacity to meet the growing demands for our network and data transmission services in order to become the market leader in both residential and corporate network and data transmission services.

*Develop integrated voice, data and multimedia services for residential and corporate clients*

We intend to offer voice, data and multimedia products and services through our existing distribution channels as well as through new mobile phone stores. Our strategy is to provide a one-stop shopping environment for both residential and corporate clients, satisfying all of their local, long distance, mobile, network and data transmission

service needs. We intend to maximize synergies and increase client loyalty by providing value-added services and to attract new clients and maintain existing clients by offering competitively priced products. We also intend to provide integrated customer service which will allow us to improve our service quality as well as increase our sales.

*Evaluation of possible participation in consolidation of Brazilian telecommunications industry*

The Brazilian telecommunications industry has experienced and may continue to experience consolidation. We continue to evaluate potential consolidation opportunities in Brazil, which may include acquisitions or other methods of participation designed to increase our market share or to improve our efficiency.

*Convergence*

With the implementation of our effective mobile operations, we became the largest integrated telecommunications carrier in Region II, and this integration can be observed in our convergent and innovative products and in our One Stop Shop point of sales strategy.

*Our Services*

The fixed-line telecommunications services offered to our customers consist of (i) local services, including all calls that originate and terminate within a single local area in the region, as well as installation, monthly subscription, measured services, public telephones and supplemental local services, (ii) intraregional long-distance services which include intrastate (calls between local areas within a state in our region) and interstate (calls between states in our region), (iii) interregional and international long-distance services, (iv) network services, including interconnection and leasing, (v) data transmission services, (vi) wireless services and (vii) other services.

The following table sets forth our revenue by type of service for the indicated years. Our rates for each category of service are discussed below under " Rates." Trends and events affecting our operating revenue are discussed under Item 5. Operating and Financial Review and Prospects."

	<b>Year ended December 31</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
		(millions of <i>reais</i> )	
Local services	6,900	7,371	7,603
Intraregional (Intrastate and Interstate) long-distance service	1,923	2,394	2,626
Interregional and International long-distance service		249	364
Network services	1,051	970	941
Data transmission	766	1,069	1,531
Mobile Services		88	732
Other	437	622	890
Gross operating revenues	11,077	12,763	14,687
Taxes and discounts	(3,162)	(3,698)	(4,549)
Net operating revenues	7,915	9,065	10,138

A concession of a telecommunication service is defined under the General Telecommunications Law as the delegation of the rendering thereof under the public regime, by means of a written agreement and for a determine period of time. The concessionaire will bear all business risks and its compensation will be the tariffs charged from the users and other alternative revenues. The concessionaire is directly responsible for the fulfillment of the underlying obligations and the damages it may cause. Concessions may only be granted to companies incorporated under Brazilian laws, and with both head office and management located in Brazil. Concessions will be granted by Anatel on a non exclusive basis and must comply with the general plan of awards approved by the Executive Branch

as mentioned above. The maximum term of a concession will be of twenty years, renewable only once for an equal period.

Concessions of telecommunications services have always been granted by means of a bidding procedure. The rules governing such bidding procedures were established by Anatel in Resolution No. 65, dated October 29, 1998. The provisions of Resolution No. 65 observe the constitutional principles and provisions of the General Telecommunications Law, particularly the following:

- (a) the purpose of the bidding procedure is to determine the party which may provide and expand the service under the public regime, as well as fulfill the relevant universalization obligations, on an efficient and secure basis and charging reasonable tariffs;
- (b) the draft request for proposal of each procedure will be submitted to public consultation;
- (c) the request for proposal will (i) identify the relevant service and the conditions for the rendering, expansion and universalization thereof, (ii) establish objective criteria for acceptance and judgment of the proposals, (iii) regulate the procedure, (iv) indicate the applicable sanctions, and (v) determine the clauses and conditions of the relevant concession agreement;
- (d) the technical and operational and economic-financial requirements to be fulfilled for purposes of qualifying each bidder, as well as occasional bid or performance bonds, must be applicable equally to all bidders, compatible with the purpose of the procedure and proportional to the nature and dimension thereof;
- (e) all bidders must evidence that the same are in good standing and situation before the tax and social security authorities;
- (f) the judgment of the proposals must always be made in accordance with the criteria established in the relevant request for proposal, provided that one of the following criteria is adopted: (i) lowest tariff to be charged from the service users; (ii) highest price offered for the concessions; (iii) highest quality level of the services; (iv) best fulfillment of the demand; or (v) a combination of any two or more of the foregoing criteria; and
- (g) the rules governing the bidding procedures must ensure publicity of the request for proposal, adequate term of submission of the proposals and ample defense rights.

According to the General Telecommunications Law and Resolution No. 65, the authorization by Anatel is an administrative act which permits the exploitation under the private regime of a telecommunications service, provided that the applicable objective and subjective requirements are duly met.

Resolution No. 65 sets forth the procedures for the granting of authorizations by Anatel. Anatel may only deny a request for authorization if the maximum number of service providers is already achieved, if the granting of the authorization would jeopardize the rendering of the services under the public regime or in case of a relevant reason, in each case as duly justified by Anatel.

There are certain objective requirements for the award of an authorization, including: (i) availability of the required radiofrequency, if applicable; and (ii) submission of a project that is technically feasible and compatible with the applicable regulations.

In relation to the subjective requirements for obtaining an authorization for the exploitation of a collective interest service under the private regime, (i) the interested party must be organized under Brazilian laws, with both head office and management located in Brazil; (ii) such party may neither be prevented from participating in bidding procedures carried out by the public authorities, nor from entering into agreements with public authorities; (iii) the Brazilian authorities may not have declared the forfeiture of any concession, permission or authorization held by the interest party in the prior two years; (iv) the interested party must have technical qualification to provide service, economic-financial capacity, be in good standing before the tax and social security authorities; (v) the interested party is not, in the same region, place or area, a provider of the same category of service.

On June 20, 2003, Anatel approved a new General Plan on Quality and the concession contract model under which all fixed-line telecommunications carriers already operate since January 1, 2006 onwards. On June 28, 2003, Decree

4769 was entered approving the General Plan on Universal Service. See " Obligations of Telecommunications Companies New Telecommunications Regulations." The new Concession Contracts for

Public Switched Telephone Network were signed in December 22, 2005 and begin as of January 1, 2006. It has duration until 2025. Five year reviews are budgeted during the concession period.

Additionally, the AICE regulation was included in the General Plan on Universal Service in order to facilitate the progressive universalization of individual fixed telephone access. AICE is a class of PSTN basic plan in which subscriber must pay a monthly subscription of R\$16.5 (net of taxes). On the AICE plan, the rate paid is the same as that of a local call with 2 minutes increment per each realized call (customer care rate), with a 2 minute minimum call rate. The plan operates as a pre-paid model in that the subscriber has to obtain credits in order to use the service, being offered in households that do not have other residential lines.

#### *Local Services*

We are the leading provider of local telecommunications services in our region with an estimated 94.6% market share as of December 31, 2005. In local fixed-line services, our main competitor is Global Village Telecom. Global Village Telecom is an independent service provider operating under an authorization from Anatel. As of December 31, 2005, we had approximately 9.6 million lines in service. We own and operate public telephones throughout our region. At December 31, 2005 we had approximately 296,900 public telephones and a ratio of public telephones per 100 lines installed equal to 2.69 which meets Anatel's service targets. We also provide a variety of other supplemental local services that include voice mail, call waiting, call forwarding, conferencing, speed dialing and caller ID.

To date, numerous companies have been authorized by Anatel to provide local fixed telecommunications services in our region. Our fixed-line services are also subject to competition from wireless service providers. See Item 3. Key Information Risk Factors Risks Related to the Brazilian Telecommunications Industry We face increasing competition in the Brazilian telecommunications industry which may have a material adverse effect on our market share, results of operations and financial condition." We have also been authorized to provide local fixed telecommunications services outside our region, although as of May 31, 2006, we have not done so.

Our local services also include fixed-to-mobile services, consisting of calls that originate on a fixed-line telephone and terminate on a mobile or cellular device. The fixed-to-mobile basic tariff per-minute are generally known as Communication Value-1, or VC-1.

#### *Intraregional (intrastate and interstate) long-distance services*

Calls from one local area in a region to another local area in the same region are referred to as "intraregional long-distance" calls. Intraregional long-distance service includes intrastate long-distance calls (calls within a given state in a region) and interstate long-distance calls (calls between states in a region). Prior to merging into us, each of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre, CTMR and CRT was the exclusive provider of intrastate long-distance service in their respective state. As a result we became and still are the leading provider of intrastate fixed-line telecommunications services in our region with a 90.6% intrastate average market share and an estimated 84.1% interstate average market share in 2005.

Pursuant to Anatel regulations, callers are able to choose a service provider for each long distance call by selecting a carrier selection code that identifies the carrier. Until July 6, 2003, this was permitted only for calls made from fixed-line phones. Since such date, mobile callers can also choose a service provider by selecting a carrier selection code. Our carrier selection code is "14."

Until July 1999, Embratel was the exclusive provider of interstate long-distance service. In July 1999, Embratel and Intelig were authorized by Anatel to provide intrastate long-distance services within the states in our region, and we were authorized to begin providing interstate long-distance services between the states in our region. See

" Competition." As a result we expanded our network to provide interstate long-distance service in our region to compete against Embratel, and Embratel and Intelig expanded their networks to provide intrastate long-distance service to compete against us. Even with this expansion, we may from time to time lease transmission facilities from other carriers to complete interstate long-distance calls between states in our region. To date, numerous

companies have permission by Anatel to provide intraregional long distance telecommunications services in our region. See Item 3. Key Information Risk Factors Risks Related to the Brazilian Telecommunications Industry.

Our intraregional services also include fixed-to-mobile services, consisting of calls that originate in a fixed-line telephone and terminate on a mobile or cellular device. The fixed-to-mobile rate per-minute charges are generally Communication Value 2, or VC-2, for calls outside the cellular subscriber's registration area but inside the region where the respective cellular provider provides service, and Communication Value 3, or VC-3, for calls outside the subscriber's registration area and outside the region where the respective cellular provider provides service. The use of our fixed-to-mobile services has increased significantly in the past five years as the penetration rate of mobile phones in our region has increased. We are the leading operator in the inter-city fixed-to-mobile services segment in our Region and reached, in December 2005 a market share of 86.2% and 66.2% for interregional calls in VC-2 and VC-3 areas, respectively.

#### *Interregional and International Services*

Historically, under Anatel rules, regional fixed-line companies, such as us, generally were not permitted to offer interregional or international long-distance services until December 31, 2003. As a result of Anatel having certified our compliance with universalization targets, on January 19, 2004, we began offering interregional long-distance and international long-distance services. Interregional long-distance services consist of calls between regions within Brazil. International long-distance services consist of calls between different regions within Brazil and a location outside of Brazil. In order to provide these services, we have entered into interconnection agreements with Telemar and Telesp and we will also make use of the cable network we acquired through the Grupo BrT Cabos Submarinos acquisition (linking Brazil with the United States, Bermuda and Venezuela) and through the Brasil Telecom Comunicação Multimídia acquisition (providing network facilities in São Paulo, Rio de Janeiro and Belo Horizonte). Our market share for these services has increased rapidly throughout 2005 and reached averages of 58.7% and 33.8% in the interregional and international segments in our Region, respectively, as of December 31, 2005. To date, numerous companies have been authorized by Anatel to provide interregional and international long distance telecommunications services in our region. See Item 3. Key Information Risk Factors Risks Related to the Brazilian Telecommunications Industry.

#### *Network Services*

Our network services consist of interconnection and lease of facilities.

#### *Interconnection Services*

Interconnection services consist of the use of our network by other telecommunications providers in order to:

- receive calls that originate on our network;
- complete calls that terminate on our network; and
- connect switching stations to our network.

Use of our interconnection services has grown substantially since they were introduced in 1998, as a result of:

- the spin-off of the cellular telecommunications businesses of each of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR;

- the breakup of Telebrás; and
- the advent of competition in the telecommunications sector in Brazil.

Telecommunications service providers are required to provide interconnection services on a nondiscriminatory basis. Subject to certain requirements, they are free to negotiate the terms of their interconnection agreements, but if the parties fail to reach an agreement, Anatel will arbitrate the controversy and establish the terms and conditions of interconnection. See " History and Development of the Company Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies Interconnection" and " Rate Regulation." The terms of our interconnection services, particularly the pricing and technical requirements of these services, may affect our results of operations, competitive environment and capital expenditure requirements.

We provide interconnection services to long-distance providers, such as Embratel, Intelig, Global Village Telecom, small private regime operators called *espelinhos*, and certain operators of trunking services. We also provide interconnection services to the cellular service providers that were spun off from each of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR as well as all Band B, Band D and Band E cellular service providers in our region.

#### *Lease of Facilities*

Other telecommunications service providers, particularly cellular service providers, lease trunk lines from our company for use within their own network, which are used for bulk transmission of voice and data messages. Large corporate customers lease lines from our company for use in private networks connecting different corporate sites. We also lease our telecommunications facilities to Embratel and Intelig in order to provide access to our network.

#### *Data Transmission Services*

We provide a variety of data transmission services through various technologies and means of access. Since 1999, we have invested in data transmission capacity in response to the growing demand in Brazil for data, images and text transmission services, mainly for corporate networks and corporate and residential Internet access.

The primary data product that we offer to both residential and corporate clients is Turbo, our broadband access service based on Asymmetric Digital Subscriber Line (ADSL) technology. Turbo is an important product because it creates additional revenues for fixed line, retains customers and acts as a primary access or last mile for other services which we offer currently, such as BrTurbo, our broadband internet service provider for residential clients and corporations that will be a platform for new services, such as video on demand and Voice-Over-Internet Protocol, or VoIP. We intend to continue to invest in our broadband business focusing on the growth of average per user, or ARPU, and the expansion of our network in order to better serve the expected increase in demand for this type of service, particularly in the Internet access market.

In addition to ADSL, we offer various data transmission services that are designed specifically for corporate and government customers. Since October 2004, in order to deliver services that fulfill the needs of our customers applications, our data transmission services portfolio was reformulated into four product families.

*Point-to-Point Family* designed for corporate customers that need point-to-point dedicated services, with high security, protocol transparency and national or international coverage. The Point-to-Point Family includes a Digital Dedicated Line Service ("DATAlink( SLDD ) ), which is a leased dedicated line service offering wider band width with 100% of guarantee and transparency of protocol.

*Network Infrastructure Family* designed for corporate customers that need security, performance and flexibility to image, data and voice transmission through corporate networks. The Network Infrastructure Family includes Asynchronous Transfer Mode (ATM), Frame Relay and xDSL, which is a new product we market to corporate customers under the *InterLAN* brand name. *InterLAN* offers switching service and data transmission service for

corporations through a secure, reliable and low cost technology. The Network Infrastructure Family also includes Virtual Private Networks, or VPN, based on internet protocol. VPN is a new product that we market to corporate customers under the "Vetor" brand name. The virtual private network allows companies to consolidate

and organize their data communications services and improve the quality of such services through a virtual private network, which we create for each client using our data transmission infrastructure.

*Internet Access Family* designed for corporate customers that need a high performance and high quality connection to internet backbone. The Internet Access Family includes a Dedicated Internet Protocol ("Dedicated IP), which is a leased line that functions as a dedicated gate for access to the internet backbone typically used by internet service providers. The Internet Access Family also included Dial up internet access, a remote dial up internet access which we market under the name "DialNet." DialNet is used primarily by corporate internet service providers to provide remote access to corporate networks.

*Advanced Services Family* comprised of value-added technologies and services to complement our data transmission services portfolio. The Advanced Services Family includes (1) PLUS, which is a set of services that provide rental and management of telecommunications equipments to corporate customers, (2) VIP, which is a set of services that provide to corporate customers the transparency of the network quality by combining on-line reports, differentiated service level agreements and e pro-active network supervision, and (3) Audio, Video and Web Conferencing Services, which is a new product that we market to corporate customers under the MultiConferências brand name as a value-added service, which is fully integrated, with expert advice, support and management.

#### *Brasil Telecom Comunicação Multimidia*

On May 13, 2004, we purchased the remaining 80.1% stake giving us 99.99% of the capital share of MTH, the parent company of Brasil Telecom Comunicação Multimidia. Brasil Telecom Comunicação Multimidia established its Brazilian branch in August 1997, beginning its commercial operations in December 1998 by providing private digital telecommunications network capabilities to the corporate segment.

Brasil Telecom Comunicação Multimidia plays a key role in our strategy to expand outside Region II, due to its excellent positioning in the key data service markets (São Paulo, Rio de Janeiro and Belo Horizonte) as well as its highly qualified executive team. With a technologically advanced data network which complements our existing networks, Brasil Telecom Comunicação Multimidia gives us direct access to main corporate clients in Brazil to whom we can offer national as well as international services, through Grupo BrT Cabos Submarinos' infrastructure. The integration process of Brasil Telecom Comunicação Multimidia with our other services, carried out throughout 2004, captured many synergies, not only on sales opportunities but also in reduction of general and administrative, and information technology costs. According to a study we conducted in 2002, approximately 80.0% of the interregional long-distance traffic originating in our region terminates in the three states where Brasil Telecom Comunicação Multimidia has its network and using its infrastructure, we realize savings, as we do not have to use a third party infrastructure to complete these calls. The integration of Brasil Telecom Comunicação Multimidia with our existing services also increases our competitiveness in the other Regions, furthering our strategy of expanding beyond Region II.

Brasil Telecom Comunicação Multimidia provides services in data center, internet, data transmission, and was the first Brazilian company to use fiber optics to provide high quality performance and security for offices. The BrT Multimidia Communication infra-structure has 343 km of metropolitan network in São Paulo, Rio de Janeiro and Belo Horizonte, and 1,600 km of long-distance network connecting these three cities.

In addition to its private network, Brasil Telecom Comunicação Multimidia also has an Internet solution center of 3,790 square meters, which offers data center services and support including co-location and hosting. As part of our acquisition, we acquired a management team with expertise in these markets. Currently, Brasil Telecom Comunicação Multimidia has 636 clients in Brazil, comprised primarily of corporate clients.

Vant

On May 13, 2004, we exercised our option to purchase for R\$15.6 million the remaining 80.1% of the capital of Vant, giving us 99.99% of the share capital of Vant. Founded in October 1999, Vant was the first telecom company in Brazil to offer a network based on the Internet Protocol, or IP, technology. Vant offers internet protocol

as well as other products to the corporate market throughout Brazil, with a presence in the most territories of the country. In order to create a better synergy between the companies of our Group, and to decrease costs and operational expenses, we currently intend to cease the operations of Vant, with its corporate client base and assets being distributed to the rest of our Group.

### Grupo BrT Cabos Submarinos

We offer bandwidth and interconnectivity to our customers through Grupo BrT Cabos Submarinos (formerly known as GlobeNet), a company formed in 1998 to provide fiber-optic communications services in the United States and internationally between the United States and South America. Grupo BrT Cabos Submarinos's system is composed of two armored submarine cable rings, representing approximately 22,000 kilometers of high quality fiber-optic cable, linking Brazil to the United States, passing through Venezuela and the Bermuda Islands, with an installed capacity of 80 Gbps and the potential to increase to 1,360 Gbps.

The infrastructure offered by Grupo BrT Cabos Submarinos assists us particularly in the expansion of our corporate data transmission services, allowing us to offer integrated services to national and international corporate clients which includes data communications (Internet and corporate) between Brazil and the US. In addition, we can reduce our voice and data interconnections costs.

During 2005, Grupo BrT Cabos Submarinos reduced operational costs, renegotiated contracts and developed new businesses in Venezuela, the Caribbean, the United States, Brazil, and other Mercosul countries. It also established important strategic partnerships which allowed the optimization of our network. As a result, Grupo BrT Cabos Submarinos started providing international services in Venezuela where we signed service provider contracts that represent 40% of the total Venezuelan international Internet traffic.

Additionally, Grupo BrT Cabos Submarinos gave us the necessary autonomy to carry our international voice and data traffic (including IP traffic), reducing interconnection and transport costs. In 2005, we saved approximately US\$16.0 million in international capacity rental expenses and we expect to save approximately US\$20.6 million in 2006.

### *Internet Services*

In October 2001, we formed BrTSi (a wholly owned subsidiary) which provides internet services through BrTurbo, iBest, and iG, and data communications services through Grupo BrT Cabos Submarinos.

In October 2005, we began the operational integration process of our three Internet service providers: iG, iBest and Br Turbo. Through this consolidation, we expect to maintain our competitive position in the Brazilian internet market. More important than the traffic obtained by these providers and the access revenues originated from paid services is the customer relationship channel with other potential customers around the country.

Our strategy is to use our internet business as the main vehicle in the Brazilian market, focusing on communication, information, services and entertainment. The internet service provider's operational integration allows us to offer the best portfolio of products and services to our customers in addition to the operational synergy that we will gain.

### BrTurbo

We offer broadband Internet services through BrTurbo, our broadband Internet service provider, or ISP. We created BrTurbo in 2002 as a broadband ISP to offer competitively priced broadband access and internet content.

BrTurbo's content includes live transmission of news, entertainment channels, video channels with on-demand feature films and documentaries and an exclusive on-line games channel. In November 2002, BrTurbo launched TurboMeeting service, which allows two-line video-conferencing.

In 2002, we developed BrTurbo Empresas, a line of services aimed at corporate clients, particularly small and medium-sized companies and home offices. As part of these services, we launched a portal which offers space

for backup and storage of information, e-mail account, publication of Internet sites and hosting services. In March 2004, BrTurbo Empresas started offering a number of new products including Web Presence, Enterprise Webmail, Video Co