

BRASIL TELECOM SA
Form 20-F
June 23, 2004
As filed with the Securities and Exchange Commission on June 23, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003
Commission file number: 1-15256**

BRASIL TELECOM S.A.

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

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

(Address of Principal Executive Offices)

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

Title of each class	Name of each exchange on which registered
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, 2003 there were outstanding:

249,597,049,542 Common Shares, without par value
295,569,090,398 Preferred Shares, without par value

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 which financial statement item the registrant has elected to follow:

Item 17 Item 18

TABLE OF CONTENTS

	<u>Page</u>
<u>PRESENTATION OF FINANCIAL INFORMATION</u>	4
<u>FORWARD-LOOKING INFORMATION CONTAINED IN THIS ANNUAL REPORT</u>	5
<u>PART I</u>	7
<u>ITEM 1. Identity of Directors, Senior Management and Advisors</u>	7
<u>ITEM 2. Offer Statistics and Expected Timetable</u>	7
<u>ITEM 3. Key Information</u>	7
<u>Selected Financial Data</u>	7
<u>Exchange Rates</u>	13
<u>Risk Factors</u>	14
<u>ITEM 4. Information on the Company</u>	25
<u>History and Development of the Company</u>	25
<u>Capital Expenditures</u>	32
<u>Business Overview</u>	33
<u>Regulation of the Brazilian Telecommunications Industry</u>	61
<u>Property, Plant and Equipment</u>	68
<u>Environmental and Other Regulatory Matters</u>	68
<u>ITEM 5. Operating and Financial Review and Prospects</u>	69
<u>Overview of Results of Operations</u>	69
<u>U.S. GAAP Reconciliation</u>	74
<u>Critical Accounting Policies</u>	75
<u>New Accounting Pronouncements</u>	78
<u>Results of Operations for the Years Ended December 31, 2001, 2002 and 2003</u>	79
<u>Liquidity and Capital Resources</u>	92
<u>ITEM 6. Directors, Senior Management and Employees</u>	98
<u>Board of Directors and Senior Management</u>	98
<u>Board Practices</u>	101
<u>Corporate Governance Practices</u>	104
<u>Employees</u>	104
<u>Performance Bonus Plan</u>	105
<u>Share Ownership</u>	105
<u>ITEM 7. Major Shareholders and Related Party Transactions</u>	105
<u>Major shareholders</u>	105
<u>Related Party Transactions</u>	109
<u>ITEM 8. Financial Information</u>	109
<u>Consolidated Statements and Other Financial Information</u>	109
<u>Legal Proceedings</u>	109
<u>Dividend Policy</u>	115
<u>ITEM 9. The Offer and Listing</u>	117
<u>Offer and Listing Details</u>	117
<u>Markets</u>	120
<u>ITEM 10. Additional Information</u>	122
<u>Memorandum and Articles of Association</u>	122
<u>Changes to the Brazilian Corporation Law</u>	122
<u>Material Contracts</u>	123
<u>Exchange Controls</u>	126
<u>Taxation</u>	127
<u>Independent Auditors</u>	133
<u>Documents on Display</u>	133
<u>ITEM 11. Quantitative and Qualitative Disclosures About Market Risk</u>	133
<u>Quantitative Information About Market Risk</u>	133
<u>ITEM 12. Description of Securities Other than Equity Securities</u>	135
<u>PART II</u>	136
<u>ITEM 13. Defaults, Dividend Arrearages and Delinquencies</u>	136
<u>ITEM 14. Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	136
<u>ITEM 15. Controls and Procedures</u>	136
<u>ITEM 16A. Audit Committee Financial Expert</u>	136
<u>ITEM 16B. Code of Ethics</u>	136

Edgar Filing: BRASIL TELECOM SA - Form 20-F

<u>PART III</u>			
	<u>ITEM 16C.</u>	<u>Principal Accountant Fees and Services</u>	<u>136</u>
			<u>138</u>
	<u>ITEM 17.</u>	<u>Financial Statements</u>	<u>138</u>
	<u>ITEM 18.</u>	<u>Financial Statements</u>	<u>138</u>
	<u>ITEM 19.</u>	<u>Exhibits</u>	<u>139</u>
	<u>INDEX OF DEFINED TERMS</u>		<u>140</u>
	<u>TECHNICAL GLOSSARY</u>		<u>141</u>
	<u>SIGNATURES</u>		<u>145</u>
	<u>INDEX TO EXHIBITS</u>		<u>150</u>
	<u>CONSOLIDATED FINANCIAL STATEMENTS</u>		

PRESENTATION OF FINANCIAL INFORMATION

In this Annual Report, Brasil Telecom S.A. (previously Telecomunicações do Paraná S.A. - Telepar), 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 combined consolidated basis for the years 1999 and 2000 and on a consolidated basis for the years 2001, 2002 and 2003 as if our merger with each of Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR (each as defined below) had occurred as of January 1, 1996 and as if the merger of *Companhia Riograndense de Telecomunicações - CRT* ("CRT") with and into our company had occurred as of July 31, 2000. See Item 4 "Information on the Company - History and development of the company - Historical Background."

References to (i) the "real" "reais" or "R\$" are to Brazilian *reais* (plural) and the Brazilian *real* (singular) and (ii) "U.S. dollars," "dollars" or "U.S.\$" 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*. At May 31, 2004, the Commercial Market selling rate (as defined in Item 3 "Key Information - Selected Financial Data - Exchange Rates") was R\$3.1287 to U.S.\$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 No. 6404/76, as amended by Law No. 10.330/02), 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 others. 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, 2001, 2002 and 2003 and net income (loss) for each of the years ended December 31, 2001, 2002 and 2003. Brazilian GAAP when applied to us differs in certain important respects from generally accepted accounting principles in the United States ("U.S. GAAP"). See Note 31 to our audited consolidated financial statements for (i) a summary of the principal differences between Brazilian GAAP and U.S. GAAP as they relate to us and (ii) a reconciliation to U.S. GAAP of shareholders' equity as of December 31, 2002 and 2003 and net income (loss) for each of the years ended December 31, 2001, 2002 and 2003. These audited consolidated financial statements are referred to herein as the "Financial Statements."

Our audited annual consolidated financial statements for the year ended December 31, 2001 prepared in accordance with Brazilian GAAP and consistent with the rules and regulations of the CVM and the accounting standards issued by IBRACON included in this Annual Report, have been audited by Deloitte Touche Tohmatsu Auditores Independentes, as stated in their report appearing in this Annual Report.

Our audited annual consolidated financial statements as of December 31, 2002 and December 31, 2003 and for each of the two years in the period ended December 31, 2003 prepared in accordance with Brazilian GAAP with reconciliation of shareholder's equity and income statements to U.S. 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 140 lists the page where each defined term is defined within this document. Technical terms are defined in the Technical Glossary on page 141.

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.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

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

- our regional marketing strategy;
- our ability to meet our network expansion, service quality and modernization obligations;
- our market share;
- our compliance with International Commission for Non-Ionizing Radiation Protection ("ICNIRP") 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 demand for cable television services in our region;
- our projected capital expenditures;
- our projected subsidies and financing; 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 our region in particular;
- the receipt of additional, and/or the revocation of our existing, governmental approvals and licenses;
- the availability of the necessary equipment to maintain, operate and improve our network;
- the existence of difficulties in the operation of our equipment and/or the provision of our services;
- the availability of financing;
- the availability of qualified personnel;
- the business abilities and judgment of our personnel;

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- the emergence of new technologies and the response of our customer base to those technologies;
- acquisition 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.

[Table of Contents](#)

PART I

[Table of Contents](#)

ITEM 1. Identity of Directors, Senior Management and Advisors

We are filing an Annual Report under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Accordingly, this item does not apply to us.

[Table of Contents](#)

ITEM 2. Offer Statistics and Expected Timetable

We are filing an Annual Report under the Exchange Act. Accordingly, this item does not apply to us.

[Table of Contents](#)

ITEM 3. Key Information

[Table of Contents](#)

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 combined consolidated basis for the years 1999 and 2000 and on a consolidated basis for the years 2001, 2002 and 2003 as if our merger with Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR (each as defined below) had occurred as of January 1, 1996 and the merger of CRT with and into our company had occurred on July 31, 2000.

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.

Brazilian GAAP and U.S. GAAP

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Our Financial Statements are prepared in accordance with Brazilian GAAP, which differ in certain significant respects from U.S. GAAP. See Note 31 to our Financial Statements for (i) a summary of the principal differences between Brazilian GAAP and U.S. GAAP as they relate to us, and (ii) a reconciliation to U.S. GAAP of shareholders' equity as of December 31, 2002 and 2003 and net income (loss) for each of the years ended December 31, 2001, 2002 and 2003.

Effects of Inflation

Our financial statements until the year 2000, and unless otherwise specified, all financial information included in this Annual Report until the year 2000, recognize certain effects of inflation and are restated in constant reais of December 31, 2000, all in accordance with Brazilian GAAP. We used the General Market Price Index, *Índice Geral de Preços de Mercado* ("IGP-M"), published by *Fundação Getúlio Vargas* for purposes of restating our Financial Statements. Inflationary gains or losses on monetary assets and liabilities were allocated to their corresponding income or expense caption in our combined statements of income until the year 2000. However, pursuant to Brazilian GAAP, our audited financial statements as of and for the years ended December 31, 2001, 2002 and 2003, no longer recognize the effects of inflation after January 1, 2001 and are not restated in constant reais.

Change in Accounting Methodology

Depreciation

During our fiscal year 1999, we shortened our depreciation schedule for our automatic switching and transmission equipment from thirteen years and ten years, respectively, to five years in order to better reflect the estimated useful life of this equipment in light of rapidly changing technology and industry practices. 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, 2001, 2002 and 2003 Cost of Services Depreciation and Amortization."

Accounting Consequences of the Breakup of Telebrás

Our financial statements for the fiscal years prior to 2000 are not necessarily indicative of what our financial condition or results of operations would have been if we had merged with Telesc, Telegoiás, Telebrásília, Telemat, Telems, Teleron, Teleacre and CTMR before February 2000.

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. Our audited consolidated financial statements for the year 2000 include the effects of inflation through December 31, 2000, while our Statutory Financial Statements include the effects of inflation only through December 31, 1995. 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, 2001, 2002 and 2003 and net income (loss) for each of the years ended December 31, 2001, 2002 and 2003. Our Statutory Financial Statements also differ from our Consolidated Financial Statements in respect of certain reclassifications, presentation of comparative information and consolidation procedures.

Selected Financial Information

	Year ended December 31,				
Income Statement Data:	1999 ⁽¹⁾	2000 ⁽¹⁾	2001 ⁽²⁾	2002 ⁽²⁾	2003 ⁽²⁾
	(thousands of <i>reais</i> , except per share data)				
Brazilian GAAP:					
Net operating revenue	3,591,723	4,652,184	6,158,408	7,071,368	7,915,194
Cost of services	2,698,465	3,774,109	4,798,434	5,163,861	5,472,142
Gross profit	893,258	878,075	1,359,974	1,907,507	2,443,052
Operating expenses:					
Selling expenses	347,207	381,371	724,570	763,375	821,656

Edgar Filing: BRASIL TELECOM SA - Form 20-F

General and administrative expenses	548,084	509,993	604,890	661,060	847,074
Other net operating expenses (income)	(31,282)	(56,964)	56,769	(118,496)	214,953
Operating income (loss) before net financial expenses	29,249	43,675	(26,255)	601,568	559,369
Net financial expenses	4,919	5,577	236,357	618,899	844,802
Operating income (loss)	24,330	38,098	(262,612)	17,331	(285,433)
Net non-operating expenses (income)	57,510	(3,970)	93,071	64,497	541,691
Employee's profit share	18,869	18,516	50,834	41,387	1,076
Income (loss) before taxes and minority interests	(52,049)	23,552	(406,517)	(123,215)	(828,200)
Income and social contribution tax benefits	7,744	16,218	199,039	111,596	320,751
Income (loss) before minority interests	(44,305)	39,770	(207,478)	(11,619)	(507,449)
Minority interests	---	77,605	---	---	14
Net income (loss)	(44,305)	117,375	(207,478)	(11,619)	(507,435)
Number of Common Shares (millions) ⁽³⁾	---	237,165	237,165	243,564	249,597
Number of Preferred Shares (millions) ⁽³⁾	---	292,260	293,218	292,020	289,850
Operating Income (loss) per thousand Common Shares (<i>reais</i>) ⁽³⁾	---	0.16	(1.10)	0.07	(1.14)
Net income (loss) per thousand Common Shares (<i>reais</i>) ⁽³⁾	---	0.49	(0.87)	(0.05)	(2.03)
Dividends per thousand Common Shares (<i>reais</i>) ⁽³⁾	---	0.33	0.37	0.51	0.39
Dividends per thousand Common Shares (U.S. dollars) ⁽³⁾⁽⁴⁾	---	0.17	0.16	0.14	0.14
Dividends per thousand Preferred Shares(<i>reais</i>) ⁽³⁾	---	0.33	0.37	0.51	0.39
Dividends per thousand Preferred Shares(U.S. dollars) ⁽³⁾⁽⁴⁾	---	0.17	0.16	0.14	0.14

(1) Presented in constant *reais* of December 31, 2000.

(2) Pursuant to Brazilian GAAP, our audited consolidated financial statements for the years ended December 31, 2001, 2002 and 2003 no longer recognize the effects of inflation after January 1, 2001 and are not restated in constant *reais*.

(3) Since our present capital structure was not in place for the year ended December 31, 1999, earnings and dividends per share were not presented for those periods. See Note 3r to our Consolidated Financial Statements.

(4) Dividends per thousand shares were converted into dollars at the Commercial Market selling rate of R\$1.955 per U.S. dollar on December 31, 2000, of R\$2.32 per U.S. dollar on December 31, 2001, of R\$3.5333 per U.S. dollar on December 31, 2002 and of R\$2.8892 per U.S. dollar on December 31, 2003, respectively.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Selected Financial Information (continued)

Year ended December 31,

Income Statement Data (continued)

	1999 ⁽¹⁾	2000 ⁽¹⁾	2001 ⁽²⁾	2002 ⁽²⁾	2003 ⁽²⁾
(thousands of <i>reais</i> , except per share data)					
U.S. GAAP:					
Net income (loss)	(458,003)	7,096	(169,716)	317,280	(287,739)
Net income (loss) per thousand shares (<i>reais</i>) ⁽⁵⁾ :					
Common Shares Basic	(1.02)	0.01	(0.32)	0.59	(0.54)
Common Shares Diluted	(0.91)	0.01	(0.32)	0.59	(0.54)
Preferred Shares Basic	(1.02)	0.01	(0.32)	0.59	(0.54)
Preferred Shares Diluted	(0.91)	0.01	(0.32)	0.59	(0.54)

(5) In accordance with Statement of Financial Accounting Standards ("SFAS") No. 128 "Earnings Per Share," basic and diluted earnings per share have been calculated, for U.S. GAAP purposes, using the "two class method." See Note 31e to our Consolidated Financial Statements.

At December 31,

	1999 ⁽¹⁾	2000 ⁽¹⁾	2001 ⁽²⁾	2002 ⁽²⁾	2003 ⁽²⁾
(thousands of <i>reais</i>)					
Balance Sheet Data:					
Brazilian GAAP:					
Intangibles ⁽³⁾		472,680	372,537	470,544	531,556
Property, plant and equipment, net ⁽⁴⁾	8,522,126	11,498,689	12,240,270	11,260,625	9,567,243
Total assets	10,823,447	14,992,076	15,772,551	16,432,198	15,622,803
Loans and financing current portion	801,410	1,253,861	530,661	683,276	1,990,274
Loans and financing non-current portion	208,647	1,959,207	3,504,489	4,398,532	2,645,563
Total liabilities (including funds for capitalization and minority interests)	3,080,942	6,243,687	7,796,249	8,808,409	8,781,841
Shareholders' equity	7,742,505	8,748,389	7,976,302	7,623,789	6,840,962
U.S. GAAP:					
Intangibles ⁽⁵⁾	740,869	1,178,789	873,559	830,328	978,414
Property, plant and equipment, net	7,033,417	11,292,820	12,139,658	11,670,826	10,035,667
Total assets	9,948,904	15,807,758	16,546,508	17,202,182	16,538,085
Loans and financing current portion	799,245	1,120,475	525,137	480,666	1,737,494
Loans and financing non-current portion	208,647	1,959,281	3,504,489	4,252,221	2,455,897
Total liabilities (including funds for capitalization and minority interests)	3,474,959	7,590,763	8,711,767	9,390,158	9,281,644
Shareholders' equity	6,473,945	8,216,995	7,834,741	7,812,024	7,256,440

- (1) Presented in constant *reais* of December 31, 2000.
- (2) Pursuant to Brazilian GAAP, our audited consolidated financial statements at December 31, 2001, 2002, and 2003 no longer recognize the effects of inflation after January 1, 2001 and are not restated in constant reais.
- (3) Includes the goodwill from our acquisition of a controlling stake in CRT, which was calculated based on book value.
- (4) Stated at indexed cost up to December 31, 2000, less accumulated depreciation. See Note 3g to our Consolidated Financial Statements.
- (5) Intangibles under U.S. GAAP at December 31, 1999, include the step-up goodwill paid by Solpart Participações S.A. ("Solpart") as a consequence of the exchange of shares between companies under our common control pursuant to our merger with Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR. Intangibles under U.S. GAAP at December 31, 2000, 2001, 2002 and 2003 also include the goodwill from our merger with Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR and our merger with CRT but do not include amounts relating to our PCS licenses. See Note 31o to our Consolidated Financial Statements.

Table of Contents

Exchange Rates

There are 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 are carried out on the Commercial Market. Purchases of foreign exchange in the Commercial Market may be carried out only through a financial institution authorized to buy and sell currency in that market. The Floating Market rate generally applies to transactions to which the Commercial Market rate does not apply. Prior to February 1, 1999, the exchange rate in each market was established independently, resulting in different rates during some periods. Since February 1, 1999, the Central Bank authorized the unification of the exchange positions of the Brazilian financial institutions in the Commercial Market and Floating Market, which led to a convergence in the pricing and liquidity of both markets. However, each market continues to have a specific regulation. Most trade and financial transactions are carried out on the Commercial Market. The foreign currencies may only be purchased through a Brazilian financial institution authorized to operate in these markets. In both markets, rates are freely negotiated but may be strongly influenced by Central Bank intervention.

Under the *Real Plan* ("*Real Plan*"), 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 U.S.\$1.00. The issuance of reais was initially subject to quantitative limits backed by a corresponding amount of U.S. dollars in reserves, but the government subsequently expanded those quantitative limits and allowed the *real* to float, with parity between the *real*/U.S. dollar (R\$1.00 to U.S.\$1.00) as a ceiling.

From its introduction in 1994 through March 1995, the *real* appreciated against the U.S. dollar. On March 6, 1995, in an effort to address concerns about the overvaluation of the *real* relative to the U.S. dollar, the Brazilian Central Bank introduced new exchange rate policies that established a band within which the *real*/U.S. dollar exchange rate could fluctuate. The Brazilian Central Bank initially set the exchange rate band with a floor of R\$0.86 per U.S.\$1.00 and a ceiling of R\$0.90 per U.S.\$1.00 and provided that, after March 10, 1995, the exchange rate band would be between R\$0.88 and R\$0.93 per U.S.\$1.00. Thereafter, the Brazilian Central Bank periodically adjusted the exchange rate band to permit the gradual devaluation of the *real* against the U.S. dollar. On January 13, 1999, the Brazilian Central Bank widened the exchange rate fluctuation band in which the *real* was allowed to trade from between R\$1.12 and R\$1.22 per U.S.\$1.00 to a new band of between R\$1.20 and R\$1.32 per U.S.\$1.00. This resulted in an immediate devaluation of the *real* to R\$1.32 per U.S.\$1.00.

Since January 15, 1999 the *real* has been allowed to float freely. The *real* devalued to a low of R\$2.165 per U.S.\$1.00 on March 3, 1999, but subsequently appreciated to R\$1.789 per U.S.\$1.00 on December 31, 1999, representing a net devaluation against the U.S. dollar of 32.4% during 1999. In 2000, the *real* devalued by a further 8.5% against the U.S. dollar.

Further deterioration in the political and economic environment in 2001, in addition to the Brazilian energy crisis, resulted in the *real* devaluing by 15.7% against the U.S. dollar in the year. In the final quarter of 2001, however, the *real* appreciated by 15.1% from R\$2.671 per U.S. \$1.00 at September 30, 2001 to R\$2.3204 per U.S.\$1.00 at December 31, 2001.

In 2002, as a reaction to political and economic uncertainties, the global economic downturn, the crisis in Argentina and the Brazilian presidential elections, the U.S. dollar appreciated by 34.3% against the real to R\$3.5333 per U.S.\$1.00 at December 31, 2002. The *real* recovered in 2003, appreciating by 18.3% to R\$2.8892 per U.S.\$1.00, at December 31, 2003. During the first five months of 2004, the *real* has depreciated approximately 8.3% against the U.S. dollar. We cannot assure you that the *real* will not substantially devalue again in the future. See " Risk Factors Risks Relating to Brazil."

As of May 31, 2004, the Commercial Market selling rate published by the Brazilian Central Bank was R\$ 3.1287 per U.S.\$1.00.

Commercial Market Selling Rate for U.S. Dollars

Edgar Filing: BRASIL TELECOM SA - Form 20-F

The following table sets forth the reported high and low Commercial Market selling rates for U.S. dollars for the months indicated.

	High	Low
December 2003	R\$2.9434	R\$2.8883
January 2004	2.9409	2.8022
February 2004	2.9878	2.9042
March 2004	2.8752	2.9400
April 2004	2.9630	2.8755
May 2004	3.2118	2.9534

Source: Brazilian Central Bank

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

For the Year Ended December 31,	High	Low	Average	Period
1999	R\$2.165	R\$1.208	R\$1.816	R\$1.789
2000	1.985	1.723	1.835	1.955
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

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 assure you that these types of measures will not be taken by the Brazilian government in the future. See " Risk Factors Risks Relating to Brazil."

[Table of Contents](#)

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 you could lose a substantial portion or all of your investment.

The information included in this Annual Report concerning Brazil and the ownership of Telecom Italia International N.V. ("TII"), current name of STET International Netherlands N.V., Techold Participações S.A. ("Techold"), and Timepart Participações Ltda. ("Timepart"), has been included herein to the extent publicly available. We have assumed such information to be correct and have not independently verified such information.

Risks Relating to Our Company

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

We operate under concessions from the Brazilian Government that authorize us to provide local fixed-line telecommunications services in our region and long-distance telecommunications services within Brazil, and require us to comply with certain obligations related to rates, quality of service, network expansion and modernization, and interconnection of our network. Our failure to comply with the terms of the concessions may result in the imposition of fines or other government actions, including the termination of our concessions. Any partial or total revocation of our concessions would have an adverse effect on our business.

Our business, including the services that we provide and the rates that we charge, is subject to comprehensive regulation under Brazilian law. Brazil's telecommunications regulatory framework is continuously evolving. The interpretation and enforcement of regulations, the assessment of compliance with regulations and the flexibility of regulatory authorities are all marked by uncertainty. Our ability to retain our concessions is

Edgar Filing: BRASIL TELECOM SA - Form 20-F

a precondition to our success, but in light of the regulatory framework, we cannot assure you that Anatel will not modify the terms of our concessions in an adverse manner.

Under Brazilian law, public regime companies, like us, must have the rates that they charge for products and services approved by Agência Nacional de Telecomunicações ("Anatel"). On June 20, 2003, Anatel enacted Resolution 341, which provides for new types of Anatel concession contracts, effective from January 1, 2006 until 2025. The Form of New Concession Contract provides for changes in the way in which rates are set, for example under the current proposals, the General Price Index - Internal Availability, *Índice Geral de Preços Disponibilidade Interna* (IGP-DI), will no longer be used to determine the annual inflation-based adjustments to rates. Private regime companies that compete with us, like Global Village Telecom or Intelig, do not require Anatel approval when setting their rates and may unilaterally determine the prices that they charge for their services. As a result, adverse changes in Brazilian telecommunications regulations and non-approval or even delays in the approval of rate changes by Anatel, could adversely impact our operations and competitive position.

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 by the Brazilian telephone concessionaires, including Brasil Telecom, for fixed line services. The bill is still subject to the approval of other Committees within the House of Representatives, the Senate and President Lula's signature. Should this bill be approved, it will have an impact on our rate structure currently in place. As a result, our operations and competitive position could be adversely impacted.

We may need additional third party financing which may not be available in the future or on terms acceptable to us

In addition to amounts we have already borrowed in 2004, we may require additional third party financing for potential strategic acquisitions and to commence new operations. During 2003, our net debt decreased from approximately R\$3,659.0 million at December 31, 2002 to approximately R\$3,170.0 million at December 31, 2003. During 2004, approximately R\$1,840.0 million of our debt will mature and we may decide to refinance other existing debt in order to reduce costs or extend debt maturities. We do not anticipate being able to finance all of our funding requirements from cash flow from operations and will need to rely on third party financing in the future. We cannot assure you that such third party financing will be available on terms acceptable to us or at all.

Certain beneficial shareholders control a large percentage of our voting shares and their interests may conflict with the interests of our other shareholders, including minority shareholders.

We are controlled by Brasil Telecom Participações S.A., which is in turn controlled by Solpart Participações S.A. (Solpart), the capital of which is held by Timepart, Techold and TII. The shareholders of Solpart entered into a shareholders agreement dated July 19, 1998 and last amended as of August 27, 2002 (the "Solpart Agreement"). As our controlling shareholder Solpart has the power to modify our business plan, modify our dividend plan and sell our material assets, among others. At December 31, 2003, to the best of our knowledge, Timepart and Techold hold 20.9% and 47.5% respectively of the voting capital of Solpart. We cannot assure you that any of Solpart's shareholders will not take any actions that are inconsistent with your interests.

TII is a company controlled by Telecom Italia S.p.A. ("Telecom Italia "). Telecom Italia prevented us from entering in the first auction of personal communication service (PCS) licenses that took place on 2001 and acquired for itself, through various subsidiaries now consolidated into TIM Celular S.A., (TIM), licenses to deploy PCS in the whole country, including Region II, where we provide fixed-line services. As a matter of Brazilian law, TII and we were deemed to be affiliates and therefore TIM could not initiate to exploit the PCS authorizations before January 1, 2004 unless either Telecom Italia ceased to be affiliated with us or we anticipated our 2003 universalization targets. In order to allow TIM to explore immediately its PCS licenses TII, Techold and Timepart agreed to amend the Solpart Agreement on August 27, 2002 by means of which TII had certain rights suspended subject to subsequent restoration upon the fulfillment of certain conditions and a certain number of common shares in the Solpart were sold by TII to Techold and Timepart so as to reduce TII's indirect ownership in Solpart and consequently in us to below the affiliate level, subject to corresponding call and put rights. Since TII's departure from our control group, the following events have occurred (i) TIM acquired authorizations to render national and international fixed-line services, in the full knowledge that we already had since 1998 an option to provide such services aiming at transforming ourselves from a regional to a national and international carrier; (ii) we, through a wholly owned subsidiary, 14 Brasil Telecom Celular S.A., acquired authorization to render PCS in Region II; and (iii) we exercised our pre-existing right aiming at providing the long distance national and international services. Therefore we and Telecom Italia now have overlapping rights to provide PCS (in Region II) and long distance national and international services (Regions I, II and III). Article 68 of the General Telecommunication Law prevents the exploitation by the same juridical person, whether directly or indirectly, of the same services in the same Region. Notwithstanding, TII is now requesting to repurchase its voting stock and return to our control group which is against our best interests as we and TIM would then be considered affiliates and therefore prevented from offering the same services in the same regions.

Disputes among 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. Shareholders of Solpart have entered into the Solpart Agreement. There have been disputes among the shareholders of Solpart including in respect to the ownership structure of Solpart and

Edgar Filing: BRASIL TELECOM SA - Form 20-F

further disputes may arise again in the future. Such disputes may arise between and among members of our control group with respect to the interpretation, application, performance and exercise of rights under the Solpart Agreement. Any such disputes could consume significant management time and resources which could have a material adverse effect on our financial condition and results of operations.

Currently, TII is involved in a dispute with Techold and Timepart relating to TII's attempt to return to our control group. As discussed above, TII is attempting to return to our control group. On December 19, 2003, Techold and Timepart submitted to the ICC a request for arbitration to resolve the dispute for Solpart's control aiming at avoiding that TII exercise control for the benefit of Telecom Italia in an attempt to prevent us, in our own and in the public interest, from reaching our full potential as a national and international provider of telecommunications services. On January 16, 2004 Anatel consented that during an 18 month period TII may return to our control group so long as TII does not participate or vote in any matters related to the overlapping services. After the 18 month period if we and Telecom Italia do not reach an agreement Anatel reserved the right to impose sanctions. In January 2004, TII notified us of its intention to regain its voting stock in Solpart and to restore the suspended control rights in Solpart as a result of our attainment of the universalization targets. TII filed lawsuits against Solpart, Timepart, Techold and us to force its return to our control group. To date, TII's requests have not been adjudicated. In the meantime, ANIMEC (the Brazilian Association of Investors of Capital Markets) filed an injunction before the Conselho Administrativo de Defesa Econômica ("CADE") (Brazil's Antitrust Authority) to prevent TII from returning to the control group. On March 17, 2004, the injunction was granted by unanimous decision and TII appealed from CADE's decision. This matter is still unresolved. We cannot assure you that this dispute will not have an adverse effect on our management's time and resources or our financial condition and results of operations, particularly with respect to our mobile and long distance services.

We depend on sophisticated information and processing systems to operate our company, the failure of which could affect our financial condition and results of operations

Sophisticated information and processing systems are vital to our growth and our ability to monitor our costs, bill customers, detect fraud, provide customer service, achieve operating efficiencies and meet our service targets, particularly in light of the increasing competition in our region. We routinely evaluate, upgrade and modernize our systems as needed. Our billing and information systems are continuously being upgraded and modernized by both in-house technicians and outside service providers. However, the failure of these technicians and service providers to successfully integrate and upgrade our systems as necessary or the failure in the future of any of those systems to operate properly, could have a material adverse effect on our financial condition and results of operations.

We may be liable for labor liabilities, including those related to the companies that we merged with, which could have an adverse effect on our results of operations

As of December 31, 2003, we were involved in approximately 18,578 labor proceedings, which include pre-existing labor proceedings of the companies we merged with. As of December 31, 2003, contingent liabilities for labor proceedings in which the risk of loss was considered "probable" amounted to approximately R\$424.0 million and contingent liabilities for which the risk was considered "possible" amounted to approximately R\$625.1 million. The estimated total amount involved in these proceedings is approximately R\$1,177.0 million. In particular, we acquired CRT, the leading fixed-line services provider in the state of Rio Grande do Sul in 2000 and, as a result of such acquisition, we inherited a number of labor proceedings, as well as other tax and civil proceedings. As a result of recent court decisions, we now regard a portion of our loss relating to these proceedings as "probable" and accordingly, in 2003, we provisioned R\$281.5 million of contingent liabilities with respect to such proceedings. See Item 8 "Financial Information Consolidated Statements and Other Financial Information Legal Proceedings Labor Legal Proceedings."

Contingencies classified as having a probable risk of loss are recorded under liabilities. Under Brazilian labor law, a change of control, corporate structure or ownership does not affect the enforceability of pre-existing employment contracts of an entity. Brazilian labor courts have taken the position that any entity that acquires the control of a manufacturing or commercial establishment becomes liable for the labor liabilities of its target even when such liabilities originated prior to the date of the acquisition. Although we believe that we have no other material pre-existing labor liabilities, there can be no assurance that additional material labor proceedings for actions undertaken by the companies we merged with prior to our merger with them, or any other labor liabilities, will not be brought in the future, or if they are, that an adverse judgment regarding the same would not have a material adverse effect on our results of operations or financial condition.

We may be held liable for engaging in certain activities without an environmental license, which may subject us to fines of up to R\$10.0 million, total or partial suspension of activities in certain states, and/or civil and criminal sanctions. This could have an adverse effect on our results of operations

In Brazil, environmental licensing is regulated mainly by Resolution No. 237 of 1997 enacted by the *Conselho Nacional do Meio Ambiente* ("CONAMA") (Environmental National Council). This resolution lists the activities that require environmental licensing and provides that any activity that has the potential to cause a significant impact on the environment must be licensed.

In Brazil, the federal, state and local levels of government have concurrent jurisdiction to independently determine whether an activity has the potential to cause a significant impact on the environment, and to require and grant environmental permits for that activity. As part of our normal

Edgar Filing: BRASIL TELECOM SA - Form 20-F

operations, we install and maintain ducts, wires, cables and towers for transmission antennae in the states in our region. The installation and maintenance of ducts, wires, cables and towers for transmission antennae are not listed in the CONAMA Resolution No. 237 of 1997 as activities that require compulsory licensing. However, there is no guarantee that a jurisdiction will not view this installation and maintenance as activities with the potential to cause a significant impact on the environment, and thereby require an environmental permit to conduct such an activity. In any jurisdiction, to the extent that we are required to obtain an environmental permit and have not obtained such a permit, we may be subject to fines of up to R\$10.0 million, total or partial suspension of activities, and/or civil and criminal sanctions. Although we have never been charged with having conducted our installation and maintenance activities without a proper environmental permit, there can be no assurances that some state or local authority will not retroactively determine that we have failed to obtain the appropriate state or local environmental permit, as the case may be, prior to conducting such activities. This could have a material adverse effect on our results of operations.

It may be difficult to effect service of process upon, or to enforce foreign judgements 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 you to effect service of process within the United States or other jurisdictions outside of Brazil upon our company or such persons, or to enforce against them judgments of courts in the United States, predicated upon the civil liability provisions of the federal securities or other laws of the United States.

Risks Relating to the Brazilian Telecommunications Industry

We face increasing competition in the Brazilian telecommunications industry. 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. For example, in local fixed-line telecommunications services in our region, we currently face competition from Global Village Telecom Ltda. ("Global Village Telecom"). To date, *Telecomunicações de São Paulo S.A.* ("Telesp"), *Tele Norte Leste Participações S.A.* ("Telemar"), *Embratel Participações S.A.*, ("Embratel") and *Intelig Telecomunicações Ltda.* ("Intelig") have been granted permission by Anatel to provide local fixed-line telecommunications services in our region. In intraregional long distance services in our region we currently face competition from with Global Village Telecom, Intelig and Embratel. To date, *Albra Telecomunicações Ltda.* ("Albra"), *Portale Rio Norte S.A.* ("TIM") and Global Village Telecom have been granted permission by Anatel to provide intraregional long distance services in our region.

In addition, the Brazilian telecommunications industry is consolidating which results in larger competitors. The controlling interest in Embratel has been purchased by Telefonos de Mexico S.A. de C.V. ("Telmex") subject to certain conditions precedent. Embratel also provides local and broadband services in Region I and III through its subsidiaries Vésper S.A. and Vésper São Paulo S.A. (together, "Vesper"). Telmex has also acquired the assets of AT&T do Brasil, now Telmex do Brasil Ltda. ("Telmex do Brasil") and owns the mobile operator Claro, through its subsidiary América Móviles. Telesp is majority owned and controlled by Telefônica S.A. ("Telefônica"). Telesp has been granted permission to operate in our local fixed line and long distance markets. We also compete with Telesp in the data services market outside of our region. We also expect to compete with Telefônica in the wireless market against "Vivo", its joint venture with Portugal Telecom S.A. ("Portugal Telecom").

Our ability 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. This may adversely affect our market share and our margins.

In addition, we may also face increased competition due to unbundling regulations. On May 13, 2004, Anatel issued Order (*Despacho*) no. 172, which establishes rules for partial 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 partial unbundling to R\$15.42 per 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 legislation is expected 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. These regulations are recent and we cannot guarantee whether we can compete effectively in this environment.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

The expected increases in consolidation of telecommunications operators in Brazil and the increase in competition in our region due to unbundling or otherwise, may have a material adverse effect on our market share, margins, results of operations and financial condition.

The telecommunications industry may not continue to grow or may grow at a slower rate

We derive most of our revenue from our fixed-line telecommunications services and have recently commenced offering wireless services. As a result, we depend on the continuing development and growth of the market for telecommunications services in Brazil. Our ability to increase our business depends partially on continuing economic development in Brazil. 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 also diversify 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 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 network operator to the other for the use of each other's network are currently regulated by Anatel. However, beginning in July 2004, interconnection rates for wireless operators will be freely negotiated. If we are not able to negotiate favorable interconnection agreements in the future, subject to potential intervention by Anatel under its legal power to establish the terms of agreements between telecommunications companies that cannot agree on interconnection rates and terms, our operating and financial results may be adversely affected.

The failure to develop and implement the technology necessary to quantify 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 2003, we continued to improve our systems in order to implement an "on-line" fraud management system. However, we have not yet been able to implement our "on-line" fraud management system or to implement a fraud detection system related to billing.

In addition, we rely on other long-distance carriers for interconnection, some of whom do not have anti-fraud technology in their network. In 2001, we created a fraud management department to provide specialized customer service to customers affected by fraud. During the fiscal year 2002, several automated procedures were created to detect and control possible abnormalities that could represent fraudulent activities and were placed in various parts of our operations. These control points have a preventive function, and work both pro-actively and, should a fraud occur, reactively. In 2003, we implemented controlling points 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 claim from the community. These actions achieved a better level of control in mitigating the risk of loss from frauds as compared to previous years. However, these procedures are still below the level of accuracy and effectiveness desired and expected for fraud control. Should we not be able to develop and implement the technology necessary to quantify and combat fraud on our network, our results of operations could be adversely affected.

The failure of other operators to effect bill collection may have an adverse effect on our long-distance services revenues generated through other providers, on our provision for doubtful accounts, and on the productivity ratio of our call centers.

Anatel Resolution 343, dated July 17, 2003, requires all telecommunications services providers to provide billing and collection services to other telecommunications services providers with whom they have line or access sharing agreements. As part of our entrance into new long-distance services markets, we entered into agreements with several mobile telephone operators and fixed-line operators to include our long-distance services in their telephone bills and provide collection and collection-related services to us and vice-versa. If other operators experience difficulties with bill collection or collection-related activities, our long-distance services revenues generated from the lines or accesses of other telecommunications operators, our provision for doubtful accounts, and the productivity ratio of our call centers may be adversely affected.

The failure to develop and implement the technology necessary to extract, analyze, monitor and take actions upon revenue leakage present in our revenue stream could adversely affect our results of operations in a competitive environment

Revenue leakage occurs at different stages of the billing process, from ordering the new service to the provider making network switch changes and establishing accurate billing records reflecting the change. Service providers may lose a significant portion of their annual services revenue due to services that were never billed. Since 2002 we have been implementing systems and processes which verify the accuracy of billing and improve our recording of traffic. In 2003, we introduced the following new systems or processes in order to implement our revenue leakage control which include:

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- a "conformity certificate" from Bureau Veritas of Quality International ("BVQI"), an international certification organization which validates the accurate rates for local, international long distance ("ILD") and domestic long distance ("DLD") calls through our carrier selection code originating from public telephones;
- the renewal of a "conformity certificate", issued by BVQI and annually required by Anatel, for the collection, registry, rate and billing process, including the local measured and billed service and the public switched telephone network (Serviço Telefônico Fixo Comutado, or STFC); and
- a procedure for the analysis and recovery of unpaid invoices, monitoring of the installation of telephone lines and related services, and monitoring the improper use of terminals.

Notwithstanding our efforts, we continue to face challenges in finding and preventing revenue leakage, including the gathering of data from multiple sources within our complex network/IT platforms and the reconciliation of such data in order to identify the root cause(s) of leakage. This identification, prevention, and correction process typically involves multiple operational functions throughout the organization. If we are not able to develop and implement the technology necessary to detect, quantify, and prevent revenue leakage in 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 further 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, we cannot assure you that our network will not be challenged by competition from new or improved 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. This would have a material adverse effect on our financial condition and results of operations.

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 concession in the event of natural disaster, war, significant public disturbance, threats to internal peace or for economic reasons, and for 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 we cannot assure you that the actual compensation paid would be adequate or that such payment would be timely. This would have a material adverse effect on our financial condition and results of operations.

Risks Relating to Brazil

Brazilian political and economic conditions have a direct impact on our business and the market price of the Preferred Shares underlying the 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. In 2003 the *real* appreciated in value by 22.3% in relation to the U.S. dollar, from 3.5333 *reais* per U.S. dollar at December 31, 2002 to 2.8892 *reais* per U.S. dollar at December 31, 2003. In 2003, the Central Bank raised Brazil's base interest rate by a total of 10.0 percentage points in an effort to stabilize the currency and decrease inflationary pressures. 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;

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- 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. Until now, the economic policies of former President Cardoso have been continued by the current administration of the Brazilian government. Although the new government has not departed significantly from previous policies, and the *Real* appreciated 22.3% against the U.S. dollar during 2003, concerns remain about the policies of the future of the Brazilian government. While the current administration's policies have to date not been adverse to the telecommunications industry, the uncertainty over what policies the current Brazilian government may propose or adopt in the future may have an impact on our business and may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian international securities markets and thus have an impact on our business.

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 IBGE). Inflation itself and governmental measures to combat inflation have in the past had significant negative effects on the Brazilian economy. Inflation, 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.

Inflationary pressures may also curtail our ability to access foreign financial markets and may lead to further government intervention in the economy, including the introduction of government policies that may adversely affect the overall performance of the Brazilian economy and thus reduce our revenues.

Adverse changes in Brazilian economic conditions could cause an increase in bad debt provisions for doubtful accounts, which could materially reduce our earnings

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;
- devaluation of the *real*;
- inflation; 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. Losses from accounts receivable reached R\$298.0 million in 2003, against R\$263.5 million in 2002, almost flat in percentage of gross revenues terms. However, should economic conditions worsen in Brazil and bad debts increase, this could materially reduce our earnings and have a material adverse effect on us.

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

The Central Bank has periodically devalued the Brazilian currency during the last four decades. The exchange rate between the *real* and the U.S. dollar has varied significantly in recent years. For example, the *real*/U.S. dollar exchange rate fell from R\$1.9554 per U.S. dollar at December 31, 2000 to R\$3.5333 at December 31, 2002. In 2003, the *real* has strengthened against the U.S. dollar. At December 31, 2003 the *real*/U.S. dollar exchange rate was R\$2.8892 per U.S. dollar.

A significant amount of our financial assets and liabilities are denominated in or indexed to foreign currencies, primarily U.S. dollars. When the Brazilian currency is devalued, we incur losses on our liabilities denominated in or indexed to foreign currencies, such as our U.S. 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 a 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.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

The proposed changes in Brazilian labor law may affect labor relations

In April 2003, the Lower House reopened the discussions regarding the changes in the Brazilian Labor Law (*Consolidação das Leis do Trabalho*, or CLT). According to the system currently in force, labor relations are strongly regulated. Although still protecting fundamental labor rights, the committee in charge of the preparation of a new bill has proposed to include more flexibility in the rules regulating labor relations in Brazil, allowing for employers and employees to more freely negotiate certain aspects of their employment relations. A revision of union relations in Brazil may also be discussed. It is not clear whether the proposed changes, if approved by the Congress, would be well accepted by employees of Brazilian companies, including us, and their respective unions. These changes, if implemented, may adversely impact our business in the future.

Restrictions on the movement of capital out of Brazil may hinder your ability to receive dividends and distributions on, and the proceeds from any sale of the Preferred Shares

The Brazilian government may impose restrictions on capital outflow that would hinder or prevent the custodian in Brazil, or you if you have exchanged your ADSs for the underlying Preferred Shares, from converting the proceeds relating to the Preferred Shares into U.S. dollars and remitting those proceeds abroad. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil's balance of payments or reasons to foresee such a serious imbalance. Although, there is no current material imbalance in Brazil's balance of payments, there can be no assurance that such an imbalance may not arise in the future or that the Brazilian government will not institute more restrictive exchange control policies in the future. See Item 10 "Additional Information Taxation Brazilian Tax Considerations."

As a holder of ADSs you 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, you and the holders of our Preferred Shares may have fewer and less well defined rights to protect your 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 could potentially disadvantage you as a holder of our Preferred Shares and/or ADSs. For example, when compared to Delaware general corporation law, Brazilian Corporation Law and practice has less detailed and well-established rules and 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, and shareholders in Brazilian companies ordinarily do not have standing to bring class action suits.

Risks Associated with Our Preferred Shares or American Depositary Shares

The relative volatility and illiquidity of the Brazilian securities markets may substantially limit your ability to sell the Preferred Shares underlying the American Depositary Shares at the price and time you desire

Investing in securities in emerging markets, such as Brazil, involves greater risk than investing in securities from more developed countries and such investments are generally considered speculative in nature.

Brazilian investments, such as investments in our securities, are subject to economic and political risks, involving, among others:

- changes in the regulatory, tax, economic and political environment that may affect the ability of investors to receive payment, in whole or in part, in respect of their investments; 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 these markets. The relatively small capitalization and the illiquidity of the Brazilian equity markets may substantially limit your ability to sell the Preferred Shares underlying the ADSs.

Developments in other countries, including Argentina, may affect the Brazilian economy, market price of the Preferred Shares and your American Depositary Shares

Edgar Filing: BRASIL TELECOM SA - Form 20-F

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, including the recent economic crisis in Argentina, Venezuela, Uruguay and Paraguay have also experienced a significant economic downturn. 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 U.S. 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 Brasil Telecom, or that prevailing interest rates in these markets will be advantageous to us and our ability 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.

Holding your Preferred Shares in ADS form may subject you to several risks and may jeopardize certain rights relating to voting, dividends and distributions, and preemptive rights, among others, that you would otherwise enjoy as a holder of Preferred Shares

- In the limited circumstances where holders of Preferred Shares are able to vote, you will be able to exercise your 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 your ability, as an ADS holder, to exercise your 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."
- If you are a resident of the United States you may not be able to exercise your preemptive rights, or exercise other types of rights, with respect to our Preferred Shares. Your ability to exercise preemptive rights is not assured unless a registration statement is effective with respect to those rights or an exemption from the registration requirements of the U.S. Securities Act of 1933, as amended (the "Securities Act") is available. We are not obligated to file a registration statement relating to preemptive rights with respect to our Preferred Shares. Moreover, 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 you will be entitled to receive your share of the proceeds of the sale. However, the preemptive rights will expire if the Depositary cannot sell them. For a more complete description of preemptive rights with respect to our Preferred Shares, see Item 10 "Additional Information Memorandum and Articles of Association."
- Payments of cash dividends and distributions, if any, will be made in Brazilian currency to Banco Bradesco S.A., as custodian for your Preferred Shares represented by the ADSs, on behalf of the Depositary, which will then convert such proceeds into U.S. dollars and will cause such U.S. dollars to be delivered to the Depositary for distribution to you, as a holder of ADSs. 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 of the Preferred Shares underlying our ADSs. See Item 10 "Additional Information Memorandum and Articles of Association Dividends."
- As an ADS holder, you will be required to pay certain fees to the Depositary in connection with certain events, such as exercising your rights to purchase additional ADSs and redemption of your ADSs by our company, among others.
- We may agree with the Depositary to modify the deposit agreement at any time without your consent. We undertake to give holders of ADSs 30 days' prior notice of any modifications that would materially prejudice any of their substantial rights under the deposit agreement. You will be bound by the modifications to the deposit agreement if you continue to hold your ADSs after the modifications to the deposit agreement become effective.

Tax reform will be gradually implemented in the following years

In December 2003, the Federal Senate approved part of the tax reform bill that had been under discussion for eight months. The text approved by the Senate was consolidated in Constitutional Amendment No. 42, enacted on December 19, 2003. Constitutional Amendment No. 42 is already in force, and 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.

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 shall be gradually adopted in 2005 and 2007. The delay in the approval and implementation of the tax reforms bill may negatively affect the Brazilian economy and capital markets.

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

Edgar Filing: BRASIL TELECOM SA - Form 20-F

According to Law No. 10,833, enacted on December 29, 2003, the disposition of assets located in Brazil by non-residents of Brazil, whether to other non-residents of Brazil or Brazilian residents and whether made within or outside Brazil is subject to taxation in Brazil. Considering the general and unclear scope of Law No. 10,833 and the absence of judicial guidance in respect thereof, we are unable to predict how the scope of Law No. 10,833 would be interpreted in the courts of Brazil.

[Table of Contents](#)

ITEM 4. Information on the Company

[Table of Contents](#)

History and Development of the Company

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. Telebrasilíia* ("Telebrasilíia"), *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 formerly controlled by Telefônica S.A. and acquired by us 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) 415-1140. 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 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 settle conflicts of interest among the companies that render telecommunications services;
- to protect and defend the users' rights;
- to prevent, control and punish penalties of the economic order, in the telecommunications industry;
- to establish restrictions, limits or conditions to corporate groups in obtaining or transferring the concessions, permissions and authorizations, in order to assure the competition; and
- to establish the rate structure for each kind of services rendered in the public regime.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

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 intraregional long-distance service in one of the three regions into which Brazil has been divided for purposes of fixed-line telecommunications, and (iii) Embratel, which provides 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. (previously Tele Centro Sul Participações S.A.), is our parent company, and is one of the three holding companies providing local and long-distance 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 previous company; 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 its voting shares of 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 only 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 which further its policy of promoting competition and quality of service in the Brazilian telecommunications market place. 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 have accomplished our universalization targets. Accordingly, we are now 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 to operate in our region.

History of Our Company

The following bullet points illustrate a brief history of our company:

- 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.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- 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 S.A.*, which held 85.2% of the voting capital of CRT, representing 31.6% of the total share capital of CRT, for approximately R\$1,500.0 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 worth approximately R\$900.0 million.
- December 28, 2000: TBS was merged into CRT, and immediately afterwards CRT was merged with and into our company. 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 our company. The exchange of shares was made based on the market value of our company's shares compared to those of CRT.
- November 1, 2001: *BrT Serviços de Internet S.A.* ("BrTSi") acquired 15.4% of the total capital stock of *iBest Holding Corporation* (which controls *iBest S.A.*), 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").
- June 3, 2002: Our shares listed on BOVESPA and started trading under new symbols: "BRTO3" for Common Shares and "BRTO4" for Preferred Shares.
- December 18, 2002: We acquired licenses for the personal communications system ("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 announced the acquisition of 19.9% of the capital of *MTH do Brasil Ltda.* ("MTH"), a company that holds 99.99% of the capital of *MetroRED Telecomunicações Ltda.* ("MetroRED"), for U.S.\$17.0 million together with an option to purchase the remaining 80.1% of the capital of *MTH* for U.S.\$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 of *360 Networks Americas do Brasil Ltda.* ("GlobeNet") for U.S.\$46.8 million. A total of U.S.\$27.6 million was payable on June 11, 2003, with the remaining U.S.\$19.2 million paid 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 out of our original concession area and to offer mobile services in our region.
- March 16, 2004: CADE, released a provisory decision determining that TII, one of our former controlling shareholders could not return to Brasil Telecom's block of control, notwithstanding the authorization from Anatel that they could do so. The outcome is still pending.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- May 13, 2004: We purchased the remaining 80.1% of the capital of MTH for U.S.\$51.0 million which could only be possible once we received certification of our compliance with the 2003 targets stipulated by Anatel in our concession contracts.
- May 13, 2004: We purchased the remaining 80.1% capital of Vant for R\$15.6 million which could only be possible once we received certification of our compliance with the 2003 targets stipulated by Anatel in our concession contracts.
- May 2004: We received acceptances of our offer to purchase 63.0% of the shares of Internet Group do Brasil Ltda.'s ("iG") capital stock from certain shareholders for U.S.\$100.7 million. The purchase of these shares is still subject to due diligence and execution of final purchase and sale agreements.

Organizational structure

We are structured as a consolidated operational company, in which we conduct substantially all of our operations, and currently have four wholly-owned subsidiaries, BrT Serviços de Internet S.A., 14 Brasil Telecom Celular S.A., Vant Telecomunicações S.A. and MTH Ventures do Brasil Ltda. 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 voting capital held in each of our significant subsidiaries as of December 31, 2003. All of our significant subsidiaries are organized and existing under the laws of the Federative Republic of Brazil, except for Brasil Telecom Submarine Cable System (Bermuda) Ltd. incorporated under the laws of Bermuda, Brasil Telecom of America Inc. incorporated under the laws of the United States of America and Brasil Telecom de Venezuela S.A. incorporated under the laws of Venezuela.

BrT Serviços de Internet S.A.

We formed BrTSi in October 2001. Through BrTSi, we provide broadband internet services based on ADSL (Assymmetric Digital Subscriber Line) technology through our internet service provider (ISP) BrTurbo. BrTSi is also the parent company of the subsidiaries that operate our submarine fiber optic cable system which we refer to as GlobeNet, and iBest, our free internet service provider.

iBest

In February 2002, BrTSi acquired 15.5% of iBest Holding Corporation for approximately U.S.\$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 U.S.\$36.0 million, consolidating our 100% ownership of iBest.

GlobeNet (Submarine Fiber-Optic Cable System)

On June 11, 2003, we acquired, through BrTSi, the entire submarine fiber-optic cable system of 360 Networks Americas do Brasil Ltda. which we refer to as GlobeNet, for U.S.\$46.8 million. A total of U.S.\$27.6 million was paid on June 11, 2003, with the remaining U.S.\$19.2 million payable within 18 months of the first installment. As part of this acquisition, BrTSi formed five operating subsidiaries: Brasil Telecom Cabos Submarinos (Holding) Ltda., Brasil Telecom Cabos Submarinos Ltda., Brasil Telecom of America, Inc., Brasil Telecom Subsea Cable System (Bermuda) Ltd. and Brasil Telecom de Venezuela, S.A. These companies own and operate the GlobeNet fiber optic cable system that connects the United States, Bermudas, Brazil and Venezuela. Brasil Telecom of America, Inc. is headquartered in Boca Raton, Florida, and coordinates all GlobeNet s activities and supports the commercial activities of the group in the international market.

14 Brasil Telecom Celular S.A.

14 Brasil Telecom Celular S.A., is our mobile telephony services subsidiary, which we expect to be operational during the third-quarter of 2004. 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%, giving us 100%, of the capital of Vant. This purchase was made possible once we received certification by Anatel of our compliance with our 2003 universalization targets. Vant offers internet protocol as well as other products to the corporate market throughout Brazil.

MetroRED Telecomunicações Ltda.

On May 13, 2004, we exercised our option to purchase for U.S.\$51.0 million the remaining 80.1% giving us 100% of the capital of MTH. This purchase was made possible once we received certification by Anatel of our compliance with our 2003 universalization targets. MetroRED is a leading local fiber optic network provider, with 331 kilometers of local area network in São Paulo, Rio de Janeiro and Belo Horizonte, and a 1,485 kilometer long-distance network linking these three metropolitan areas as well as an internet solutions data center in São Paulo which will provide internet support to our customers. As part of the acquisition, we also acquired a management team with expertise in these markets.

Intelig

We are engaged in on-going discussions with Intelig's shareholders, France Telecom, Sprint Corp. and National Grid Group PLC, with respect to a possible acquisition of Intelig. Intelig started operations in 2000, and provides national and international long distance services nationwide and competes directly with Embratel. Intelig has built out an extensive fixed-line telecommunications network throughout the country. The terms of any acquisition have not been determined and accordingly, it is not possible to predict the outcome of this process.

iG

In May 2004, we received acceptances of our offer to purchase 63.0% of the shares of iG's capital stock from certain shareholders for U.S.\$100.7 million. The purchase of these shares is still subject to due diligence and execution of final purchase and sale agreements. iG is a free internet services provider. This acquisition will consolidate our already leading position in the ISP market by giving us more than 50.0% of the dial-up minutes in the Brazilian market as well as an additional three million active internet users.

Table of Contents

Capital Expenditures

Before the breakup of Telebrás, our capital expenditures were planned and allocated by Telebrás on a system-wide basis and subject to approval by the Federal Government. These constraints on capital expenditures prevented us from making certain investments that otherwise would have been made to improve telecommunications service in our region. Since the breakup of Telebrás, we are no longer subject to these restrictions. We are now permitted to determine our own capital expenditure budget, subject to compliance with certain obligations under our concessions. See Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies.

The following table sets forth our capital expenditures on plant expansion and modernization for each of the years ended December 31, 2001, 2002 and 2003.

	Year ended December 31,		
	2001	2002	2003
	(millions of reais)		
Switching	455.8	235.0	164.0
Transmission	463.1	133.5	136.2
Access Network	1,094.1	212.9	108.8
Data Network	176.3	312.3	209.4
Infrastructure	312.5	148.7	37.4
Other investments ⁽¹⁾	924.0	935.2	1,138.2
Total capital expenditures	3,425.7	1,977.6	1,794.0

(1) Other investments include the acquisition of PCS licenses, the acquisition of GlobeNet, MetroRED and iBest and investments to replace plant equipment and other fixed assets generally without altering the capacity of the assets replaced and certain investments in operational and technical support such as telecommunications management network systems, IT investments and expansion projects.

Our capital expenditures decreased approximately 9.3% to R\$1,794.0 million in the year ended December 31, 2003, from R\$1,977.6 million for the corresponding period in 2002. Of our total capital expenditures, R\$1,328.2 million related to expansion and modernization of our fixed telephony operations, R\$109.2 million to mobile telephony operations and R\$356.7 million to the acquisition of the capital stock of GlobeNet,

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Develop our wireless telecommunications services

As we have received Anatel's certification that our 2003 universalization targets have been met, we have recently begun offering wireless telecommunications services using Global System for Mobile Communications ("GSM"), technology through our subsidiary, 14 Brasil Telecom Celular S.A., and under the brand name "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 GlobeNet, our submarine fiber optic cable system, and our acquisition in May 13, 2004 of MetroRED, our local fiber-optic network, 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 most of Latin America and the United States, as well as 331 kilometers of local and 1,485 kilometers of long-distance fiber-optic lines in Brasil, allowing us to expand geographically to three principal corporate markets outside our region - São Paulo, Rio de Janeiro and Belo Horizonte. In addition, through MetroRED we obtained an internet center in São Paulo that will host various internet services. We intend to integrate these networks and this center into our existing network and business and 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, which we expect to open this year. 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.

We are engaged in on-going discussions with Intelig's shareholders, France Telecom, Sprint Corp. and National Grid Group PLC, with respect to a possible acquisition of Intelig. Intelig started operations in 2000, and provides national and international long distance services on a nationwide basis and competes directly with Embratel. Intelig has built out an extensive fixed-line telecommunications network throughout the country. The terms of any acquisition have not been determined and accordingly, it is not possible to predict the outcome of this process.

We are also in discussions with respect to the acquisition of iG, a free internet services provider. This acquisition would consolidate our already leading position in the ISP market by giving us more than 50.0% of the dial-up minutes in the Brazilian market as well as three million active internet users.

Our Services

The fixed-line telecommunications services that we offer 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, leasing of facilities and fixed-to-mobile services, (v) data transmission services, (vi) wireless mobile services and (vii) other services. We do not sell, rent or otherwise provide telephone equipment such as handsets or switchboards. On January 19, 2004, Anatel certified our compliance with universalization targets which enabled us to provide mobile services in our region and interregional and international long-distance services in all regions.

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

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Prospects."

	Year ended December 31,		
	2001	2002	2003
	(millions of reais)		
Local services	5,548	6,255	6,900
Intraregional (Intrastate and Interstate) long-distance service	1,341	1,748	1,923
Interregional and International long-distance service ⁽¹⁾	1	1	1
Network services	994	1,021	1,051
Data transmission	324	505	764
Other	250	310	439
Gross operating revenues	8,458	9,840	11,077
Taxes and discounts	(2,300)	(2,769)	(3,162)
Net operating revenues	6,158	7,071	7,915

(1) On January 19, 2004, Anatel certified our compliance with universalization targets which enabled us to provide interregional and international long-distance service.

Local Services

Local services include all calls that originate and terminate within a single local area in our region, as well as, installation, monthly subscription, public telephones, and supplemental local services. We are the leading provider of local telecommunications services in our region with an estimated 96.5% market share. In local fixed-line services, our sole competitor is Global Village Telecom. Global Village Telecom is an independent service provider operating under an authorization from Anatel. As of December 31, 2003, we had approximately 9.85 million lines in service. We own and operate public telephones throughout our region. At December 31, 2002, we had approximately 293.3 thousand public telephones. At December 31, 2003, we had approximately 296.3 thousand public telephones and a ratio of public telephone/ 100 lines installed equal to 2.77 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, Telemar, Embratel, Intelig, Telesp, CTBC, Aerotech Telecomunicações Ltda. (Aerotech), Telefree do Brasil Ltda. (Telefree), Impsat, Easytone Telecomunicações Ltda. (Easytone) and Transit do Brasil Ltda. (Transit) have been granted permission by Anatel to provide local fixed telecommunications services in our region. We have also been authorized to provide local fixed telecommunications services outside our region, however as of May 2004, we have not done so.

Intraregional (intrastate and interstate) long-distance service

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, Telebrasil, Telemat, Telems, Teleron, Teleacre, CTMR and CRT was the exclusive provider of intrastate long-distance service in its state. As a result we became and still are the leading provider of intrastate fixed-line telecommunications services in our region with an estimated 89.9% intrastate market share and an estimated 75.1% interstate market share at December 31, 2003. Until July 1999, Embratel was the exclusive provider of interstate long-distance service.

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".

As of July 1999, Embratel and Intelig were authorized to provide intrastate long-distance services within the states in our region, and we were authorized to begin to provide interstate long-distance services between the states in our region. See Competition. As a result we have been expanding our network to provide interstate long-distance service in our region to compete against Embratel, and Embratel and Intelig have been expanding their networks to provide intrastate long-distance service to compete against us. Until we complete this expansion, we may lease transmission facilities from other carriers to complete interstate long-distance calls between states in our region. Telesp, Albra, TIM, Aerotech, CTBC Telecom, *TeleNorte Leste PCS* (TNL PCS), Telmex do Brasil, Sercomtel, Telefree, Easytone, Transit, *Telenova Comunicações Ltda.* (Telenova), Tmais S.A. (Tmais) and Global Village Telecom have also been granted permission by Anatel to provide intraregional telecommunications services in our region.

Interregional and International Service

Edgar Filing: BRASIL TELECOM SA - Form 20-F

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 (the date designed to correspond with the certification of our universalization targets by Anatel). 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 locations 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 GlobeNet acquisition (linking Brazil with the United States, Bermuda and Venezuela) and through the MetroRED acquisition (providing network facilities in São Paulo, Rio de Janeiro and Belo Horizonte). To date, Telesp, Albra, TIM, Aerotech, CTBC Telecom, TNL PCS, Telmex do Brasil, Sercomtel, Telefree, Easytone, Transit, Telenova, Tmais and Global Village Telecom have been granted permission by Anatel to provide intraregional telecommunications services in our region.

Network Services

Our Network services consist of interconnection, lease of facilities and fixed-to-mobile services.

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, Telebrasil, Telemat, Telems, Teleron, Teleacre and CTMR;
- the breakup of Telebras; 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, espelinhos, small private regime operators, 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, Telebrasil, Telemat, Telems, Teleron, Teleacre and CTMR as well as all Band B, D and 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.

Fixed-to-Mobile Services

Fixed-to-mobile services consist of calls that originate in a fixed-line telephone and terminate on a mobile or cellular device. The use of our fixed-to-mobile services has increased significantly in the past five years as the penetration rate of mobile services in our region has increased.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

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 service that we offer to both residential and corporate clients is ADSL, which we launched in 2001. ADSL is a technology that allows normal telephone services, as well as delivery of high speed data transmission to virtual private networks or to public internet networks over existing copper lines. ADSL is an important service because it acts as a primary access or last mile for other services which we offer such as, BrTurbo, our broadband internet service provider for residential clients and corporations, and Frame Relay, our data transmission service for corporations. We also sell ADSL accesses to competing ISPs who offer ADSL accesses to their end users. In addition ADSL provides us with a platform to provide new value added services that increase the average revenue per user such as TvFone, which we launched in October of 2003. TvFone allows point-to-point videoconferences, over ADSL technology with more than 600kbps, using regular TV and telephone sets. We intend to continue to invest in our ADSL business in order to better serve the expected increase in demand for this type of service particularly in the Internet access market.

In 2003 we reached 346,233 ADSL installed ports and 281,900 accesses in service, which represents 120,933 new ADSL accesses added in 2003. This represents a 100.4% growth from the 140,690 accesses in service in 2002, and a growth in the ratio of active customers to 81.4% in 2003 compared to 62.5% in 2002. During 2003 we also increased the number of cities with ADSL services from 172 to 323.

	Year ended December 31,		
	2002	2003	% Change
ADSL			
Installed Ports	225,300	346,233	53.7
Accesses in Service	140,690	281,900	100.4

In addition to ADSL, we offer various data transmission services that are designed specifically for corporate clients such as:

- Asynchronous Transfer Mode (ATM) and Frame Relay a broadband switching service and data transmission service for corporations;
- Dedicated Internet Protocol (Dedicated IP) a leased line which functions as a dedicated gate for access to internet backbone typically used by internet service providers;
- Digital Dedicated Line Service (SLDD) a newly introduced leased dedicated line service which offers wider band width than Dedicated IP;
- 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; and
- virtual private networks based on internet protocol a new product which we market to corporate clients under the Vetor brand name. The virtual private network offered by Vetor 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.

ATM, Frame Relay, and Dedicated IP, expanded by 24.5% in 2003 compared to 2002. As of December 31, 2003, we had installed 10,245 ATM, Frame Relay or Dedicated IP ports, in 87 cities. The DialNet service increased from 89,020 ports installed at the end of 2002, to 150,174 ports installed in 180 cities at the end of 2003, representing an increase of 68.7%.

	Year ended December 31,		
	2002	2003	% Change
DialNet	89,020	150,174	68.7
ATM / Frame Relay / Dedicated IP	8,232	10,245	24.5

MetroRED

Edgar Filing: BRASIL TELECOM SA - Form 20-F

On May 12, 2004, we purchased the remaining 80.1% stake giving us 100% of the capital share of MTH, the parent company of MetroRED. MetroRED established its Brazilian branch in August 1997, beginning its commercial operations in December 1998 by providing private digital telecommunications network to the corporate segment.

Through MetroRED we intend to provide our corporate data transmission services through local fiber optic networks in the São Paulo, Rio de Janeiro and Belo Horizonte markets. MetroRED has 339 km of metropolitan network in São Paulo, Rio de Janeiro and Belo Horizonte, and 1,485 km of long-distance network connecting these three cities. In addition to its private network, MetroRED also has an Internet solution center of 3,790 square meters, which offers data center services and support such as co-location and hosting among others. As part of the acquisition, we acquired a management team with expertise in these markets. Currently, MetroRED has almost 600 clients in Brazil.

MetroRED 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, MetroRED gives us direct access to main corporate clients in Brazil to whom we can offer national as well as international services, through GlobeNet's infrastructure. MetroRED's integration with our other services will bring many synergies, not only on sales opportunities but also in reduction of general and administrative, information technology, and personnel 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 MetroRED has its network. By using MetroRED's infrastructure, we expect to realize savings as we will no longer have to use third parties infrastructure to complete these calls.

Vant

On May 13, 2004, we purchased the remaining 80.1% stake giving us 100.0% of the share capital of Vant. Founded on October 1999, Vant was the first telecom company in Brazil to offer 100.0% of its services over the TCP/IP network technology. Through Vant we intend to offer Dedicated IP and other products to the corporate market throughout Brazil. The Vant acquisition will expand our corporate solutions services to the other two regions where we were not active.

GlobeNet

We offer bandwidth and interconnectivity to our clients through GlobeNet. GlobeNet was formed in 1998 to provide fiber-optic communications services in the United States and internationally between the United States and South America. GlobeNet'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 80Gbps, with the potential to increase to 1,360Gbps.

We anticipate that the infrastructure offered by this system will assist us particularly in the expansion of our corporate data transmission services. The acquisition of GlobeNet is part of our strategy of becoming a complete telecommunications service company. The GlobeNet acquisition will allow us to offer integrated services to national and international corporate clients which includes data communications (Internet and corporate) between Brazil and the USA. In addition, we can reduce our voice and data interconnections costs, and offer international long-distance services without having to use third party links. Currently we are using only a small percentage of the capacity of GlobeNet to meet our internal needs. Telemar is also a client of GlobeNet.

Internet Services

In October 2001, we formed BrTSi (a fully owned subsidiary) which provides internet services through BrTurbo and iBest, and data communications services through GlobeNet.

BrTurbo

We offer broadband Internet services in Region II through BrTurbo, our broadband Internet service provider, based on our ADSL technology. We created BrTurbo in 2002 as a broadband ISP through which we offer our ADSL access. Through BrTurbo, we offer competitively priced broadband access as well as modems for purchase and internet content. BrTurbo's content includes live transmission of news, entertainment channels, video channels with short-length feature films and documentaries and an exclusive on-line games channel. In November 2002, BrTurbo launched TurboMeeting service, which allows two-line video-conferences.

In 2002, we started BrTurbo Empresas, a line of services aimed at corporate clients, particularly small and medium-sized companies and small and home offices. As part of these services, we launched BrTData, a portal which offers space for backup and storage of information, e-mail account, publication of Internet sites and hosting services.

iBest

Edgar Filing: BRASIL TELECOM SA - Form 20-F

We offer free dial up internet services through iBest which we acquired in June 2003. iBest was created in 1999 to develop commercially the Prêmio iBest brand name, an Internet award instituted in 1995 that quickly became a national reference for Internet awards in Brazil. In December 2001, iBest extended its activities in the Internet market by providing free dial up Internet access. The acquisition of iBest is a significant step in our Internet strategy. We intend to leverage iBest's large customer base by targeting sales of broadband services (ADSL) to iBest's dial up customers. In addition to ADSL, we can also offer integrated services such as voice (local and long-distance), data and internet to iBest's customers, making iBest an important sales channel for us and allowing us to protect an important customer base from our competition.

In addition, iBest is an important traffic generator (incoming calls), which balances our traffic exchange with other networks in our Region. Traffic drain occurs when a competitor offers free internet services to customers in our region. Because the interconnection regime in Brazil requires us to pay an interconnection fee to the service provider who completes a call originating from our network, free internet increases the traffic in only one direction which generates this interconnection revenue for the telecommunications provider. Without a matching increase in traffic in the other direction, the continued traffic imbalance will result in increasing costs for us. Through iBest, we have been able to minimize the risk of traffic drain by stimulating the use of iBest through dial up access thereby increasing incoming traffic to our network.

iG

We also expect to begin offering free internet through iG. Our pending acquisition of iG will consolidate our already leading position in the ISP market by giving us more than 50.0% of the dial-up minutes in the Brazilian market as well as three million active internet users.

Other Services

We provide telecommunications services beyond local, long distance, network and data transmission services including value-added services (900, follow-me, voice mail, call waiting) and advertising in the Yellow Pages and advertising on public telephone cards. However, in accordance with our concessions, we are prohibited from providing cable television services, but we may lease our network to providers of such services.

Wireless Services

As a result of our universalization targets certification by Anatel on January 19, 2004, we have begun offering wireless telephony services in our region in furtherance of our business strategy to provide integrated telecommunications services both in our region and throughout Brazil using the PCS wireless license we obtained on December 18, 2002. Our license to provide wireless service is valid for fifteen years and may be renewed for another fifteen years.

We expect to operate on the GSM technology platform throughout Region II and our wireless business will generate revenues in the following ways:

- usage fees for outgoing calls made and value-added services such as access to the internet, data transmission, short messages, call forwarding, call waiting and call blocking;
- monthly subscription charges;
- roaming fees;
- interconnection fees received from other operators on incoming calls; and
- sales of handsets.

We have begun offering our wireless services using a relatively low amount of capital expenditure compared to that of some of our competitors while providing our customers with comparable level of services to that of our competitors, mainly due to lower prices we obtained for our equipment compared to the cost obtained by our competitors. We expect our coverage to be similar to the Band A operators in the main metropolitan areas and similar to the Band B operators in the other areas of Region II. We have budgeted U.S.\$300.0 million in capital expenditure through the end of 2005 of which we anticipate 85.0% will be expended in 2004 principally for building out our network infrastructure and information technology systems. We expect to contain costs and meet our limited expense budget by:

- containing costs via the use of our existing wireline sites and infrastructure (approximately 50.0% of the network);
- sharing cell sites with other companies (approximately 45.0% of the network);

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- initially running our wireless business as one of our divisions and not as a separate business (as is the case for certain of our competitors), which will allow us to use existing administrative and organizational or infrastructure resources such as our billing, finance and maintenance departments;
- keeping our subscriber acquisition costs low by using our existing client base and sales channels, linking our marketing strategy to our existing "Brasil Telecom" brand rather than creating an additional marketing brand (as has been the case for certain of our competitors).

Our investments in wireless network infrastructure in 2003 have already provided us with coverage in all state capitals in our region. In addition, our wireless footprint is forecasted to cover 82.0% of the GDP in Region II by the end of 2005.

We intend to provide both our new and existing clients with a complete range of telephony services, including mobile services. We will offer both pre-paid and post-paid wireless plans and we expect that the ratio of pre-paid to post-paid will initially be 3 to 1. We will target customers via direct channels such as our corporate stores and kiosks in major cities, via the internet, through our call centers, through our door-to-door salesforce and through our corporate consultants. We will also use indirect channels such as Brasil Telecom dealers, retail chains and other authorized dealers.

We anticipate that we will be able to gain customers both by targeting new wireless customers in Region II (as of December 31, 2003 market penetration for wireless services was 31.2%) and by attracting customers from our competitors.

Our Region

Until January 2004, we were authorized by our original concessions to provide fixed-line telecommunications service only in nine states of Brazil located in the western, central and southern regions of Brazil, and in the Federal District, as listed in the chart below, excluding small areas in the States of Goiás, Mato Grosso do Sul and Paraná, which we refer to as our region. We have a unique advantage in this region as we inherited the telecommunications business in this region upon privatization of Telebrás. Since we received certification that we had met our universalization targets, we are now authorized 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 out of our original concession area. Our primary source of revenues continues to come from operations in our region.

The states in our region cover an area of approximately 2.85 million square kilometers, representing approximately 33.4% of the country's total area and generating approximately 25.0% of Brazil's Gross Domestic Product (GDP) in 2003. At December 31, 2003, the estimated population of our region was approximately 41.6 million, representing approximately 24.0% of the population of Brazil. Our region has four metropolitan areas with populations in excess of one million inhabitants, including Brasilia, the capital of Brazil.

The following table sets forth certain key economic data for the states in our region.

State	Population (millions) ⁽¹⁾	Population per square kilometer ⁽¹⁾	Percentage of Brazil's GDP for 2000 ⁽²⁾	Per capita income (R\$) for 2000 ⁽²⁾
Paraná	9.6	47.96	5.99	6,886
Santa Catarina	5.4	56.14	3.85	7,903
Distrito Federal	2.1	352.16	2.69	14,377
Tocantins	1.2	4.17	0.22	2,111
Mato Grosso	2.5	2.77	1.22	5,347
Mato Grosso do Sul	2.1	5.81	1.08	5,696
Rondônia	1.4	5.80	0.51	4,066
Rio Grande do Sul	10.2	36.14	7.73	8,344
Acre	0.6	3.65	0.15	3,042
Goiás	5.0	14.69	1.97	4,318

(1) Source: Instituto Brasileiro de Geografia e Estatística-- IBGE ("IBGE") pursuant to the 2000 national demographic census.

(2) Source: IBGE.

Set forth below is a map of Brazil showing the location of our region.

Our business, financial condition, results of operations and prospects depend in part on the performance of the Brazilian economy and the economy of our region, in particular.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

The following table sets forth a breakdown of our approximate revenues in each of the states in which we operate for the year ended December 31, 2001.

R\$ millions	Acre	Rondônia	Mato Grosso	Mato Grosso do Sul	Brasília	Goiás	Tocantins	Santa Catarina	Paraná	Rio Grande do Sul	Total
Local service	44	110	290	282	690	574	57	680	1,233	1,587	5,548
Intraregional and interregional	9	35	95	71	51	138	28	266	319	329	1,341
International	0	0	0	0	0	0	0	0	1	0	1
Network services	6	28	54	58	103	101	18	133	241	252	994
Data transmission	0	2	9	12	50	24	0	88	80	59	324
Other	1	3	10	8	52	28	3	34	64	47	250
Gross operating revenues	60	178	458	431	947	865	106	1,201	1,938	2,274	8,458
Taxes and discounts	(12)	(46)	(143)	(115)	(262)	(243)	(26)	(326)	(522)	(605)	(2,300)
Net operating revenues	48	132	315	316	685	622	80	875	1,416	1,669	6,158

The following table sets forth a breakdown of our approximate revenues in each of the states in which we operate for the year ended December 31, 2002. Since 2002, our consolidated revenues also include BrTSi's revenues, which are not broken down per state.

R\$ millions	Acre	Rondônia	Mato Grosso	Mato Grosso do Sul	Brasília	Goiás	Tocantins	Santa Catarina	Paraná	Rio Grande do Sul	Total
Local service	53	134	338	303	747	663	83	853	1,406	1,675	6,255
Intraregional and interregional	12	51	129	88	62	175	39	329	398	465	1,748
International	0	0	0	0	0	0	0	0	1	0	1
Network services	7	26	66	62	114	101	29	131	239	246	1,021
Data transmission	3	8	19	20	94	39	6	126	112	102	505
Other	2	5	11	12	62	36	4	40	74	60	310
Gross operating revenues	77	224	563	485	1,079	1,014	161	1,479	2,230	2,548	9,840
Taxes and discounts	(21)	(71)	(177)	(130)	(294)	(294)	(34)	(411)	(646)	(683)	(2,768)
Net operating revenues	56	153	386	355	785	720	127	1,068	1,584	1,865	7,071

The following table sets forth a breakdown of our approximate revenues in each of the states in which we operate for the year ended December 31, 2003. Since 2002, our consolidated revenues also include BrTSi revenues, which are not broken down per state.

R\$ millions	Acre	Rondônia	Mato Grosso	Mato Grosso do Sul	Brasília	Goiás	Tocantins	Santa Catarina	Paraná	Rio Grande do Sul	Total
Local service	57	147	384	341	790	723	98	973	1,545	1,832	6,899
Intraregional and interregional	11	48	157	88	70	183	43	367	431	525	1,923
International	0	0	0	0	0	0	0	0	1	0	1
Network services	8	31	72	67	124	115	26	131	226	251	1,051
Data transmission	5	13	34	35	125	61	9	177	172	160	764
Other	2	7	18	16	82	42	7	51	105	78	439
Gross operating revenues	84	245	664	546	1,191	1,124	183	1,699	2,480	2,847	
Taxes and discounts	(23)	(85)	(207)	(156)	(326)	(327)	(40)	(482)	(723)	(772)	(3,042)
Net operating revenues	60	161	457	390	865	798	143	1,216	1,756	2,075	7,915

Seasonality

Our main activity, which is to provide fixed-line telecommunications services, is generally not affected by seasonal variations.

Targets Established by Anatel Applicable to Us

We are required to achieve certain targets established by Anatel and required under the terms and conditions of our concessions, in connection with the quality and universalization of our services.

Quality Targets

We are required, pursuant to the Telecommunications Regulations and our concession contracts, to meet certain service quality targets relating to call completion rates, repair requests, rate of response to repair requests, operator response periods and other aspects of our telecommunications services. Noncompliance with these quality targets can result in certain fines. See History and Development of the Company Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies Quality of Service General Plan on Quality.

The following table summarizes our obligations relating to our quality of service from 1999 to 2005. Our quality of service targets are set by the Telecommunications Regulations and by the concessions originally granted to each of Telepar, Teleacre, Teleron, Telemat, Telegoiás, Telebrasília, Telems, Telesc, CRT and CTMR.

	Quality of Service Targets beginning on December 31,						
	1999	2000	2001	2002	2003	2004	2005
	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Call completion rate during peak periods (% of calls attempted) - Local:	60	60	65	65	70	70	70
Call completion rate during peak periods (% of calls attempted) - Long-distance:	60	60	65	65	70	70	70
Maximum monthly repair requests (% of lines in service)	3	3	2.5	2.5	2	2	1.5
Maximum monthly public telephone repair requests (% of public telephones in service)	15	15	12	12	10	10	8
Operator availability during peak periods (% response within 10 seconds)	92	92	93	93	94	94	95
Billing inaccuracy (per 1,000 bills issued) ⁽¹⁾	4	4	3	3	2	2	2
Credit issued within one billing cycle for claimed inaccuracies (% of cases)	95	95	96	96	97	97	98
Maximum number of uncompleted calls due to network congestion - Local (% of calls attempted)	6	6	5	5	4	4	4
Maximum number of uncompleted calls due to network congestion - Long-distance (% of calls attempted)	6	6	5	5	4	4	4
Residential repair response speed (% within 24 hours) ⁽²⁾	95	95	96	96	97	97	98
Nonresidential repair response speed (% within 8 hours) ⁽³⁾	95	95	96	96	97	97	98
Public telephone repair response speed (% within 8 hours)	95	95	96	96	97	97	98
Response rate to address change requests from residential users in up to 3 business days	95	95	96	96	97	97	98
Response rate to address change requests from non-residential users in up to 24 hours	95	95	96	96	97	97	98

(1) A bill is considered inaccurate for this purpose if a customer claims it is inaccurate.

(2) Must always be within 48 hours.

(3) Must always be within 24 hours.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

The following table indicates the individual performance of each of our concessions in accomplishing their respective quality of service obligations as of December 31, 2003.

Quality Performance of Services measured on December 31, 2003

	Teleacre	Teleron	Telemat	Telegoias	Tele-brasil	Telems	Telepar	Telesc	CRT	Pelotas
Rate of completed originated local calls - Morning	72.75	69.94	70.75	71.87	68.8	72.43	73.69	71.81	71.01	72.93
Rate of completed originated local calls - Afternoon	74.71	72.12	71.22	72.88	70.54	73.43	73.14	71.06	69.95	73.18
Rate of completed originated local calls - Night	73.89	66.31	67.79	59.48 ⁽¹⁾	67.61	70.04	69.39	66.26	68.26	65.98
Rate of completed originated DLD calls - Morning	72.35	68.86	67.64	68.20	66.58	70.47	70.05	70.41	68.99	68.80
Rate of completed originated DLD calls - Afternoon	68.17	68.59	67.86	69.28	68.69	70.56	69.81	70.38	68.65	68.26
Rate of completed originated DLD calls - Night	70.39	68.73	64.05 ⁽¹⁾	65.91	66.08	65.07	65.79	64.98 ⁽¹⁾	65.69	66.95
Rate of amount of repair requests per 100 accesses in service - Integral	1.13	1.55	1.6	1.73	1.53	1.4	1.6	1.72	1.6	1.6
Rate of amount of repair requests per 100 public telephones - Integral	6.76	8.58	10.71	9.42	11.35	7.77	7.18	8	7.51	5.2
Response rate for user telephones of the STFC within 10 seconds - Morning	99.51	99.51	99.14	99.31	99.76	99.83	99.84	99.90	99.83	100.0
Response rate for user telephones of the STFC within 10 seconds - Afternoon	99.85	99.58	99.66	99.59	99.87	99.43	99.88	99.92	99.78	99.65
Response rate for user telephones of the SFTC within 10 seconds - Night	99.55	99.42	98.45	98.96	99.60	99.17	99.68	99.23	99.29	99.45
Amounts of bills with complaints of errors in every 1,000 bills issued - local mode	2.5	2.06	1.69	2.36	1.66	1.34	2.06	2.27	1.36	1.55
Amounts of bills with complaints of errors in every 1,000 bills issued - DLD mode	1.91	0.54	0.55	0.32	0.17	0.32	0.2	0.15	0.21	0.09
Rate of claimed inaccurate bills with credit issued (for each 100 bills) for the local mode - Integral	100	100	100	100	100	100	100	100	100	100
Rate of originated DLD calls not completed due to traffic jam - Morning	2.16	1.97	2.42	2.88	3.28	1.76	1.48	1.33	2.04	1.11
Rate of originated DLD calls not completed due to traffic jam - Afternoon	3.86	2.24	2.70	3.27	2.00	1.92	2.39	1.37	2.68	2.52
Rate of originated DLD calls not completed due to traffic jam - Night	3.93	2.42	4.05	5.35 ⁽¹⁾	3.37	3.15	1.44	1.91	4.04	3.38
Rate of originated local calls not completed due to traffic jam - Morning	2.60	4.03	1.26	0.96	1.55	1.43	0.80	0.94	0.74	1.28
Rate of originated local calls not completed due to traffic jam - Afternoon	1.39	2.37	0.98	0.80	1.02	0.97	0.88	1.16	1.64	0.57
Rate of originated local calls not completed due to traffic jam - Night	3.32	9.97 ⁽¹⁾	2.30	11.4 ⁽¹⁾	1.20	3.08	1.05	2.13	1.96	6.3 ⁽²⁾
Response rate to repair requests made by residential users in up to 24 hours - Integral	99.77	99.62	99.15	99.31	99.26	99.39	99.73	99.33	99.54	99.71
Response rate to repair requests made by non-residential users in up to 8 hours - Integral	98.94	98.81	98.03	98.73	96.04	99.02	99.05	94.55 ⁽³⁾	98.55	98.42
Response rate to repair requests made for public telephones in up to 8 hours - Integral	99.64	99.24	99.61	99.29	99.72	98.83	98.9	96.9	99.63	99.4
Response rate to address change requests from residential users in up to 3 business days - Integral	100	100	99.93	99.71	99.57	99.86	99.89	99.33	99.77	100
Response rate to address change requests from non residential users in up to 24 hours - Integral	100	100	99.78	98.94	99.39	98.58	99.57	96.38	98.82	100

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- (1) Numbers outside the target due to the traffic jam of Vivo mobile operator route.
- (2) Numbers outside the target due to the traffic jam of TIM mobile operator route.
- (3) Numbers outside the target due to a failure in the interface of SGE/SAC system.

Universalization Network Expansion

We are also required under the Telecommunications Regulations and our concessions to meet certain targets relating to network expansion and modernization. See *History and Development of the Company Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies Network Expansion General Plan on Universal Service*.

On January 19, 2004, Anatel certified the accomplishment of our network expansion and universal service targets established for 2003 in our concession contract. We thereby received authorization to provide (i) local and intraregional long-distance services in Regions I and III; (ii) international long-distance services in Regions I, II and III; (iii) interregional long-distance service to anywhere within Brazil (iv) wireless telecommunications services in our region and (v) corporate data services throughout Brazil. In anticipation of these new services, and as part of our strategy, we made investments in a number of fixed assets, including our wireless service infrastructure and the acquisition of GlobeNet and iBest in 2003 and the acquisition of the remaining shares of Vant and MetroRED in 2004.

In addition, the authorization granted to us by Anatel to provide local services out of our area of concession imposes certain scope commitments on us, since it requires us to install telephone terminals in several municipalities, including the capital cities of Regions I and II of the General Concession Plan, annually, by December 31, 2005.

The table below indicates certain of our obligations relating to the expansion and modernization of our network from 2000 to 2005, and our performance in accomplishing those obligations as of December 31, 2003.

	Company status at December 31, 2003	By December 31, ⁽²⁾		
		2003	2004	2005
Minimum number of installed lines (millions)	10.69	8.1	8.1	8.1
Fixed-line service available to all communities larger than (inhabitants)	— ⁽³⁾	600	600	300
Maximum waiting time for installation of a line (weeks) ⁽¹⁾	2	2	1	1
Minimum number of public telephones in service (thousands)	296	216	216	216
Minimum number of public telephones (per 1,000 inhabitants)	8.3	7.5	7.5	8.0
Minimum public telephones as a percentage of fixed lines	2.7	2.5	2.5	3.0
Minimum digitalization level of network (%)	99.0%	95.0%	95.0%	99.0%

(1) Applies only to areas where fixed-line service is fully available.

(2) These expansion and modernization requirements are inclusive of the requirements for the CRT concession.

(3) Obligation met.

Our Rates

Our telecommunications service rates are subject to comprehensive regulation. See *Regulation of the Brazilian Telecommunications Industry Rate Regulation*. Since the relative stabilization of the Brazilian economy in mid-1994, there have been two major changes in rates for local and long-distance services. Effective in January 1996, rates for all services were increased, primarily to compensate for accumulated effects of inflation. Effective in May 1997, the rate structure was modified through a rate rebalancing that resulted in higher charges for measured service and monthly subscription and lower charges for intraregional, interregional and international long-distance services.

For basic plans, our concessions establish a mechanism of annual rate adjustment, based on rate baskets and the use of the IGP-DI price index. A rate basket is defined for local services (local basket) and long-distance services (DLD basket). The rates for the provision of services through payphones and the rates for address change are treated separately.

The adjustment index considers the IGP-DI price index variation, discounting the pre-established productivity factor in the Concession Contract. Within each basket, the rates have a cap price, which can be adjusted up to a percentage above the established index (up to 9.0% higher for the local basket and up to 5.0% higher for the DLD basket). However, the application of a higher index to one of the items in the basket will require a balancing of the remaining items so as not to exceed the established limit for such basket.

The local basket includes activation fees (activation of the terminal), subscriptions and local pulse, and represents the weighted average of these rates. The national long-distance basket includes the many different values of the minute distributed by distance and the times of application.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

On the adjustment dates for the local and DLD baskets, the rate adjustments for network use are also approved. These rates apply when our networks are used by other telecommunications carriers.

The maximum adjustment indexes allowed for the baskets within the period of 1999 to 2003 are as follows:

	1999	2000	2001	2002	2003
Local Basket	7.9%	14.2%	10.4%	8.3%	16.0%
DLD Basket	5.4%	11.9%	7.7%	4.9%	12.5%

On June 27, 2003, Anatel authorized an increase in rates based on the IGP-DI index, in connection with local and long distance services and network usage, as provided for in our concession contract. These rate increases were equal to an average of 28.8% on local services, 24.9% on domestic long distance services and 10.5% on international long distance services. The rate adjustments gave rise to a number of judicial claims throughout Brazil challenging the adjustments. On July 11, 2003, the Superior Court of Brazil (STJ) provisionally ordered that, pending its final ruling, rates were to be adjusted based on the accumulated IPCA index (*Índice de Preços ao Consumidor Amplo*) variation over the 12 months prior to May 2003 (amounting to an average increase of approximately 17.2%). Although a final decision is still pending, on July 12, 2003, in accordance with the provisional ruling, we readjusted our rates downwards according to the IPCA index, effective retroactively to June 29, 2003.

On September 11, 2003, the Second Federal Court of the Federal District issued an injunction, stating that the rate adjustments should be based on the IPCA index and not the IGP-DI index which is set forth in the concession contracts of the regional fixed-line telecommunications companies. The injunction was amended on September 26, 2003 to stipulate that the IPCA index would replace the IGP-DI index in the concession contracts. The decision was affirmed in preliminary judgements in the 1st Region Federal Regional Court (TRF) on October, 20, 2003, the STJ on January, 22, 2004 and the Brazilian Supreme Court (STF) on March, 15, 2004. No final ruling has yet been rendered in this matter.

The following table sets forth the rate adjustments for 2003 for various services, as adjusted by Anatel pursuant to the IGP-DI index, and as actually applied by us in accordance with the STJ provisional order, pursuant to the IPCA index.

	Anatel	Actual Rate
	<i>(based on IGP-DI)</i>	<i>(based on IPCA)</i>
Local services basket	28.75%	16.07%
Installation	41.75%	(16.67)%
Residential subscription	25.60%	17.24%
Non-residential subscription	41.75%	17.24%
Trunk subscription	41.75%	11.22%
Pulses	25.60%	17.24%
Phone credits	24.60%	17.24%
Change of address	30.05%	17.24%
Local interconnection	14.34%	3.07%
Domestic long distance basket	24.85%	12.55%
Long distance interconnection	24.85%	12.55%
Average	30.05%	17.24%

Local Rates

Our revenue from local services consists principally of activation and installation charges, monthly subscription charges, measured service charges and public telephone charges.

The monthly subscription charge is the amount paid for the availability of fixed switched telephone service, regardless of utilization. Payment of this charge includes 100 free pulses per month for residential clients and 90 free pulses per month for non-residential clients. Any pulses in excess of such amounts are billed to the customer as a measured service.

Since October 8, 2003, the date of the last rate adjustment, monthly subscription charges (net of taxes) have been R\$22.18 for residential customers and R\$29.08 for commercial customers. Since the last adjustment, the pulse charge free of tax is R\$0.0894.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Users of measured service, both residential and non-residential, pay for local calls depending on usage, which is measured in pulses. Pulses occur system wide every four minutes for most local calls and every sixty seconds for local calls made between certain municipalities. These system-wide pulses are recorded independently of when the individual calls are actually made. In addition to system-wide pulses, the system records one pulse for every call when the call is connected. After the first pulse, only system-wide pulses are used in determining the charge for a call. As a result, the time between the first and the second (system-wide) pulse may vary. For example, for a call being charged using four-minute pulse increments, the time between the first pulse and the second (system-wide) pulse may vary between one second and four minutes.

Local call charges for calls made on weekdays between 6:00 a.m. and 12:00 a.m. and on Saturdays between 6:00 a.m. and 2:00 p.m., are determined by multiplying the number of pulses by the charge per pulse. For calls being made any weekday between midnight and 6:00 a.m., on Saturdays between 2:00 p.m. and midnight and all day on Sundays and holidays, a caller is charged for only one pulse regardless of the duration of the call.

The following table sets forth selected information regarding our subscription charges and measured service charges for local telephone services for the periods indicated.

	Year ended December 31,		
	2001	2002	2003
	<i>(reais)</i>		
Average rates for local telephone service ⁽¹⁾ :			
Monthly subscription:			
Residential	16.58	18.92	22.18
Commercial	24.59	24.80	29.08
Measured service (per local pulse)	0.07065	0.07624	0.08938

(1) Average rates, net of value-added taxes.

(2) Average rates for local telephone service decreased slightly in 2000 mostly due to the monetary restatement into constant *reais* of December 31, 2000.

Since the date of the last rate adjustment, which occurred in October 2003, we charge an installation fee for a new line between R\$8.97 and R\$69.39 (depending on the state) and a fee of R\$73.04 when a subscriber changes his/her address.

Domestic Long-Distance Rates

Domestic long-distance calls are measured by the duration of the call and registered in the telephone bill call by call. The value per minute is defined by the distance involved (rate degrees from one to four), the day of the week and the time of the call. The measurement is based on a rate unit of one tenth of a minute (six seconds) and the minimum billable time is one minute.

The following table sets forth selected information regarding our domestic long-distance rates during the periods indicated.

	Year ended December 31,		
	2001	2002	2003
	<i>(reais)</i>		
Domestic long-distance rates ⁽¹⁾ :			
0 to 50 km	0.47	0.50	0.59
50 to 100 km	0.70	0.73	0.82
100 to 300 km	0.81	0.85	0.95
Over 300 km	1.07	1.12	1.15

(1) Average rates for a domestic long-distance call (interstate), three minutes in duration between the hours of 9 a.m. and noon and 2 p.m. and 6 p.m. (peak hours) on weekdays, net of value-added taxes.

Network Usage Charges

The network usage rates, responsible for a large part of our interconnection revenue, are applied in the following situations:

Edgar Filing: BRASIL TELECOM SA - Form 20-F

- in DLD calls originating and terminating at our network, executed with the use of the selection code of other providers;
- in calls terminating at our network, originating from networks of mobile carriers; and
- in local fixed-fixed type calls made between two local telephony carriers at the same location. In this case, interconnection revenue must be of the local carrier that configures a volume of traffic receipt above 55.0% of the total volume of minutes between the two networks. The revenue will be calculated over whatever exceeds this limit.

The Local Network Usage Rate (*Tarifa de Uso de Rede Local* – TU-RL) is applied when third parties use our local network to complete their calls. When third parties use our long-distance network the Intercity Network Usage Rate (*Tarifa de Uso de Rede Interurbana* – TU-RIU) is applied.

The following table sets forth the average per-minute rates that we charged for network services during the indicated years.

	Year ended December 31,		
	2001	2002	2003
		<i>(reais)⁽¹⁾</i>	
Network usage rate (local)	0.0501	0.0512	0.05284
Network usage rate (long-distance)	0.0819	0.0860	0.09681

(1) Net of value added taxes. Network usage rates (local and long-distance) refer to the rates that we charged.

As of the date of the last rate adjustment, network usage rates for local and long-distance services were approximately R\$0.05284 and R\$0.09681, respectively. The adjustment of rates for network usage in October 2003 was 3.1% for the Local Network Usage Rate and 12.6% for the Intercity Network Usage Rate.

Our revenue from network services also includes payments from other telecommunications service providers arranged on a contractual basis to use part of our network. Other telecommunications service providers, such as providers of trunking and paging services, may use our network to connect a central switching station to our network. Some cellular service providers use our network to connect cellular central switching stations to the cellular radio base stations. We also lease transmission lines, certain infrastructure and other equipment to other providers of telecommunications services.

Fixed-Mobile Rates

Cellular telecommunications service in Brazil, unlike in North America, is offered on a calling party pays basis. Under the policy of calling party pays, a cellular service subscriber generally pays cellular usage charges only for calls made by the cellular service subscriber and not for calls received. In addition, a subscriber pays roaming charges on calls made or received outside his or her home registration area. Calls received by a cellular service subscriber are paid for by the party that places the call in accordance with a rate based on cellular per-minute charges. For example, a fixed-line service customer pays a rate based on cellular per-minute charges for calls made to a cellular service subscriber. The cellular base rate per-minute charges are generally VC-1 (Communication Value 1) for local calls, VC-2 (Communication Value 2) for calls outside the cellular subscriber's registration area but inside the region where the respective cellular provider provides service, and VC-3 (Communication Value 3) for calls outside the subscriber's registration area and outside the region where the respective cellular provider provides service.

We charge our fixed-line service customers per-minute charges based on either VC-1, VC-2, or VC-3 rates when a fixed-line service customer calls a cellular subscriber. In turn, we pay the cellular service provider a mobile network usage charge for such calls. For local calls, the VC-1 is applied, and for national long-distance calls, the VC-2 and VC-3 rates are applied.

The criteria for measurement of these calls are defined in the Concession Contract and have the following rules:

- Rating unit: six seconds (one tenth of a minute);
- Billable Minimum: 30 seconds; and
- Billable Calls: only calls with a duration of over three seconds are billed.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Like the local and DLD basket rates, the value of rates for calls involving mobile telephones are set in the Concession Contract and are adjusted annually based on IGP-DI price index, after approval by Anatel. The month of reference for the readjustment is February.

During the same month, the values for mobile network use (VU-M) are also readjusted and are used to determine the amount that the fixed carriers will have to pay per minute, after the execution of calls of the fixed-mobile type, whether in local range or in national long-distance range.

Since July 6, 2003, by determination of Anatel, mobile telephone customers can choose, via the carrier selection code, the DLD carrier they prefer to complete their calls, following the same system adopted by the fixed telephony sector. With the introduction of this new system, the DLD carriers began to take part in this new market.

In February 2002, the VU-M was adjusted, on average, by 10.6% in our concession area. In February of 2003, it was readjusted, on average, by 22.0% in our concession area and in February 2004 it was readjusted, on average, by 9.2% in our concession area.

On February 14, 2001, Anatel established new price caps for VC-1, VC-2 and VC-3 rates. The VC-1 rate increased by 9.5% while the VC-2 and VC-3 rates each increased by approximately 7.5%, all net of taxes. In February 2002, the VC-1 rate was adjusted by 9.9% and the VC-2 and VC-3 rates were adjusted by 8.8%. In February 2003, the VC-1 rate was adjusted by 23.5% and the VC-2 and VC-3 rates were adjusted by 22.0%. In February 2004, the VC-1, VC-2 and VC-3 rates were adjusted by 6.99%.

The following table sets forth the average per-minute rates that we charged for network services during the indicated years.

	Year ended December 31,		
	2001 ⁽¹⁾	2002	2003
		<i>(reais)</i>	
VC-1	0.306	0.335	0.414
VC-2	0.626	0.694	0.847
VC-3	0.689	0.764	0.932

(1) Net of Value Added Taxes (ICMS). Network usage rates (local and long-distance) refer to the rates that we charged.

Data Transmission Rates

The majority of revenue from data transmission services is generated by monthly line rental charges for private leased circuits. The balance consists mainly of nominal charges for access to the data transmission network and measured service charges based on the amount of data transmitted. The following table sets forth selected information about our average monthly line rental charges for private leased circuits during the indicated years.

	Year ended December 31,		
	2001	2002	2003
		<i>(reais)</i>	
Average rates for monthly line rental per leased circuit:			
Local circuit			
4.8 Kbps	174.50	254.75	302.00
9.6 Kbps	174.50	254.75	302.00
64Kbps	358.75	523.74	586.00
2Mbps	4,545.11	6,635.45	6,636.00
Long-distance circuit ⁽¹⁾			
4.8 Kbps	750.00	1,094.93	1,303.00
9.6 Kbps	750.00	1,094.93	1,303.00
64Kbps	2,028.75	2,961.79	3,317.00
2Mbps	25,731.20	37,565.23	37,566.00

(1) Average of rates, net of value-added taxes, assuming a transmission distance between 300 and 500 kilometers and a three-year contract.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

The table below sets forth the rates that we charged for ADSL services. These costs do not include the fees normally paid by customers to their Internet service providers.

Residential Plans	Downstream/Upstream Speed	Monthly Subscription ⁽¹⁾
<i>Turbo 300</i>	Up to 300 Kbps/Up to 150 Kbps	79.90
<i>Turbo 600</i>	Up to 600 Kbps/Up to 300 Kbps	99.00
<i>Mega Turbo</i>	Up to 1.0 Mbps/Up to 300 Kbps	199.00
Corporate Plans	Downstream/Upstream Speed	Monthly Subscription ⁽¹⁾
<i>Rápido</i>	Up to 256 Kbps/Up to 128 Kbps	119.90
<i>Super Rápido</i>	Up to 768 Kbps/Up to 128 Kbps	253.12
<i>Profissional</i>	Up to 1.5 Mbps/Up to 256 Kbps	593.44

(1) Monthly rates in reais, including value-added taxes.

Taxes on Telecommunications Services

The cost of telecommunications services in Brazil includes a variety of taxes. The principal tax is a state value-added tax, the *Imposto sobre Circulação de Mercadorias e Serviços* (ICMS), which Brazilian states impose at varying rates on telecommunications services. The current average ICMS tax rate for telecommunications services is 25.0%. However, the ICMS tax rate varies between states. In the State of Acre, for example, the ICMS tax rate is 25.0%, while in the State of Mato Grosso the ICMS tax rate is 30.0%. In the State of Mato Grosso do Sul, the ICMS tax rate is 27.0%. In the State of Goiás, the ICMS tax rate is 26.0%.

The telecommunications tax burden also includes four other federal taxes, the *Programa de Integração Social*; (PIS) and *Contribuição para Financiamento da Seguridade Social* (COFINS) which are the two social contribution taxes based on our gross revenues and the Universal Telecommunications Service Fund (FUST) and the Fund for Technical Development of Brazilian Telecommunications (FUNTTEL).

Until February 1, 2004, PIS was applied at a 0.7% rate and COFINS was applied at a 3.0% rate. Since December 2002, we have been subject to a 1.7% PIS rate for telecommunications services and may be entitled to PIS credits calculated on our costs and expenses to offset the PIS due on our gross revenues. Since February 2004, we have been subject to a 7.6% COFINS rate for services other than telecommunications, and may be entitled to COFINS credits calculated on our costs and expenses to offset the COFINS due on our gross revenue.

The FUST and FUNTEL are imposed on certain telecommunications services at the rates of 1.0% and 0.5%, respectively, of gross operating revenues net of certain deductions. See Item 10 Additional Information Taxation Brazilian Tax Considerations Other Brazilian Taxes.

In 2003, taxes on telecommunications services represented approximately 27.3% of our annual operating revenues.

Billing and Collection

We send each customer of local services, long-distance services and other services a monthly bill covering all the services provided during the prior period. We group our customers into six different monthly cycles with six different payment dates. The telephone bill itemizes long-distance calls, calls made to cellular telecommunications networks, 300, 500 and 800 services and other services such as call waiting, voice mail and call forwarding.

For interregional and international long-distance services, customers either receive separate monthly bills from each company they use for long-distance calls or a combined bill issued by us. Customers make payments under agreements with various banks or other alternative agents by direct payment to a bank or an alternative agent, or by allowing their checking account to be debited.

Pursuant to Brazilian law, subscribers must receive a bill at least five days before the due date. When a payment is not made by the due date, we must send the customer, 15 days after the due date, a notice informing the customer that they have the right to contest the debt and if payment is not made within 30 days after the due date, all outgoing service will be suspended, and the customer will only be able to receive incoming calls. Thirty days after the due date we can block calls originating from such customer's phone. If payment is not made within 45 days after the due date, we send another notice informing the customer that if payment is not made within 60 days after the due date, all services will be suspended, the contract will be cancelled and the customer's failure to pay will be reported to a credit protection agency.

At December 31, 2003, approximately 20.1% of our customers' accounts receivable were more than 30 days outstanding, 15.4% of our customers' account receivables were more than 60 days outstanding, and 11.5% of our customers' account receivables were more than 90 days outstanding. For the discussion of provisions for past due accounts, See Item 5 Operating and Financial Review and Prospects Operating Results.

*Network and Facilities**General*

The network is the combination of the physical and logical infrastructure which provides telecommunications services and which offers support to information traffic, whether it is voice, data and/or image.

On December 31, 2003, our plant consisted of approximately 10.7 million installed lines, of which 9.85 million were in service. Of the lines in service at that time, approximately 72.7% were residential lines, 15.9% were commercial lines, 3.0% were public telephone lines and 8.4% were other. Long-distance transmission is provided by a fiber-optic cable network and by microwave lines.

The following table sets forth combined information about our network for the periods indicated.

	At and for the year ended December 31,		
	2001	2002	2003
Installed lines (millions)	10.0	10.5	10.7
Lines in service (millions)	8.6	9.5	9.85
Average lines in service for year ended (millions)	8.5	9.1	9.7
Lines in service per 100 inhabitants	21.5	23.1	23.4
Percentage of installed lines connected to digital exchanges	97.3	99.0	99.0
Employees per 1,000 lines installed	0.8	0.5	0.49
Number of public telephones (thousands)	285.7	293.3	296.3

We are required, under the Telecommunications Regulations and our concessions, to meet certain targets relating to network expansion and modernization. See History and Development of the Company Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies Network Expansion General Plan on Universal Service.

Network Expansion

During the 2001 fiscal year, we slowed our aggressive network expansion carried out in 2000, increasing lines in service by approximately 16.0%, from approximately 7.4 million in 2000 to 8.6 million in 2001, thereby increasing the telephone density in our region to 21.5 lines in service per 100 inhabitants. During the 2002 fiscal year, we increased lines in service by approximately 10.0% from approximately 8.6 million in 2001 to 9.5 million in 2002, thereby increasing the telephone density in our region to 23.1 lines in service per 100 inhabitants. At the end of 2003, we had 9.85 million lines in service and the telephone density reached 23.4 lines in service per 100 inhabitants.

Network Modernization

With respect to our network infrastructure, we apply an operating model based on operating efficiency, continuous updates and use of cutting-edge technological resources to assure flexibility and quality for our users. Our model is based on the following basic objectives:

- Flexibility to service the needs of our clients;
- Gradual evolution to preserve the investments which have already been made;
- Investment optimization through thorough planning for the usage of network resources;
- Open and multi-vendor environment;
- Flexibility to maximize the introduction of new network services;
- Independence for client access;
- Maximum operating efficiency; and
- High availability and security.

By constantly developing our network infrastructure we work toward creating an integrated model of services and applications, as well as a single and flexible network accessible to all clients from any location and at any time.

During 2003, the following steps were taken to further the objectives listed above:

- a) Duplication of the IP core, with the implementation of QoS (Quality of Service) mechanisms and security;

Edgar Filing: BRASIL TELECOM SA - Form 20-F

b) Implementation of MPLS (Multi Protocol Label Switch) which enables us to provide services based on VPNs IP/MPLS (Virtual Private Networks based on IP - *Redes Privadas Virtuais baseadas em IP*);

c) Introduction of Media Gateway and Softswitch equipment, which enables us to offer new services that use VoIP (Voice over IP). The services provided through this equipment are based on next generation network technology;

d) Introduction of Service Gateways in the broadband aggregation layer, which enables us to offer a new set of services to our broadband users;

e) Capillarity of the broadband accesses, which uses technology based on Digital Subscriber Line Access Multiplexer and Home Phonenumber Networking Alliance; and

f) Implementation of hot spots for wi-fi access.

Competition

We operate in the local fixed-line telecommunications, domestic long distance telecommunications as well as in the data communications markets in our region. We compete primarily on the basis of features, pricing and customer service. In general, the increasingly competitive marketplace has resulted in decreasing prices for telecommunications services, driven by increasing competition, implementation of new technology and regulatory oversight. Accordingly, the cost of maintaining our market share has increased and our margins have decreased due to higher subscriber acquisition costs in the form of advertising and discounts.

As a result of the certification by Anatel that we have met our universalization targets on January 19, 2004, we started offering interregional and international long distance services and we recently began offering wireless telephony services in our region in furtherance of our business strategy to provide integrated telecommunications services both in our region and throughout Brazil. The certification of other service providers' compliance with universalization and expansion targets, permits other service providers to operate in our region. We may now have to compete in our region against competitors from outside of our region that offer a more extensive array of fixed-line, mobile, local and/or long-distance telecommunications services throughout Brazil. As the telecommunications industry continues to consolidate, we may also face competition from larger competitors with greater resources. In addition, we could face increased competition if new or competing technologies are developed and launched. There can be no assurance that increased competition will not have a material adverse effect on our results of operations and financial condition.

Local Services

Currently, we are the leading local fixed-line telecommunications services provider in our region, with an estimated 96.5% market share. This estimate is based on outside consultants' statistical estimates using volume of outgoing and incoming local calls of our competitors that interconnect through our network. Global Village Telecom is our sole competitor in providing local fixed-line telecommunications services in our region. Our dominant position in the local fixed-line telecommunications market is due, among other things, to the fact that we did not face any competition in this market until the entry of Global Village Telecom in November of 2000. Global Village Telecom is an independent service provider operating under an authorization from Anatel. Since then, we have been able to maintain our market share in our region due to our extensive network and the features, prices and services we offer.

In the short-term, we could lose market share in the provision of local fixed-line telecommunications services as additional competitors are allowed to enter the fixed-line market in our region. To date, Telesp, Telemar, Embratel, Intelig, CTBC Telecom, Aerotech, Telefree, Impsat, Easytone and Transit have been granted permission by Anatel to provide local fixed telecommunications services 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. This could have a material adverse effect on our market share, margins, results of operations and financial condition. See Item 3 "Key Information Risk Factors Risks Relating to Our Company". Since January 2004, we have the ability to counteract losses in market share in the local fixed-line market by providing telecommunications services in other regions.

Intraregional (intrastate and interstate) Long-Distance Service

We are currently the leading intraregional long-distance telecommunications services provider in our region, with an estimated 80.0% of the intraregional market share. These estimates are based on the volume of outgoing and incoming long-distance calls that select us to carry such calls by imputing our carrier selection code. 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".

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Accordingly, domestic long distance carriers including us, are now competing in the mobile-line long distance market. As our carrier selection code "14" was widely used for calls originating from fixed telephones, we quickly gained a significant share of the long-distance calls originating from mobile phones. Embratel is our most significant competitor in providing intraregional long-distance telecommunications services in our region with approximately 18.0% of the total market share. The remaining market share is divided among Global Village Telecom, Intelig and other operators. The licenses awarded to Embratel, Intelig and Global Village Telecom are not subject to the same service quality and network expansion and modernization obligations that we are subject to under our concessions.

In the short-term, we expect to lose market share in the provision of intraregional long-distance telecommunications services as additional competitors are allowed to enter the market. To date, Telesp, Albra, TIM, Aerotech, CTBC Telecom, TNL PCS, Telmex do Brasil, Sercomtel, Telefree, Easytone, Transit, Telenova, Tmais and Global Village Telecom have been granted permission by Anatel to provide intraregional telecommunications services in our region. As a result of Anatel having certified our compliance with universalization targets we expect to be able to counteract losses in market share in the interregional long-distance services market by providing these services in other regions.

Interregional and International Service

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. Having received certification by Anatel of our compliance with universalization targets on January 19, 2004, we began offering interregional and international long-distance services. Due to our unique position in Region II combined with marketing and promotional pricing, we were quickly able to gain approximately 30.0% of the interregional market share and 15.0% of the international market share in Region II. We compete primarily against Embratel which has approximately 68.0% and 85.0% of the interregional and international market share, respectively, in our region. We expect our market share to increase as clients are no longer concerned about selecting a carrier based on where the call ends.

To date, Telesp, Albra, TIM, Aerotech, CTBC Telecom, TNL PCS, Telmex do Brasil, Sercomtel, Telefree, Easytone, Transit, Telenova, Tmais and Global Village Telecom have been granted permission by Anatel to provide interregional and international telecommunications services in our region. This could have a material adverse effect on our ability to increase our market share.

Data Transmission Services

Over the past few years, the data communications sector of the telecommunications industry has shown the highest annual growth rates and has accordingly attracted many participants. We believe that within data transmission services, the broadband market will grow substantially over the next few years as broadband, and in particular ADSL, can offer users a single access point through which they can obtain voice, data and image services. On a national level, Embratel is the largest provider of data transmission services with approximately 50.0% of the total market share.

We have increased our market share in the data communications market primarily through the development of our ADSL service. We are the leading provider of ADSL accesses in Region II with approximately 95.0% of the market share of ADSL accesses. This market share in ADSL is based upon our market share of the local service market as ADSL accesses are provided through the local telephone lines in our region. Approximately 50.0% of the ADSL accesses we provide in Region II are to our BrTurbo customers. The remaining ADSL accesses are provided to customers of third party ISP's for which we charge an access fee. Global Village Telecom also provides ADSL accesses in our region. We also face competition from cable TV operators who provide broadband access through cable modems.

In the corporate data transmissions market, our DialNet service has approximately 85.0% of the dial up service market in our region. This estimate is based upon our share of the total volume and duration of dial up calls that are made using our network, which we can identify as calls made to dial up services including our own. We compete in the dial up internet market primarily with Global Village Telecom. We have approximately 90.0% of the market share for Dedicated IP services in Region II, with the remainder offered by Embratel. We believe that MetroRED gives us approximately a 3.0% market share in its markets where it faces competition from Telesp, Embratel and Telmex do Brasil. GlobeNet competes against the submarine cable business of Telesp and Global Crossing. We may face significant competition in all of our data transmission services if we are required by Anatel to lower the rates we are permitted to charge other operators or ISPs to use our lines.

Internet Services

At December 31, 2003, BrTurbo had an approximate 47.3% market share of the monthly broadband ISP sales in Region II. BrTurbo was the leader in terms of number of active clients among the providers operating high-speed access services based on ADSL technology in Region II. At December 31, 2003, it had 104,624 residential clients and 3,320 business clients. Currently, about 50.0% of the ADSL accesses we provide are to BrTurbo's clients. BrTurbo competes primarily against the ISPs Terra.com and Globo.com and local area ISPs who operate primarily in the rural areas.

Since we acquired iBest, the company has grown mainly in Region II, where it is currently the market leader with approximately 54.0% of the free internet minutes. iBest ended 2003 with more than 4.5 million registered users of which 1.3 million were active, generating approximately

Edgar Filing: BRASIL TELECOM SA - Form 20-F

14 billion dial-up minutes during that year which represents approximately 20.0% of the national dial-up minutes. In Region II, iBest generates approximately 4.4 billion dial-up minutes which represents approximately 28.0% of the Region II dial-up minutes. The "Prêmio iBest" brand name has become the largest Internet Award in Brazil, with more than 30,000 websites registered in the 2003 edition. iBest's main competitors in Region II are iG and Pop, which is owned by Global Village Telecom.

Wireless Services

We have recently commenced offering our wireless services. Wireless services are equally competitive and we face competition in Region II from (i) a joint venture between Telefônica and Portugal Telecom (marketing under the brand name "Vivo"), (ii) Telmex, which competes against us in our region through América Móviles (marketing under the brand name "Claro") and (iii) TIM. In addition wireless services compete directly against local services.

Effects of Competition

The deregulation that started in 2002 and includes our recent certification and authorization to provide additional services inside and outside our region is expected to increase competition in our businesses. Although we believe we have a unique infrastructure in Region II (having inherited the incumbent network upon privatization of Telebrás) and we have been developing strategies to effectively protect our business, we expect that the entry of additional competitors into the market for local, long distance and wireless services in Region II as well as significant industry consolidation may adversely affect our related revenues. We anticipate, however, that growth in the Brazilian market will generate higher revenues, especially now that we are able to offer long distance and data services on a nationwide basis and wireless services in our region. While we expect that local traffic per line will continue to decline as we expand our network to lower-income customers who, on average, make fewer calls, we expect that our expansion into new business areas will provide us with new growth opportunities.

The impact of these competitive pressures will depend on a variety of factors that cannot currently be assessed at this time, some of which are beyond our control. Among such factors are the technical and financial resources available to our competitors, the business strategies and capabilities of our competitors, prevailing market conditions, the regulations applicable to new entrants and us, and the effectiveness of our efforts to prepare for increased competition and consolidation.

Customer Service

We provide customer service primarily through call centers. In addition we provide services through our website and in physical locations through lottery booths (which will take payments) and will soon provide service through post offices which will take payments as well as provide other services.

We have consolidated our call center structure, by merging our 30 pre-existing sites into four sites (Goiânia, Campo Grande, Florianópolis and Curitiba) while improving the level of service through outsourcing. In order to reduce further overlapping costs, we have closed most of our stores and centralized our customer service into the call centers.

In an effort to improve service to our corporate customers, we have created a call center which is dedicated to such customers. We have implemented a customer relationship management system which integrates our systems and provides a database of information for each customer so that we can provide better service and identify sales opportunities during each contact we have with our customers. In addition, we are targeting small and medium-sized companies, in order to render more specialized customer services to them.

Sales Channels and Marketing

We have improved our sales channels in order to render specialized customer services in different niches and sectors of our market, but primarily in the corporate market. Our sales channels consist of direct marketing, our website, and our customer service contacts. Our residential sales are primarily handled through our 800 numbers or our website. Our corporate sales are primarily handled through direct sales contacts with our sales representatives. We intend to open shops to sell our mobile services as well as other services.

We have increased our use of direct marketing in conjunction with active and receptive telemarketing as a way of targeting our market sectors (residential, commercial and corporate). At the same time, we have developed a complete portfolio of products and services, such as SLDD, Frame Relay, ATM, IP WAN, Dedicated IP, Light IP and DialNet, to meet the needs of our customers.

We have also developed and improved our website, in an effort to deliver some of our services online. Currently, customers are able to access over 16 different types of services online, including: registration for the purchase of a telephone line, issuance of a second copy of a bill, consultation of a detailed and summarized bill, download of a bill, verification of receipt of payment, and requests for repairs.

Intellectual Property

Our business is not heavily dependent on the development and exploitation of proprietary technology. We conduct research and development in the areas of telecommunications services, but do not independently develop any new telecommunications technology.

Since prior to the breakup of Telebrás, our company, as well as each of the other operating subsidiaries of Telebrás, have contributed to *Fundação CPqD - Centro de Pesquisa e Desenvolvimento em Telecomunicações* ("the Center"), a research and development center formerly operated by Telebrás which develops telecommunications technology in Brazil. Pursuant to our arrangement with the Center, we have access to telecommunications software developed by the Center and other technological services provided by the Center, such as equipment testing and consulting and training services. In addition to the Center, we also depend on manufacturers of telecommunications products for the development of new hardware and new telecommunications technologies. See Item 5 "Operating and Financial Review and Prospects - Research and Development." and " History and Development of the company - Capital Expenditures - Research and Development."

Our Trademarks in Brazil

As of December 31, 2003, we had 107 trademarks registered with the Brazilian Institute of Industrial Property (INPI), one of which is subject to an administrative proceeding for invalidity of registration.

In Brazil, trademark registration has a term of validity of 10 years, after which it can be renewed for additional 10-year periods. The application for renewal of a trademark must be submitted to the INPI in the last year of validity of the trademark registration, or within six months after the trademark expiration date upon payment of an additional fee. INPI only refuses a renewal in the event that the renewal fees are not timely paid. Moreover, registrations are subject to forfeiture actions in case it is proven that the trademark was not used for five consecutive years. We expect to apply for renewal of registration of all of its material trademarks, so as to avoid their expiration. We believe that our significant trademarks are protected in all material respects in the markets in which we currently operate.

Besides trademarks duly registered, as of December 31, 2003, the Company had 255 requests for trademark registration filed and awaiting registration, out of which 20 were opposed by third parties. There are also 12 trademarks in the name of third parties which were transferred to the Company but whose assignments were not published yet at INPI's website. Among these 12 trademarks, there are eight registered trademarks, one trademark subject to an administrative proceeding for invalidity of registration, and four requests for trademark registration being examined by INPI, out of which three have been opposed by third parties.

In relation to trademarks filed by third parties, the Company has opposed to 52 requests for registration. Also in relation to third parties' trademarks, the Company has requested the invalidity of registration of four trademarks and the cancellation for non-use of four trademark registrations.

Only entities legally functioning in Brazil, independent service providers and natural persons are permitted to register domain names. Fees are charged for the annual maintenance of the registered domain name on the Internet.

Our Domain Name in Brazil

As of December 31 2003, we had 161 registered domain names, out of which 97 are registered in Brazil and 64 are registered abroad.

[Table of Contents](#)

Regulation of the Brazilian Telecommunications Industry

General

Our business, including the services we provide and the rates we charge, are subject to comprehensive regulation under the General Telecommunications Law and various administrative enactments thereunder. We operate in each of the states in our region based on the concessions that were granted to each of Telepar, Telesc, Telegoiás, Telebrasil, Telemat, Telems, Teleron, Teleacre and CTMR. We also operate outside our original concession area based on the new authorizations received from Anatel as a result of the targets certification. These concessions and authorizations allow us to provide specified services and set forth certain obligations with which we need to comply (the "List of Obligations").

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Anatel is the regulatory agency for telecommunications under the *Regulamento da Agência Nacional de Telecomunicações* (the "Anatel Decree"). Anatel is administratively independent from the Government and financially autonomous. Anatel is required to report on its activities to the Ministry of Communications and to the Brazilian Congress. Any proposed regulation of Anatel is subject to a period of public comment, including public hearings, and Anatel's decisions may be challenged only in the Brazilian courts.

Concessions and Licenses

General

We operate under two public switched telephone network concessions (local and domestic long-distance), which grant us the right to offer local and domestic long-distance services in Region II.

Concessions to provide telecommunications services are granted under the public regime, while such services are provided through authorizations granted under the private regime.

In addition to us, the companies that operate in the public regime in Brazil ("public regime companies") include Telemar, Telesp, Embratel and certain other local operators. The four primary public regime companies are the primary providers of fixed-line telecommunications services in Brazil, including local services and intraregional, interregional and international long-distance service. All other telecommunications service providers, including the other companies authorized to provide fixed-line services in Region II, operate in the private regime ("private regime companies").

According to the terms of Article 63 of the General Telecommunications Law and of Article 13 of the Brazilian Telecommunications Service Regulations, public regime companies are subject to certain obligations as to continuity of service, universality of service, network expansion and modernization. Public regime companies are also subject to Anatel's supervision in regard to the rates that they may charge. On the other hand, private regime companies are generally not subject to the requirements as to universality of service or modernization, but they are subject to certain network expansion and quality of service obligations set forth in their licenses.

Public regime companies, such as Brasil Telecom, also often offer certain services in the private regime, of which the most significant are data transmission services. Our wireless services are offered under the private regime, according to a license acquired by us on November 19, 2002.

Fixed-line Services Public Regime

Each public regime company operates under a concession that expires in 2005. Each public regime company may extend its current concession for an additional 20-year period. On June 20, 2003, Anatel approved a new General Plan on Quality, a General Plan on Universal Service and a new form of extension to the concession contracts under which all fixed-line telecommunications incumbents will operate as of January 1, 2006. See "Obligations of Telecommunications Companies New Telecommunications Regulations." The concessions may also be revoked prior to expiration. Every second year during the 20-year renewal period, publicly-held companies will be required to pay biannual renewal fees equal to 2.0% of their annual net revenues from the provision of telecommunications services (excluding taxes and social contributions) during the immediately preceding year.

Prior to January 2004, we were not permitted to offer interregional long-distance services. Since we achieved the expansion targets for the network and the universal services in advance, we were qualified to receive a grant for such services, following the corresponding amendments of the concession contracts, which were signed on January 20, 2004, enabling us to originate long-distance calls in our concession area and terminate them at any point in the country. See "Obligations of Telecommunications Companies Public Regime Service Restrictions."

Fixed-line Services Private Regime

The Brazilian Telecommunications Regulations provide for the introduction of competition in telephone services in Brazil by requiring the Brazilian federal government to authorize four private-regime companies one to provide local services and intraregional long distance service in each of the three fixed-line regions and one to provide intraregional, interregional and international long distance service throughout Brazil. Anatel has already granted Global Village Telecom, a private-regime operator, the licenses to operate in Region II. Anatel has also granted licenses to two other private regime companies to operate in each of the other fixed-line regions and licenses to another private-regime company to provide intraregional, interregional and international long distance service in competition with Embratel. Concessions and authorizations have been granted in each fixed-line region for regional fixed-line companies to provide local services, fixed-line companies to provide intraregional long distance service and other companies to provide interregional long distance and international long distance service. Since 2002, the number of authorizations which can be given by the Brazilian federal government is unlimited.

After receiving the certification for the accomplishment of our universalization targets, we obtained authorization to provide local and domestic long-distance services in our Region, under the private sector regime and to regions I and III through the General Concession Plan. In

Edgar Filing: BRASIL TELECOM SA - Form 20-F

addition, we were authorized to provide international long-distance services in Regions I, II and III (the entire country) through the General Concession Plan. The other primary public regime companies have received similar authorizations.

Regulation of wireless services PCS

In September 2000, Anatel promulgated regulations regarding wireless telecommunications services for PCS. The new rules allow companies to provide wireless telecommunications services under SMP authorizations. The PCS authorizations allow new participants in the Brazilian telecommunications market to compete with existing telecommunications service providers. The PCS regulations divide Brazil into three separate regions, each of which corresponds to the regions applicable to the public regime fixed-line telephone service providers. PCS services may be provided within the 1800 MHz band, which contains Bands C, D and E. Accordingly, in addition to the conversion of the Band A and Band B service providers to PCS authorizations, up to three PCS authorizations may be granted in each PCS region. Anatel held auctions for PCS authorizations during 2001 and 2002.

The PCS license sets forth certain obligations and targets that must be met by a PCS company. Under these obligations, a PCS company is required:

- to cover an area equivalent to at least 50.0% of the urban area in 50.0% of the state capitals and cities with more than 500,000 inhabitants by December 17, 2003;
- to cover all state capitals and all cities with more than 500,000 inhabitants by December 17, 2004;
- to cover an area equivalent to at least 50.0% of the urban area in 50.0% of the cities with more than 200,000 inhabitants by December 17, 2005;
- to cover all cities with more than 200,000 inhabitants by December 17, 2006; and
- to cover all cities with more than 100,000 inhabitants by December 17, 2007.

A locality is considered "covered" when the covered area contains, at least, 80.0% of total urban area. Failure to meet these targets may result in the penalties established in the regulations and, in extreme circumstances, in termination of the PCS license by Anatel.

Obligations of Telecommunications Companies

Like other telecommunications service providers, we are subject to obligations concerning quality of service and network expansion and modernization. The public regime companies are also subject to a set of special restrictions regarding the services they may offer, contained in the General Plan of Concessions and Licenses, and special obligations regarding service quality, network expansion and modernization contained in the General Plan on Universal Service and the General Plan on Quality.

New telecommunications regulations

On June 10, 2003, the Brazilian government promulgated a presidential decree (the "Decree") setting forth a number of changes in the regulation of Brazil's fixed-line telecommunications sector. The Decree sets forth general policies regarding, among others, universal access to telecommunications services, stimulation of employment and development of the Brazilian industry in the telecommunications sector, competition and adoption of rate readjustment policies that take into account Brazilian socio-economic conditions and the financial equilibrium of the existing concession contracts. The Decree also states that certain changes should be reflected in the terms of each concession contract to be entered into by each public regime company as of January 1, 2006.

Pursuant to the Decree, Anatel adopted, on June 20, 2003, a new General Plan on Universal Service, which will require fixed-line telecommunications services providers to achieve certain targets as of January 1, 2006. The purpose of the plan is to allow all Brazilians, regardless of where they are located or their socio-economic status, to have access to the public switched telephone network. The costs related to meeting the targets contemplated by the plan are to be paid for solely by the incumbent telecommunications services providers pursuant to terms stipulated in each provider's concession contract. Anatel may revise the universal service targets, pursuant to the concession contracts, as well as propose additional targets and accelerate the plan. The plan applies to local, domestic and long-distance service providers in varying degrees.

Telecommunications services providers will be required to:

- install the public switched telephone network to provide access for individual residential, non-residential and "trunk" classes in areas with more than 300 inhabitants. Priority must be given to requests for individual access made by schools, hospitals, public security establishments, public libraries, museums, judiciary agencies, federal public prosecutor's agencies, and consumer protection agencies.

Edgar Filing: BRASIL TELECOM SA - Form 20-F

Special care and equipment must also be provided for the hearing and speech impaired;

- activate public telephones ("TUP"), which will allow any person to access the public switched telephone network, regardless of subscription or registration with the carrier, ensuring that the density of TUPs per general license plan sector is equal to or over 6 TUPs per 1,000 inhabitants from January 1, 2006 onwards. This requirement is less stringent than the targets established by the General Plan on Universal Service currently in force, which is 7.5 TUPs per 1,000 inhabitants for year-end 2003 and 8 TUPs per 1,000 inhabitants for year-end 2005. We believe this will have a lower impact on our costs and capital expenditures. When activating TUPs, providers must ensure there are at least 3 TUPs per group of 1,000 inhabitants evenly distributed over the service area. Fifty percent of the required TUPs must be installed in areas which are accessible twenty-four hours a day and 2.0% must be adapted for every kind of physical impairment. Local services providers are responsible for meeting the targets in areas located 30 kilometers or less from any other service area. Domestic and international long-distance providers must meet the targets in those service areas located thirty kilometers or more from any other service area.

Local service telecommunications services providers will be required to activate and maintain telecommunications services stations ("PST") in each general license plan sector in varying numbers. Such numbers will be determined by the population measured annually from the years 2007 to 2011. The public switched telephone network incumbent services providers must also activate one PST per general license plan sector in cooperative service stations ("UAC") in rural areas. For the years 2007 and 2008, the requirement will vary according to the size of the community. For the year ended 2009, all communities must be served.

The board of directors of Anatel also approved a public hearing with respect to the regulation of special individual access ("AICE"). The goal of AICE is to meet the needs of lower income households not yet serviced by the public switched telephone network, and the offer, utilization, rates, payment conditions, call treatment, network usage remuneration and taxation of AICE will be differentiated than for regular residential telephone services. AICE will be accessed via prepaid cards, which could be used for any type of telecommunications services. The installation orders of AICE will have to be fulfilled by the concessionaires within 30 days after the registration, according to the General Plan on Universal Service, effective as of January 1, 2006.

On June 20, 2003, Anatel also approved the Form of New Concession Contract. See "Risk Factors Risks Related to Our Business." In June 2003, we notified Anatel of our intention to extend Brasil Telecom's current concession. Brasil Telecom and Anatel are expected to formally enter into a new concession contract by the end of 2005.

The Form of New Concession Contract contains new terms reflecting the new General Plan on Quality and the new General Plan on Universal Service described above, which relate to:

- new universalization targets;
- changes in local rate measurement criteria from pulse to minute measurement;
- changes in rate adjustment formulas, including the creation of a telecommunications industry index and a reduction in chargeable rates for local interconnection rates; and
- a reduction in the number of local areas.

Both the new General Plan on Quality and the new General Plan on Universal Service were approved by Anatel on June 28, 2003. They will only come into force upon the execution of the new concession contract.

From our analysis to date, the major differences in the new Form of New Concession Contract relate to universalization targets and rate structure. Concessionaires will be required to install telecommunications service centers in a number of locations, including in smaller communities and the IGP-DI will no longer be used to determine the annual inflation-based adjustments to the rates. The Form of New Concession Contract also anticipates number portability and resale. This will enable customers to change telecom service providers without the inconvenience of having to change their contact number, which is especially important for corporate customers.

Public Regime Service Restrictions

Until December 31, 2003, according to the General Concession Plan, all fixed telecommunications service concessionaires, such as our company, were prohibited from offering new services, such as mobile services, fixed telecommunications services in the interregional or international long-distance mode. Embratel was also prohibited from offering local or wireless services. The anticipated accomplishment of the universalization targets on behalf of the concessionaires enabled them to be exempt from this restriction. See " Network Expansion General Plan on Universal Service" and " Quality of Service General Plan on Quality." Every publicly-held fixed telecommunications service provider was authorized, or is in the process of being authorized, to offer all other telecommunications services, except cable television services, provided that

they achieve their respective universalization and service expansion targets.

Public regime companies are subject to certain restrictions on alliances, joint ventures, mergers and acquisitions, including:

- holding more than 20% of the voting stock of any other public regime company for a five-year period beginning in July 1998. This prohibition is no longer enforced so long as the acquisition is not deemed detrimental to competition, does not put at risk the execution of the concession contract and is duly authorized by the necessary agencies;
- mergers between regional fixed-line services providers and wireless services providers (a prohibition that also applies to private-regime companies); and
- offering cable television services, unless the company offering telephone services has won a public auction to provide cable television services in the relevant region and no other bidders participated.

Network Expansion General Plan on Universal Service

Under the General Plan on Universal Service, each regional fixed-line service provider is required to expand fixed-line service within its region, and Embratel is required to expand access to long-distance service by installing public telephones in every location situated at a geodesic distance of more than 30 kilometers from the other region serviced by individual fixed telephone service. No subsidies or other supplemental financing are anticipated for the network expansion obligations of the public regime companies. If a public regime company fails to meet its obligations in a particular fixed-line region, Anatel may apply the penalties established in the terms and conditions of the concessions.

Quality of Services General Plan on Quality

Each regional public and private regime company must comply with the provisions of the General Plan on Quality and also with the terms of their respective concessions, licenses and authorizations. All costs related to the attainment of the goals established by the General Plan on Quality must be exclusively borne by the respective telephone service provider. The General Plan on Quality establishes minimum quality standards with regard to:

- responses to repair requests;
- availability of services to users;
- quality of public telephones;
- operator availability;
- personal services to users;
-