BRASIL TELECOM HOLDING CO
Form 20-F
June 30, 2006

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, 2005
Commission file number: 1-14477

BRASIL TELECOM PARTICIPAÇÕES S.A.

(F/K/A TELE CENTRO SUL PARTICIPAÇÕES S.A.)
(Exact Name of Registrant as Specified in Its Charter)

Brazil Telecom Holding Company	**The Federative Republic of Brazil**
(Translation of Registrant's Name into English)	(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, 2005 there were outstanding:
229,937,525,684 Common Shares, without par value
132,550,888,203 Preferred Shares, without par value

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

Securities Act.

Yes **X** **No** ____

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

Yes **X** **No** ____

Indicate by check mark whether the registrant is a large accelerated, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer X **Accelerated Filer ____** **Non-Accelerated Filer _____**

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

Item 17 ______ **Item 18** **X**

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PRESENTATION OF FINANCIAL INFORMATION

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

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

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

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

The "Index of Defined Terms" that begins on page 164 lists the page where each defined term is defined within this document. Technical terms are defined in the Technical Glossary on page 166.

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.

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FORWARD-LOOKING INFORMATION CONTAINED IN THIS ANNUAL REPORT

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

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

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

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

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

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

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

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

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

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

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PART I

ITEM 3. KEY INFORMATION

Selected Financial Data

Background

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

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

Brazilian GAAP and US GAAP

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

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

Change in Accounting Methodology

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

Difference from Financial Statements Published in Brazil

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

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Selected Financial Information

Income Statement Data:	**2001**	**2002**	**2003**	**2004**	**2005**
Brazilian GAAP:					
Net operating revenue	6,158,408	7,071,368	7,915,194	9,064,855	10,138,684
Cost of services	4,765,593	5,143,358	5,455,019	6,161,388	6,520,606
Gross profit	1,392,815	1,928,010	2,460,175	2,903,467	3,618,078
Operating expenses:					
Selling expenses	724,507	763,346	821,627	1,087,028	1,656,242
General and administrative expenses	624,751	687,462	865,052	1,017,421	1,288,497
Other net operating expenses (income)	60,875	(121,181)	211,308	69,142	635,903
Operating income (loss) before net financial expenses	(17,318)	598,383	562,188	729,876	37,436
Net financial expenses	47,051	330,460	610,159	399,841	(387,387)
Operating income (loss)	(64,369)	267,923	(47,971)	330,035	(349,951)
Net non-operating expenses (income)	85,167	78,312	550,022	111,771	(146,951)
Employee's profit share	52,783	42,619	3,510	58,057	0
Income (loss) before taxes and minority interests	(202,319)	146,992	(601,503)	160,207	(496,512)
Income and social contribution tax benefits	87,347	(916)	261,390	5,818	373,097
Income (loss) before minority interests	(114,972)	146,076	(340,113)	166,025	(123,415)
Minority interests	75,720	2,397	171,466	(37,907)	93,860
Net income (loss)	(39,252)	148,473	(168,647)	128,118	(29,555)
Number of Common Shares (millions)(1)	128,459,878	130,971,517	132,550,888	132,550,888	132,550,888
Number of Preferred Shares millions)(1)	219,863,511	219,863,511	222,670,188	226,007,753	229,937,525
Net income (loss) per thousand Common Shares (*reais*) (1)	(0.32)	1.13	(1.27)	0.97	(0.22)
Dividends per thousand Common Shares (*reais*)(1)	0.38	0.55	0.54	0.70	1.33
Dividends per thousand Common Shares (dollars)(1)(2)	0.17	0.16	0.19	0.26	0.57

Dividends per thousand Preferred Shares (*reais*)(1)	0.38	0.55	0.54	0.70	1.33
Dividends per thousand Preferred Shares (dollars)(1)(2)	0.17	0.16	0.19	0.26	0.57

(1) See Note 3s to our Financial Statements.
(2) Dividends per thousand shares were converted into dollars at the Commercial Market selling rate of R$2.3200 per dollar on December 31, 2001, of R$3.5333 per dollar on December 31, 2002, of R$2.8892 per dollar on December 31, 2003, of R$2.6544 per dollar on December 31, 2004, and of R$2.3407 per dollar on December 31, 2005, respectively.

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Selected Financial Information (continued)

Income Statement Data (continued)	**2001**	**2002**	**2003**	**2004**	**2005**
U.S.GAAP:					
Net income (loss)	(133,894)	279,899	(8,347)	271,444	291,066
Net income (loss) per thousand shares (*reais*) [3]:					
Common Shares Basic	(0.39)	0.80	(0.02)	0.76	0.80
Common Shares Diluted	(0.39)	0.80	(0.02)	0.76	0.80
Preferred Shares Basic	(0.39)	0.80	(0.02)	0.76	0.80
Preferred Shares Diluted	(0.39)	0.80	(0.02)	0.76	0.80

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

	At December 31				
	2001	2002	2003	2004	2005
	(Thousands of *reais)*				
Balance Sheet Data:					
Brazilian GAAP:					
Intangibles[1]	372,536	470,544	531,556	896,713	674,106
Property, plant and equipment, net	12,231,013	11,265,991	9,579,821	9,359,958	8,682,719
Total assets	16,399,570	17,154,721	16,636,543	18,721,897	18,202,788
Loans and financing current portion	448.778	591,874	1,696,958	856,638	1,201,681
Loans and financing non-current portion	2,699,466	3,584,293	2,093,044	3,851,591	3,367,400
Total liabilities (including funds for capitalization and minority interests)	9,666,203	10,491,289	10,375,112	12,593,407	12,956,768
Shareholders' equity	6,733,367	6,663,432	6,261,431	6,128,490	5,246,020
US GAAP:					

Intangibles(2)	607,509	724,160	910,511	1,420,724	1,269,703
Property, plant and equipment, net	13,186,333	11,483,967	9,883,100	9,647,334	9,238,453
Total assets	16,673,834	17,626,319	17,318,777	19,533,284	19,354,119
Loans and financing current portion	307,621	470,462	1,502,689	600,280	889,444
Loans and financing non-current portion	2,699,466	3,389,399	1,847,501	3,622,527	3,203,181
Total liabilities (including funds for capitalization and minority interests)	9,794,184	10,817,968	10,736,513	12,916,913	13,350,544
Shareholders' equity	6,879,650	6,808,351	6,582,264	6,616,371	6,003,575

(1) Includes the goodwill from our acquisition of a controlling stake in CRT, which was calculated based on book value.
(2) Intangibles under US GAAP include the goodwill from our merger with Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR and our merger with CRT at December 31, 2001, 2002, 2003,

2004 and 2005, and amounts relating to our PCS licenses at December 31, 2002, 2003, 2004 and 2005. See Note 33o to our Consolidated Financial Statements.

Exchange Rates

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

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

Under the *Real* Plan ("*Real* Plan"), adopted on July 1, 1994, the *real* was introduced as the official unit of Brazilian currency, with each *real* having an exchange rate of R$l.00 to US$1.00. The issuance of *reais* was initially subject to quantitative limits backed by a corresponding amount of dollars in reserves, but the government subsequently expanded those quantitative limits and allowed the *real* to float, with parity between the *real*/dollar (R$l.00 to US$1.00) as a ceiling.

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

Selling Rate for Dollars

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

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

Source: Brazilian Central Bank

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

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

Source: Brazilian Central Bank

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

RISK FACTORS

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

Risks Related to Our Business

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

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

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

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

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

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

Termination of Concession Contracts

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

- non-renewal upon the expiration of the concessions;

- an extraordinary situation in which the public interest is in jeopardy, during which time the Brazilian government may operate our company. In such cases, the Brazilian government must be legislatively authorized to terminate the concession and our company must be indemnified;

- contractual, legal or free-will termination by us when an act or omission of the Brazilian government makes rendering services excessively burdensome to us, or:

• the occurrence of:

(a) a split-up, spin-off, amalgamation, merger, capital reduction or transfer of our corporate power without Anatel s authorization;

(b) the transfer of the concessions without Anatel s authorization;

(c) our dissolution or bankruptcy; or

(d) an extraordinary situation where Brazilian government intervention, although legally possible, is not undertaken since such intervention would prove to be inconvenient, unnecessary or would result in unfair benefits for us.

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

On May 12, 2004, the Consumer Defense Committee of the House of Representatives approved a bill of law proposing the termination of the monthly subscription fees charged for fixed-line services by Brazilian telephone concessionaires, including our company. The bill is still under consideration before the House of Representatives, where a special committee was created on June 03, 2005 to discuss and to make a report regarding the bill. The bill will be subject to the approval of the House of Representatives, the Senate and the President. In 2005 the revenue of monthly subscription fees charged for fixed-line was R$3.5 billion. Should this bill be approved, it may have an impact on our current rate structure and, as a result, our operations and competitive position could be adversely affected.

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

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

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

On January 5, 2006, we announced that we intended to book provisions in our financial statements for the year ended December 31, 2005, in the amount of R$622 million (see description in PART II of this report in our Financial Statements). Such provisions, if booked, could affect our results and, accordingly, jeopardize the compliance in the fiscal year ended on December 31, 2005 until and including the third quarter of 2006 of financial covenants set forth in certain debt agreements, including the credit facilities with BNDES, and the *Escritura de Emissão,* relating to the Debentures of the 4th issuance, being the 3rd public, the loan agreements entered into with Japan Bank of International Cooperation (JBIC) and with Sumitomo Mitsui Banking Corporation. Therefore, prior to making the decision to book the provisions, we initiated negotiations with our creditors to adjust the affected financial covenants, in particular the ratio between EBTIDA and the financial expenses.

On January 06, 2006, we entered into negotiations with BNDES and the financial institutions acting as its agents under the credit facilities. In view of our failure to comply with certain financial covenants, BNDES decided to retain funds in a blocked account equivalent to the highest installment plus interest due under agreement in an amount of approximately R$250 million. In February 2005, the agreements were amended to determine that the funds to be retained shall be equivalent to the highest installment plus interest, instead of three times such figure, as provided for in the initial amendment to the credit facilities.

On January 30, 2006, the holders of our outstanding debentures of the 4th issuance approved an adjustment to the financial covenant relating to the ratio between Consolidated EBITDA and Consolidated Financial Expenses, contained in Section 4.19.1(e)(i) *Escritura de Emissão* from equal or higher than 2.25, to equal or higher than 1.5, as of the fourth quarter of 2005, until and including the third quarter of 2006. If we had not obtained this amendment, we would not have been in compliance with this financial covenant for the fourth quarter of 2005, when we reached a ratio of 2.19. See Item 10. Additional Information Material Contracts Debentures Escritura de Emissão.

On February 17, 2006, we signed the First Amendment to the Loan Agreement entered into with JBIC, dated March 18, 2004, and the First Amendment to the Loan Agreement entered into with Sumitomo Mitsui Banking Corporation, dated March 24, 2004. These amendments adjusted the financial covenants in each respective loan agreement relating to EBTIDA and the financial expenses from equal or higher than 2.25, to equal or higher than 1.5, as of the fourth quarter until and including the third quarter of 2006. For the fourth quarter of 2005 we achieved a Consolidated EBITDA over Consolidated Financial Expenses ratio of 2.19. See Item 10. Additional Information Material Contracts JBIC Guaranteed Loan.

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

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

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

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

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

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

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

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

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

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

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

Institucionais FIA, seeking a declaration that the resolutions adopted at the Investidores Institucionais FIA's Unitholders Meeting held on October 6, 2003 were invalid. On May 18, 2005, an injunction granted on May 17, 2005 in favor of Fundação 14 by a federal tribunal in Rio de Janeiro, which would have allowed Banco Opportunity S.A. to return to the management of Investidores Institucionais FIA s was revoked by a decision granted by Superior Tribunal de Justiça (STJ), the highest Brazilian court for non-constitutional matters; in the proceeding SLS 128.

On July 12, 2005, Fundação 14 filed before the 5th Federal Court of Rio de Janeiro a motion to abandon this lawsuit. To the best of our knowledge, this STJ decision is being challenged by Banco Opportunity S.A..

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

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

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

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

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

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

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

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

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

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