

D. Reasons for the Offer and Use of Proceeds

Not applicable.

E. Risk Factors

This section is intended to be a summary of more detailed discussions contained elsewhere in this annual report. The risks described below are not the only ones we face. Additional risks may impair our business operations. Our business, results of operations or financial condition could be harmed if any of these risks materializes and, as a result, the trading price of the ADSs could decline.

Risks Relating to Brazil

The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. Brazilian political and economic conditions have a direct impact on our business, operations and the market price of our preferred shares and our ADSs.

In the past, the Brazilian government has intervened in the Brazilian economy and occasionally made drastic changes in policy. The Brazilian government's actions to control inflation and affect other policies have often involved wage and price controls, currency devaluations, capital controls, and limits on imports, among other measures. Our business, financial condition and results of operations may be adversely affected by changes in government policies, as well as general economic factors, including:

- currency fluctuations;
- inflation;
- price instability;
- energy policy;
- interest rates;
- tax policy; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Inflation and certain government measures to curb inflation may have adverse effects on the Brazilian economy, the Brazilian securities market and/or our business and operations.

Brazil has historically experienced extremely high rates of inflation. Inflation and certain of the government's measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. Since 1994, Brazil's inflation rate has been substantially lower than in previous periods. However, inflationary pressures persist, and actions taken in an effort to curb inflation, coupled with public speculation about possible future governmental actions, have contributed to economic uncertainty in Brazil and heightened volatility in the Brazilian securities market. Brazil's general price index, or the IGP-DI, reflected inflation rates of 7.7% in 2003, 26.4% in 2002 and 10.4% in 2001. The amplified consumer price index, or IPCA, was 9.3% in 2003, as compared to 12.53% in 2002 and 7.67% in 2001. If Brazil experiences significant inflation rates, we may be unable to increase service tariffs and prices charged to our customers in amounts that are sufficient to cover our increasing operating costs, and our business may be adversely affected as a consequence.

Fluctuations in the value of the real against the value of the U.S. dollar may adversely affect our ability to pay U.S. dollar-denominated or U.S. dollar-linked obligations and could lower the market value of our preferred shares and ADSs.

The Brazilian currencies have historically experienced frequent devaluations. The *real* devalued against the U.S. dollar by 18.7% in 2001 and 52.3% in 2002. In 2003, the *real* appreciated against the U.S. dollar by 18.1%. See “Item 3.A—Selected Financial Data—Exchange Rates” for more information on exchange rates.

As of December 31, 2003, all of our R\$3.0 billion total indebtedness was denominated in foreign currencies, especially in U.S. dollars. As of December 31, 2003, we had currency hedges in place to cover 100% of our foreign currency denominated debt. Significant costs relating to our network infrastructure are payable or linked to payment by us in U.S. dollars. However, other than income derived from hedging transactions, all of our revenues are generated in *reais*. To the extent that the value of the *real* decreases relative to the U.S. dollar, our debt becomes more expensive to service and it becomes more costly for us to import the technology and the goods that are necessary to operate our business.

Deterioration in economic and market conditions in other countries, especially emerging market countries, may adversely affect the Brazilian economy and our business.

The market for securities issued by Brazilian companies is influenced by economic and market conditions in Brazil and, to varying degrees, market conditions in other Latin American and emerging market countries. Although economic conditions are different in each country, the reaction of investors to developments in one country may cause the capital markets in other countries to float. Developments or conditions in other emerging market countries have at times significantly affected the availability of credit in the Brazilian economy and resulted in considerable outflows of funds and declines in the amount of foreign currency invested in Brazil.

For example, in 2001, after prolonged periods of recession followed by political instability, Argentina announced that it would no longer continue to service its public debt. In order to address the deteriorating economic and social crisis, the Argentine government abandoned its decade-old fixed dollar-*peso* exchange rate, allowing the *peso* to float to market rate levels. In 2002, the Argentine *peso* experienced 236% devaluation against the U.S. dollar. The situation in Argentina may have negatively affected investors’ perceptions towards Brazilian securities. In 2003, the Argentine economy began to stabilize and the Argentine *peso* experienced 12.6% devaluation against the U.S. dollar.

Although market concerns that similar crises would ensue in Brazil have not become a reality, the volatility in market prices for Brazilian securities increased in 2001 and 2002. If market conditions in other countries, especially emerging market countries continue to deteriorate, they may adversely affect our ability to borrow funds at an acceptable interest rate or to raise equity capital, when and if there is a need. Accordingly, adverse developments in other countries, especially other emerging market countries, could lead to a reduction in both demand for, and the market price for the preferred shares and ADSs.

Risks Relating to the Brazilian Telecommunications Industry and Us

Extensive government regulation of the telecommunications industry and our concession may limit our flexibility in responding to market conditions, competition and changes in our cost structure or impact our tariffs.

Our business is subject to extensive government regulation. Anatel, which is the primary telecommunications industry regulator in Brazil, regulates, among other things:

- regulations;
- licensing;
- tariffs;

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- competition;
- telecommunications resource allocation;
- service standards;
- technical standards;
- quality standards;
- interconnection and settlement arrangements; and
- supervision of universal service obligations.

The initial monthly fees and usage fee tariffs for our services (local and long-distance) were initially determined in our concession agreement, which also sets the annual price adjustment. We derive a substantial portion of our revenues from services subject to this price adjustment. The method of price adjustment is basically a price cap. Anatel applies annually a price index correction that reflects the inflation index of the period (in accordance with the concession contract) and a productivity factor (in accordance with the concession contract) to our local and long-distance tariffs. Anatel has complied with the tariff range set by the concession agreement. We are currently involved in certain claims relating to the price adjustment of our fees. See “Item 4B - Local Rates” and “Item 8A - Regulatory and Antitrust Litigation” for additional information on these claims.

We operate our business under a concession from the Brazilian government. According to the terms of the concession, we are obligated to meet certain requirements and to maintain minimum quality and service standards. Failure by us to comply with the requirements of our concession may result in the imposition of fines or other government actions, including the termination of our concession. Any partial or total revocation of our concession would have a material adverse effect on our financial condition and results of operations.

As of January 2006, under the new concession agreement, the concept of price cap for our fees will be maintained. However, we will be subject to new methodologies for the calculation of price index and productivity factor. Although we have no information on the new methodologies, we expect fees to remain at current rates, since they are already lower than international standards.

We face substantial competition that may reduce our market share.

The accomplishment of the universal service targets by several fixed telecommunications services providers made our region available for the rendering of local and long-distance voice services by other providers. We are facing a period of market adjustment in which the providers are competing for clients, especially corporate clients, which results in lower prices and impacts market share. The providers that have met the universal service targets are allowed to change their shareholding structures. The result is a trend of mergers and consolidations and capital infusions. Therefore, we will face the impact of the result of the reorganization of the telecommunications market evidenced by the acquisition of Pegasus and the building of its own network in region III by Telemar (which is authorized to offer services outside its region), the acquisition of Metrored and Vant by Brasil Telecom and the acquisition of Vésper by Embratel (which provided Embratel with access to local service). Likewise, we are preparing ourselves to do business in Telemar’s and Brasil Telecom’s concession areas as often as we identify good business opportunities that meet our expectations.

The rapid growth of the cellular telecommunications industry and the expressive competition among the cellular services providers are lowering the prices of cellular services. The cellular services are increasingly becoming an alternative for the fixed line services to residential and low-income clients. In the mid-term, we expect that such trend may negatively impact the use of fixed telecommunications services.

The industry in which we conduct our business is subject to rapid technological changes and these changes could have a material adverse effect on our ability to provide competitive services.

The telecommunications industry is subject to rapid and significant technological changes. Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will be further developed.