



**Embratel Participações S.A.**

Report of Independent Public Accountants on the  
Special Review of Quarterly Information

June 30, 2001

## **Report of Independent Public Accountants on the Special Review**

(Translation of the report originally issued in Portuguese.  
See Note 24 to the quarterly report.)

To the Shareholders and Board of Directors of

Embratel Participações S.A.:

- (1) We have made a special review of the quarterly report of EMBRATEL PARTICIPAÇÕES S.A. (a Brazilian corporation), which includes the individual and consolidated balance sheets as of June 30, 2001, the related statements of income for the semester then ended, report on performance and other material information.
- (2) Our review was conducted in accordance with specific standards established by the Brazilian Institute of Independent Public Accountants - Ibracon, together with the Federal Accounting Council, and comprised: (a) inquiries of and discussions with Company's Management responsible for the accounting, financial and operating areas as to the principal criteria adopted in the preparation of the quarterly information; and (b) review of information and subsequent events that had or might have had significant effects on the financial position and operations of the Company.
- (3) Based on our special review, we are not aware of any material modification that should be made to the information contained in the quarterly report referred to in paragraph (1), for it to be in accordance with accounting practices established by the corporate law in Brazil and presented in accordance with standards laid down by Brazilian Securities Commission (CVM), specifically applicable to the preparation of quarterly information.
- (4) The individual and consolidated balance sheets as of March 31, 2001, presented for comparative purposes, were reviewed by us, and our unqualified opinion report was issued on May 7, 2001. The individual and consolidated statements of income for the semester ended June 30, 2000, presented for comparative purposes, were reviewed by us, and our unqualified special report was issued on July 21, 2000.

Rio de Janeiro, Brazil

July 25, 2001.

ARTHUR ANDERSEN S/C

Fernando Marotta  
Engagement Partner

EMBRATEL PARTICIPAÇÕES S.A.

BALANCE SHEETS AS OF JUNE 30, 2001 AND MARCH 31, 2001

(In thousands of Brazilian reais)

(Translation of the report originally issued in Portuguese.

See Note 24 to the quarterly report.)

A S S E T S

|                                   | Notes | Company          |                   | Consolidated     |                   |
|-----------------------------------|-------|------------------|-------------------|------------------|-------------------|
|                                   |       | June 30,<br>2001 | March 31,<br>2001 | June 30,<br>2001 | March 31,<br>2001 |
| CURRENT ASSETS                    |       | 98,016           | 242,145           | 3,773,394        | 3,535,608         |
|                                   |       | -----            | -----             | -----            | -----             |
| Cash and cash equivalents         | 9     | 16,097           | 16,534            | 398,066          | 390,739           |
| Trade accounts receivable, net    | 10    | -                | -                 | 2,587,443        | 2,497,936         |
| Deferred and recoverable taxes    | 11    | 36,667           | 36,662            | 593,958          | 456,523           |
| Dividends and interest on capital | 19    | 45,252           | 188,911           | -                | -                 |
| Other current assets              |       | -                | 38                | 193,927          | 190,410           |
| NONCURRENT ASSETS                 |       | 12,516           | 12,506            | 650,390          | 670,631           |
|                                   |       | -----            | -----             | -----            | -----             |
| Deferred and recoverable taxes    | 11    | -                | -                 | 251,547          | 300,555           |
| Legal deposits                    |       | 12,516           | 12,506            | 342,198          | 321,239           |
| Other noncurrent assets           |       | -                | -                 | 56,645           | 48,837            |
| PERMANENT ASSETS                  |       | 6,011,918        | 6,050,471         | 7,903,198        | 7,816,196         |
|                                   |       | -----            | -----             | -----            | -----             |
| Investments                       | 12    | 6,011,918        | 6,050,471         | 351,862          | 351,886           |
| Property, plant and equipment     | 13    | -                | -                 | 7,551,336        | 7,464,310         |
|                                   |       | -----            | -----             | -----            | -----             |
| Total assets                      |       | 6,122,450        | 6,305,122         | 12,326,982       | 12,022,435        |
|                                   |       | =====            | =====             | =====            | =====             |

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

EMBRATEL PARTICIPAÇÕES S.A.

BALANCE SHEETS AS OF JUNE 30, 2001 AND MARCH 31, 2001

(In thousands of Brazilian reais)

(Translation of the report originally issued in Portuguese.

See Note 24 to the quarterly report.)

LIABILITIES AND SHAREHOLDERS' EQUITY

|  | Notes | Company          |                   | Consolidated     |                   |
|--|-------|------------------|-------------------|------------------|-------------------|
|  |       | June 30,<br>2001 | March 31,<br>2001 | June 30,<br>2001 | March 31,<br>2001 |
| CURRENT LIABILITIES                        |       | 102,719          | 246,561           | 3,630,528        | 3,666,495         |
| Personnel, charges and social benefits     |       | 76               | 2                 | 126,092          | 108,576           |
| Accounts payable and accrued expenses      | 14    | 36,550           | 257               | 1,334,020        | 1,313,525         |
| Taxes and contributions                    | 15    | 42,459           | 42,440            | 529,907          | 567,189           |
| Dividends and interest payable on capital  | 19    | 8,061            | 14,940            | 6,411            | 15,064            |
| Proposed dividends and interest on capital | 19    | 15,563           | 188,911           | 17,378           | 191,440           |
| Loans and financing                        | 16    | -                | -                 | 1,293,689        | 1,184,301         |
| Provision for contingencies                | 17    | -                | -                 | 17,342           | 23,843            |
| Employees' profit sharing                  |       | -                | -                 | 27,572           | 39,865            |
| Pension plan - Telos                       | 18    | -                | -                 | 69,320           | 61,948            |
| Related party liabilities                  | 20    | 10               | -                 | 21,186           | 10,083            |
| Other current liabilities                  |       | -                | 11                | 187,611          | 150,661           |
| NONCURRENT LIABILITIES                     |       | 915              | 915               | 2,288,448        | 1,926,818         |
| Loans and financing                        | 16    | -                | -                 | 1,880,412        | 1,527,522         |
| Pension plan - Telos                       | 18    | -                | -                 | 190,293          | 201,218           |
| Taxes and contributions                    | 15    | -                | -                 | 216,828          | 197,163           |
| Sundry credits                             |       | 915              | 915               | 915              | 915               |
| DEFERRED INCOME                            |       | -                | -                 | 137,199          | 121,495           |
| MINORITY INTEREST                          |       | -                | -                 | 251,991          | 249,982           |
| SHAREHOLDERS' EQUITY                       | 19    | 6,018,816        | 6,057,646         | 6,018,816        | 6,057,645         |
| Capital stock - paid-in                    |       | 2,273,913        | 2,134,427         | 2,273,913        | 2,134,427         |
| Income reserves                            |       | 1,912,114        | 1,912,114         | 1,912,114        | 1,921,028         |
| Treasury share                             |       | (41,101)         | (41,101)          | (41,101)         | (41,101)          |
| Retained earnings                          |       | 1,873,890        | 2,052,206         | 1,873,890        | 2,043,291         |
| Total liabilities and shareholders' equity |       | 6,122,450        | 6,305,122         | 12,326,982       | 12,022,435        |

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

EMBRATEL PARTICIPAÇÕES S.A.

STATEMENTS OF INCOME

FOR THE SEMESTERS ENDED JUNE 30, 2001 AND 2000

(In thousands of Brazilian reais, except for net earnings (loss) per thousand shares)

(Translation of the report originally issued in Portuguese.  
See Note 24 to the quarterly report.)

|  | Notes | Company     |             | Consolidated |             |
|--|-------|-------------|-------------|--------------|-------------|
|  |       | June 30     |             | June 30      |             |
|  |       | 2001        | 2000        | 2001         | 2000        |
| <b>GROSS OPERATING REVENUE:</b>                          |       |             |             |              |             |
| Telecommunications services                              |       | -           | -           | 5,013,804    | 4,140,353   |
| Gross revenue deductions                                 |       | -           | -           | (1,310,598)  | (1,029,221) |
|  |       | -----       | -----       | -----        | -----       |
| Net operating revenue                                    | 5     | -           | -           | 3,703,206    | 3,111,132   |
| Cost of services   | 6     | -           | -           | (2,447,796)  | (2,082,964) |
|  |       | -----       | -----       | -----        | -----       |
| <b>GROSS PROFIT</b>                                      |       | -           | -           | 1,255,410    | 1,028,168   |
|  |       | -----       | -----       | -----        | -----       |
| <b>OPERATING REVENUES (EXPENSES)</b>                     |       | (64,443)    | 274,573     | (941,126)    | (567,410)   |
|  |       | -----       | -----       | -----        | -----       |
| Commercialization of services                            |       | -           | -           | (522,858)    | (252,663)   |
| General and administrative                               |       | (1,609)     | (1,639)     | (432,252)    | (301,239)   |
| Other operating revenue (expenses)                       |       | -           | (140)       | 13,984       | (13,508)    |
| Equity method results                                    |       | (62,834)    | 276,352     | -            | -           |
|  |       | -----       | -----       | -----        | -----       |
| <b>OPERATING INCOME (LOSS) BEFORE INTEREST</b>           |       | (64,443)    | 274,573     | 314,284      | 460,758     |
|  |       | -----       | -----       | -----        | -----       |
| Interest income (expense)                                | 7     | 810         | (994)       | (361,427)    | (24,673)    |
|  |       | -----       | -----       | -----        | -----       |
| <b>OPERATING INCOME (LOSS)</b>                           |       | (63,633)    | 273,579     | (47,143)     | 436,085     |
|  |       | -----       | -----       | -----        | -----       |
| Nonoperating income (expense)                            |       | (29)        | -           | (7,179)      | 11,885      |
|  |       | -----       | -----       | -----        | -----       |
| <b>NET INCOME (LOSS) BEFORE TAXES AND PARTICIPATIONS</b> |       | (63,662)    | 273,579     | (54,322)     | 447,970     |
|  |       | -----       | -----       | -----        | -----       |
| Income tax and social contribution on profits            | 8     | -           | -           | 8,859        | (155,644)   |
| Employees' profit share                                  |       | -           | -           | (23,115)     | (15,420)    |
| Minority interest  |       | -           | -           | (3,998)      | (3,436)     |
|  |       | -----       | -----       | -----        | -----       |
| <b>NET INCOME (LOSS) FOR THE YEAR</b>                    |       | (63,662)    | 273,579     | (72,576)     | 273,470     |
|  |       | =====       | =====       | =====        | =====       |
| <b>QUANTITY OF OUTSTANDING SHARES<br/>(IN THOUSANDS)</b> |       | 332,932,361 | 332,915,828 | 332,932,361  | 332,915,828 |
|  |       | =====       | =====       | =====        | =====       |
| <b>NET EARNINGS (LOSS) PER THOUSAND SHARES</b>           |       | (0.19)      | 0.82        | (0.22)       | 0.82        |
|  |       | ===         | ===         | ===          | ===         |

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

# EMBRATEL PARTICIPAÇÕES S.A.

## NOTES TO THE FINANCIAL STATEMENTS

### AS OF AND FOR THE SECOND QUARTER OF 2001

(In thousands of Brazilian reais, except as indicated)

(Translation of the report originally issued in Portuguese.  
See Note 24 to the quarterly report.)

#### 1. OPERATIONAL OVERVIEW

Embratel Participações S.A. was incorporated in accordance with article 189 of Law no. 9,472/97 - General Telecommunications Law - based on Decree no. 2,546 of April 14, 1998. The Company resulted from the spin-off from Telecomunicações Brasileiras S.A. - Telebrás, as approved at the May 22, 1998 Shareholders' General Meeting. The spin-off was based on an appraisal report as of February 28, 1998.

The Federal Government sold its interest of 19.26% in Embratel Participações S.A., at a public auction at the Rio de Janeiro Stock Exchange held on July 29, 1998, to Startel Participações Ltda. (WorldCom).

Embratel Participações S.A. holds 98.8% of the capital of Empresa Brasileira de Telecomunicações S.A. - Embratel. Embratel provides international and domestic long-distance telecommunications services in Brazil, under the terms of the concession authorized by the Federal Government, which will expire on December 31, 2005, and may be renewed for an additional 20-year term.

The businesses of the subsidiary companies, Empresa Brasileira de Telecomunicações - Embratel and Star One S.A., including the services rendered and the tariffs charged, are regulated by Agência Nacional de Telecomunicações (Anatel), the regulatory authority for the Brazilian telecommunications industry, pursuant to Law no. 9,472, of July 16, 1997 and related regulations, decrees, decisions and plans.

#### 2. PRESENTATION OF FINANCIAL STATEMENTS

The individual and consolidated financial statements as of June 30, 2001 were prepared in accordance with accounting practices established by the Brazilian corporate law, instructions applicable to telecommunications concessionaires and rules and accounting procedures established by the Brazilian Securities Commission (CVM - Comissão de Valores Mobiliários).

### 3. SUMMARY OF PRINCIPAL ACCOUNTING PRACTICES

#### a. Cash and Cash Equivalents

Cash and cash equivalents are highly liquid temporary investments which will be maintained until their maturity dates and are recorded at cost, plus interest earned through the balance sheet date, limited to market value, when applicable.

#### b. Trade Accounts Receivable, net

Trade Accounts Receivable refer, primarily, to the amounts receivable from long distance national and international telecommunication services, billed and/or unbilled at the closing dates of the financial statements, through operating telecommunications companies. Trade accounts receivable also include billings to customers for services related to data and other services.

Allowances for doubtful accounts are accrued for receivables for which recoverability is considered doubtful.

#### c. Foreign Currency Transactions

Assets and liabilities in foreign currency are stated at the exchange rate prevailing at the closing dates of the financial statements. Exchange gains or losses are recorded in the income statement, classified as Interest Income (Expense) when incurred. The effects of exchange rate differences are detailed in Note 7.

#### d. Investments

Investments in subsidiaries and Intelsat international satellite consortium are recorded under the equity method, recognizing the exchange variations as incurred. Other investments are recorded at cost less a provision for losses, when applicable.

#### e. Property, Plant and Equipment

Property, plant and equipment are recorded at cost of acquisition and/or construction, less the accumulated depreciation, monetarily restated up to December 31, 1995.

The current annual depreciation rates used are calculated on the straight-line method based on the expected useful life of the assets. The main rates used are shown in Note 13.

Expenses for maintenance and repair are expensed as incurred. Expenditures for betterment to fixed assets (which increase the utility of the asset or extend the physical life) are capitalized. The financial charges arising from financing of construction in progress are recorded in Property, Plant and Equipment.

#### f. Income Tax and Social Contribution

The corporate income tax and social contribution on net income are recorded on an accrual basis. Deferred taxes are provided on temporary differences, as described in Notes 8, 11 and 15.

#### g. Provision for Contingencies

Provision for contingencies are updated through the closing dates of the financial statements based on the probable loss, according to the nature of each contingency. The basis and nature of the provisions are described in Note 17.

#### h. Pension Plan - Telos

The subsidiary Embratel sponsors a separate entity that provides pensions and other post-retirement benefits for its employees (Note 18). Contributions for the defined benefit plan and defined contribution plan are recorded on an accrual basis. Contributions for the defined benefit plan are actuarially determined.

#### i. Deferred Income

This amount is related to the sale of the rights of ways primarily for optical fiber cables to Brazilian telecommunications companies and other international companies with activities in the Mercosul region, and is reflected in results according to the terms of the contracts.

#### j. Revenue Recognition

Revenues from services are recognized using the accrual method of accounting, after deducting an estimate for billing errors or disputes. Revenues from international services also include revenues earned under bilateral agreements between the subsidiary Embratel and overseas telecommunications companies. These agreements govern tariffs paid by the subsidiary to the foreign entities for the use of their facilities in connecting international calls billed outside Brazil. Revenues from international calls are recognized monthly as they are made, net of the cost of services rendered by overseas telecommunications companies.

#### k. Interest Income (Expense)

This represents interest and monetary and exchange variations resulting from financial applications and loans and financing obtained, which are recognized on an accrual basis.

## I. Employees' Profit Sharing

The subsidiary Embratel has provided for employee's profit sharing, payment of which is subject to approval by the Shareholders' General Meeting.

### m. Net Earnings (Loss) per Thousand Shares

Net earnings (loss) per thousand shares are calculated based on the number of shares outstanding at the balance sheet date.

## 4. CONSOLIDATION PROCEDURES

For consolidation purposes, intercompany balances and transactions were eliminated, including items such as intercompany investments, unrealized profits, when applicable, equity adjustments, intercompany income and expense accounts and intercompany balances under short and long-term assets and liabilities. The intercompany investments were eliminated against the respective intercompany shareholders' equity. Minority interests in the results and shareholders' equity are also separately reported.

The consolidated financial statements as of June 30, 2001 and March 31, 2001 include the financial statements of Embratel Participações S.A. and of its subsidiaries, directly or indirectly, as follows:

|  | Direct and/or indirect<br>participation (%) |
|--|---|
|  | June 30 and<br>March 31, 2001               |
|  | <u>Capital/voting sock</u>                  |
| Empresa Brasileira de Telecomunicações S.A. - Embratel | 98.8  |
| BrasilCenter Comunicações Ltda.                        | 100.0                                       |
| Embratel Soluções Ltda.                                | 100.0                                       |
| Embratel Americas, Inc. (1)                            | 100.0                                       |
| Star One S.A. (2)                                      | 80.0  |
| Ponape Telecomunicações Ltda. (3)                      | 100.0                                       |
| Palau Telecomunicações Ltda. (4)                       | 100.0                                       |
| Embratel Clearinghouse Ltda. (5) (6)                   | 100.0                                       |
| Acessonet Ltda. (7)                                    | 100.0                                       |

(1) Started operations in May 2000.

(2) Started operations in November 2000.

(3) (4) and (5) Started operations in December 2000.

(6) Through April 02, 2001 this Company was known as Oroluk Telecomunicações Ltda. Its objectives are to provide services in the areas of (i) Data analysis and processing, (ii) collection, routing and distribution of signaling messages and (iii) installation, supervision, operation and maintenance of networks.

(7) Started operations in December 2000.

On March 29, 2001, the subsidiary Embratel merged Keshara Empreendimentos Ltda., a company controlling 100% of the capital stock of Acessonet Ltda., which provides access to internet, and Star Sat S.A., owner of 80% of Star One S.A. capital stock.

## 5. NET OPERATING REVENUE

|                             | Consolidated           |               |
|-----------------------------|------------------------|---------------|
|                             | Six-month period ended |               |
|                             | June 30, 2001          | June 30, 2000 |
| Voice-                      |                        |               |
| Domestic long-distance      | 2,239,675              | 1,757,737     |
| International long-distance | 455,914                | 492,962       |
|                             | -----                  | -----         |
|                             | 2,695,589              | 2,250,699     |
| Data                        | 894,432                | 748,004       |
| Other services              | 113,185                | 112,429       |
|                             | -----                  | -----         |
| Net operating revenue       | 3,703,206              | 3,111,132     |
|                             | =====                  | =====         |

## 6. COST OF SERVICES

|                            | Consolidated           |               |
|----------------------------|------------------------|---------------|
|                            | Six-month period ended |               |
|                            | June 30, 2001          | June 30, 2000 |
| Interconnection/facilities | (1,766,637)            | (1,507,983)   |
| Depreciation               | (447,054)              | (389,547)     |
| Personnel                  | (114,911)              | (106,621)     |
| Third-party services       | (77,367)               | (61,292)      |
| Other                      | (41,827)               | (17,521)      |
|                            | -----                  | -----         |
| Total                      | (2,447,796)            | (2,082,964)   |
|                            | =====                  | =====         |

The interconnection costs represent charges by the local fixed-line telephone companies for the use of private-circuit lines, and interconnection charges paid by the subsidiary Embratel to the three regional fixed-line companies in accordance with the regime for interconnection, under Resolution no. 33, effective since April 1, 1998.

## 7. INTEREST INCOME (EXPENSE)

|                                   | Company                |         |           | Consolidated |
|-----------------------------------|------------------------|---------|-----------|--------------|
|                                   | Six-month period ended |         |           | Six-month    |
|                                   | June 30                |         |           | period ended |
|                                   | 2001                   | 2000    | 2001      | June 30      |
|                                   |                        |         | 2000      |              |
| Interest income-                  |                        |         |           |              |
| Interest on temporary investments | 810                    | 202     | 38,511    | 67,103       |
| Monetary variation – credit       | -                      | 736     | 139       | 568          |
| Exchange variation – credit       | -                      | -       | (3,142)   | (1,216)      |
|                                   | -----                  | -----   | -----     | -----        |
| Subtotal                          | 810                    | 938     | 35,508    | 66,455       |
|                                   | -----                  | -----   | -----     | -----        |
| Interest expenses-                |                        |         |           |              |
| Interest charges                  | -                      | -       | (136,857) | (75,350)     |
| Monetary variation – charge       | -                      | (1,932) | (12,001)  | (20,137)     |
| Exchange variation – charge       | -                      | -       | (248,077) | 4,359        |
|                                   | -----                  | -----   | -----     | -----        |
| Subtotal                          | -                      | (1,932) | (396,935) | (91,128)     |
|                                   | -----                  | -----   | -----     | -----        |
| Total                             | 810                    | (994)   | (361,427) | (24,673)     |
|                                   | ===                    | =====   | =====     | =====        |

In the first semester of 2001, the Brazilian real devalued by 17.87% against to the US dollar, resulting in an exchange variation expense in the amount of R\$248,077 in the period, net of gains from hedge contracts.

## 8. INCOME TAX AND SOCIAL CONTRIBUTION

The Company and its subsidiaries accrue the income tax (IRPJ) and social contribution on profits (CSSL) on a monthly basis paying such taxes on monthly estimates of taxable income based on the related interim financial statements as provided for in the current tax legislation. The amounts of the prepaid Income Tax and Social Contribution are recorded as Income Tax - Estimated and Social Contribution - Estimated, and are shown as a deduction from the taxes payable (see Note 15).

Tax legislation introduced in 1995 (Law no. 8,981) limited the offset of accumulated tax losses and negative calculation basis for social contribution on profits to 30% (thirty percent) of taxable income produced in each fiscal period. On June 30, 2001, the subsidiary Embratel had R\$134,130 of tax losses and R\$22,839 of negative basis of social contribution available for offset against future taxable income (on June 30, 2000 - R\$80,955 tax losses and R\$161,127 negative basis of social contribution).

## 8.1 - Income Tax and Social Contribution Income (Expenses)

The income tax and social contribution expense is comprised of current expense of the year computed in accordance with current tax legislation, and of deferred expense, corresponding to the effects of the taxes on the temporary differences originated or realized in the year. The deferred income tax and social contribution for the semester ended June 30, 2001 and 2000 totals R\$19,015 and (R\$9,345) respectively, and were calculated on the allowance for doubtful accounts, accelerated depreciation, tax losses, temporarily nondeductible taxes, and other temporarily taxable and deductible revenues and expenses.

### Composition of Income Tax and Social Contribution Income (Expenses)

|  | Consolidated                      |           |
|--|-----------------------------------|-----------|
|  | Six-month period<br>ended June 30 |           |
|  | 2001                              | 2000      |
| Current-                                 |                                   |           |
| Social contribution                      | (2,692)                           | (38,733)  |
| Income tax                               | (7,464)                           | (107,566) |
|  | -----                             | -----     |
| Total current expenses                   | (10,156)                          | (146,299) |
|  | -----                             | -----     |
| Deferred-                                |                                   |           |
| Social contribution                      | 6,703                             | 2,329     |
| Income tax                               | 12,312                            | (11,674)  |
|  | -----                             | -----     |
| Total deferred income (expenses)         | 19,015                            | (9,345)   |
|  | -----                             | -----     |
| Total income tax and social contribution | 8,859                             | (155,644) |
|  | =====                             | =====     |

## 8.2 - Reconciliation of Tax Income (Expenses) with the Nominal Rates

The reconciliation between the income tax and the social contribution, calculated based on the nominal tax rates, and the amounts recorded as expense/income for income tax and social contribution is shown below:

|   | Consolidated           |               |
|---|------------------------|---------------|
|   | Six-month period ended |               |
|   | June 30, 2001          | June 30, 2000 |
| Income before taxes and participation   | (54,322)               | 447,970       |
| Employee's profit sharing   | (23,115)               | (15,420)      |
|   | -----                  | -----         |
| Net income (loss) before taxes  | (77,437)               | 432,550       |
| <br>  |                        |               |
| Social contribution expense at nominal rate                                     | 6,969                  | (41,887)      |
| Rate adjustment to obtain the effective rate-                                   |                        |               |
| Rate adjustment from 12% to 9%  | -                      | (5,138)       |
| Social contribution credit constitution over the<br>exempt international income | 2,261                  | 16,187        |
| Undeductible financial charges  | (2,480)                | -             |
| Permanent additions and deductions  | (2,739)                | (5,566)       |
|   | -----                  | -----         |
| Social contribution benefit (expense) on<br>income statement                    | 4,011                  | (36,404)      |
|   | -----                  | -----         |
| Income tax expense at the nominal rate – 25%                                    | 19,359                 | (111,993)     |
| Rate adjustment to obtain the effective rate-                                   |                        |               |
| Undeductible financial charges  | (6,890)                | -             |
| Permanent additions and deductions  | (7,621)                | (7,247)       |
|   | -----                  | -----         |
| Corporate income tax credit (expense) on<br>statement of income                 | 4,848                  | (119,240)     |
|   | -----                  | -----         |
| Total (corporate income tax + social contribution)                              | 8,859                  | (155,644)     |
|   | =====                  | =====         |

The provision for income tax was accrued based on taxable income at the rate of 15%, plus the additional 10% foreseen in the law. The social contribution was calculated at the rate of 12% until January 2000 (alteration established in Normative Instruction 81/99, of June 30, 1999), and 9% starting February 2000 (alteration in accordance with Provisional Measure 1991-12 of December 14, 1999).

## 9. CASH AND CASH EQUIVALENTS

|                                | Company       |                | Consolidated  |                |
|--------------------------------|---------------|----------------|---------------|----------------|
|                                | June 30, 2001 | March 31, 2001 | June 30, 2001 | March 31, 2001 |
| Cash and bank deposits         | 15,483        | 15,744         | 72,206        | 110,195        |
| Foreign short-term investments | -             | -              | 89,526        | 101,105        |
| Marketable securities          | 614           | 790            | 236,334       | 179,439        |
|                                | -----         | -----          | -----         | -----          |
| Total                          | 16,097        | 16,534         | 398,066       | 390,739        |
|                                | =====         | =====          | =====         | =====          |

Marketable securities are represented, primarily, by fixed income bonds. The investments abroad are funded from mutual traffic revenues received from international operators and invested in short-term financial applications.

#### 10. TRADE ACCOUNTS RECEIVABLE

|                                 | Consolidated     |                   |
|---------------------------------|------------------|-------------------|
|                                 | June 30,<br>2001 | March 31,<br>2001 |
| National entities/clients       | 3,130,262        | 2,888,700         |
| Foreign administrators          | 281,787          | 272,961           |
|                                 | -----            | -----             |
| Subtotal                        | 3,412,049        | 3,161,661         |
| Allowance for doubtful accounts | (824,606)        | (663,725)         |
|                                 | -----            | -----             |
| Total                           | 2,587,443        | 2,497,936         |
|                                 | =====            | =====             |

#### 11. DEFERRED AND RECOVERABLE TAXES

|  | Company          |                   | Consolidated     |                  |
|--|------------------|-------------------|------------------|------------------|
|  | June 30,<br>2001 | March 31,<br>2001 | June 30,<br>2001 | March 31<br>2001 |
| Income tax withheld at source                            | 34,682           | 34,677            | 39,661           | 35,243           |
| Recoverable income tax/social contribution               | 113              | 113               | 2,210            | 5,668            |
| Deferred tax assets-                                     |                  |                   |                  |                  |
| Provision for write-off of property, plant and equipment | -                | -                 | 22,443           | 27,238           |
| Accelerated depreciation                                 | -                | -                 | 44,015           | 68,692           |
| Tax losses   | -                | -                 | 33,582           | 43,256           |
| Allowance for doubtful accounts                          | -                | -                 | 279,752          | 225,360          |
| Cofins/PIS – temporarily nondeductible                   | 1,872            | 1,872             | 89,263           | 85,928           |
| Goodwill on the acquisition of investments               | -                | -                 | 40,761           | 42,708           |
| Other deferred taxes (provisions)                        | -                | -                 | 119,101          | 93,191           |
| ICMS   | -                | -                 | 125,086          | 81,486           |
| Other  | -                | -                 | 49,631           | 48,308           |
|  | -----            | -----             | -----            | -----            |
| Total  | 36,667           | 36,662            | 845,505          | 757,078          |
|  | =====            | =====             | =====            | =====            |
| Current  | 36,667           | 36,662            | 593,958          | 456,523          |
|  | =====            | =====             | =====            | =====            |
| Noncurrent   | -                | -                 | 251,547          | 300,555          |
|  | =====            | =====             | =====            | =====            |

As part of the agreement for the admission of the new partner in subsidiary Star One S.A., in January 2001, SES Participações Ltda. (the new partner's Brazilian subsidiary) was merged into that subsidiary. The goodwill arising on acquisition of investments refers to the Deferred Income Tax and Social Contribution credits, in the amount of R\$40,761 as of June 30, 2001 (R\$42,708 as of March 31, 2001) resulting from that merger.

## 12. INVESTMENTS

|   | Company          |                   |
|---|------------------|-------------------|
|   | June 30,<br>2001 | March 31,<br>2001 |
| Investments - at equity-                    |                  |                   |
| Empresa Brasileira de Telecomunicações S.A. | 6,011,875        | 6,050,439         |
| Embratel Soluções Ltda.                     | 62               | 51                |
| Ponape Telecomunicações Ltda.               | 10               | 10                |
| Negative goodwill on purchase of stock      | (29)             | (29)              |
|   | -----            | -----             |
| Total                                       | 6,011,918        | 6,050,471         |
|   | =====            | =====             |

The consolidated investment balances on June 30, 2001 and March 31, 2001, of R\$351,862 and R\$351,886, respectively, refer substantially to interest in international joint ventures.

## 13. PROPERTY, PLANT AND EQUIPMENT

|                          | Annual<br>depreciation<br>rates (%) | Consolidated  |                             |                   |
|--------------------------|-------------------------------------|---------------|-----------------------------|-------------------|
|                          |                                     | June 30, 2001 |                             | March 31,<br>2001 |
|                          |                                     | Cost          | Accumulated<br>depreciation | Net book<br>value |
| Construction in progress | -                                   | 1,545,207     | 1,545,207                   | 1,369,673         |
| Switching equipment      | 7.69                                | 1,304,838     | (600,476)                   | 704,362           |
| Transmission equipment   | 10.00 to 20.00                      | 7,015,544     | (3,084,237)                 | 3,931,307         |
| Buildings and ducts      | 4.00                                | 1,239,042     | (579,209)                   | 659,833           |
| Other assets             | 5.00 to 20.00 (*)                   | 1,526,137     | (815,510)                   | 710,627           |
|                          |                                     | -----         | -----                       | -----             |
| Total                    |                                     | 12,630,768    | (5,079,432)                 | 7,551,336         |
|                          |                                     | =====         | =====                       | =====             |

(\*) Except for land, which on June 30, 2001 and March 31, 2001 amount to R\$165,959 and R\$165.528, respectively.

Fully depreciated assets on June 30, 2001 and March 31, 2001 amount to R\$1,634,457 and R\$1,587,223, respectively.

#### 14. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

|                                     | Consolidated     |                   |
|-------------------------------------|------------------|-------------------|
|                                     | June 30,<br>2001 | March 31,<br>2001 |
| Suppliers                           | 957,351          | 949,546           |
| Foreign companies                   | 289,883          | 256,495           |
| Consignment for third-parties/other | 86,786           | 107,484           |
|                                     | -----            | -----             |
| Total                               | 1,334,020        | 1,313,525         |
|                                     | =====            | =====             |

#### 15. TAXES AND CONTRIBUTIONS

|   | Company          |                   | Consolidated     |                   |
|---|------------------|-------------------|------------------|-------------------|
|   | June 30,<br>2001 | March 31,<br>2001 | June 30,<br>2001 | March 31,<br>2001 |
| Indirect taxes-   |                  |                   |                  |                   |
| ICMS  |                  | -                 | 116,866          | 190,858           |
| PIS/Cofins  | 12,522           | 12,503            | 47,504           | 48,602            |
| PIS/Pasep - in suspension   |                  | -                 | 94,176           | 91,162            |
| Cofins - judicial deposit (increase of tax<br>rate from 2% to 3%) | -                | -                 | 174,049          | 154,036           |
| ISS   | -                | -                 | 5,218            | 4,479             |
| Other   | -                | -                 | 11,474           | 13,246            |
| Income taxes-   |                  |                   |                  |                   |
| Income tax on interest on capital                                 | 22,601           | 22,601            | 22,601           | 22,601            |
| Income tax in suspension - Federal<br>Senate Resolution no. 82/92 | -                | -                 | 175,623          | 170,166           |
| Income tax - estimate   | 7,336            | 7,336             | 41,200           | 18,120            |
| Social contribution - estimate                                    | -                | -                 | 12,001           | 4,123             |
| Deferred taxes - liabilities-                                     |                  |                   |                  |                   |
| Law no. 8,200/91 - supplementary<br>monetary restatement          | -                | -                 | 46,023           | 46,959            |
|   | -----            | -----             | -----            | -----             |
| Total   | 42,459           | 42,440            | 746,735          | 764,352           |
|   | =====            | =====             | =====            | =====             |
| Current   | 42,459           | 42,440            | 529,907          | 567,189           |
|   | =====            | =====             | =====            | =====             |
| Noncurrent  | -                | -                 | 216,828          | 197,163           |
|   | =====            | =====             | =====            | =====             |

## 16. LOANS AND FINANCING

|                        | Consolidated     |          |                   |           |
|------------------------|------------------|----------|-------------------|-----------|
|                        | June 30,<br>2001 |          | March 31,<br>2001 |           |
|                        | Principal        | Interest | Total             | Total     |
| Financial Institutions | 3,046,003        | 64,475   | 3,110,478         | 2,643,586 |
| Suppliers              | 62,016           | 1,607    | 63,623            | 68,237    |
|                        | -----            | -----    | -----             | -----     |
| Total                  | 3,108,019        | 66,082   | 3,174,101         | 2,711,823 |
|                        | =====            | =====    | =====             | =====     |
| Current                | 1,227,607        | 66,082   | 1,293,689         | 1,184,301 |
|                        | =====            | =====    | =====             | =====     |
| Noncurrent             | 1,880,412        |          | 1,880,412         | 1,527,522 |
|                        | =====            |          | =====             | =====     |

The loans and financing with financial institutions were primarily denominated in foreign currency. The average effective interest rate ("all in") of the total debt is equivalent to US dollars plus 9.30% per annum.

The suppliers' financing is foreign currency denominated and refers to purchases of materials and equipment used to enhance domestic and international telecommunication services.

### a. Mode/Objective

|                             | June 30,<br>2001 | March 31,<br>2001 |
|-----------------------------|------------------|-------------------|
| Local currency-             |                  |                   |
| Permanent assets financing- |                  |                   |
| Financial institutions      | 25,053           | 25,179            |
|                             | -----            | -----             |
| Total in local currency     | 25,053           | 25,179            |
|                             | =====            | =====             |
| Foreign currency-           |                  |                   |
| Working capital             | 1,607,752        | 1,204,649         |
| Permanent assets financing- |                  |                   |
| Financial institutions      | 1,476,931        | 1,413,759         |
| Suppliers                   | 64,365           | 68,236            |
|                             | -----            | -----             |
| Total in foreign currency   | 3,149,048        | 2,686,644         |
|                             | =====            | =====             |

## b. Repayment Schedule

Noncurrent debt is scheduled to be repaid as follows:

| Year           | June 30,<br>2001 | March 31,<br>2001 |
|----------------|------------------|-------------------|
| 2002           | 270,937          | 333,698           |
| 2003           | 471,390          | 305,939           |
| 2004           | 505,788          | 292,115           |
| 2005 and after | 632,297          | 595,770           |
|                | -----            | -----             |
| Total          | 1,880,412        | 1,527,522         |
|                | =====            | =====             |

## c. Breakdown by Currency

| Up-dated by  | Exchange rate as of<br>June 30, 2001<br>(in R\$) | June 30,<br>2001 | March 31,<br>2001 |
|--------------|--|------------------|-------------------|
| Real         | -  | 25,053           | 25,179            |
| US Dollar    | 2.304900   | 2,322,877        | 2,179,884         |
| French-Franc | 0.299350   | 171,057          | 181,004           |
| German Marc  | 1.003980   | 10,891           | 11,468            |
| Japanese Yen | 0.018482   | 644,223          | 314,288           |
|              |  | -----            | -----             |
| Total        |  | 3,174,101        | 2,711,823         |
|              |  | =====            | =====             |

## d. Guarantees

Loans and financing operations are guaranteed primarily by promissory notes.

## 17. PROVISION FOR CONTINGENCIES

In the normal course of business, the subsidiary Embratel is party to legal proceedings and potential discussions, including among others, labor, social security, tax, administrative and civil issues.

A significant portion of the contingencies discussed below involve complex issues, with unique characteristics applying either to Embratel itself or the telecommunications industry, and arise from different interpretations of the laws in effect, which are not yet covered by consolidated jurisprudence.

It should also be noted that most issues discussed below result from procedures followed prior to the Company's privatization, based on instructions issued by government entities at the time.

Based on the facts currently available and on the legal advisors' opinion, Embratel's Management believes that the outcome of a significant portion of present and future claims will be favorable to the Company.

Details of the key legal disputes currently in progress are described below:

a. Labor Claims

The provision for loss on labor claims amounted to R\$17,342 on June 30, 2001 (R\$23,843 on March 31, 2001). Such amount represents Management's estimate, based on legal advice of probable loss on numerous suits filed by current and former employees.

b. Tax Contingencies

b.1 - Withholding Income Tax on Remittances to Foreign Telecommunications Companies

The subsidiary Embratel regularly makes payments to foreign telecommunications companies to complete international calls that originate in Brazil and terminate in a foreign country (outbound traffic). The Brazilian income tax law generally requires Brazilian recipients of services from foreign companies to withhold 25% from payments to such foreign companies for such services. However, based on decisions in 1952 and 1953, of both the Brazilian Finance Ministry and the Taxpayers' Council, the Company has never withheld Brazilian income tax from such payments.

In addition, the International Telecommunications Convention of Nairobi, Kenya (Nairobi Treaty), dated November 6, 1982, is in force in Brazil, having been approved by Decree Law no. 55, of October 4, 1989, ratified by Presidential letter of January 21, 1990, and promulgated by Presidential Decree no. 70, of March 26, 1991. As a result, the subsidiary Embratel is required to comply with the Administrative Regulation of the International Telecommunication Union (ITU), of which Brazil is a member. Accordingly, Management believes that the subsidiary Embratel is under no obligation to withhold income tax on the remittances abroad to telephone operators for payment of international calls originating from Brazil, as established in the International Telecommunications Regulations approved in Melbourne, Australia, on December 9, 1988.

On February 8, 1999, the Company made a formal consultation on the matter to the Brazilian Income Tax authorities. In their September 3, 1999 reply, the tax authorities claimed that the exemption from the withholding income tax on remittances abroad is applicable only as from October 19, 1998, based on Decree no. 2,962/99, which approved the Constitution and Convention of the ITU. In their reply, the tax authorities also recognized that the withholding income tax on remittances made by the Company to foreign telecommunication operators should comply with article 7 of the OECD Model. These guidelines are followed by Brazil for bilateral treaties on avoidance of double taxation, wherever doing so does not result in breaches of specific treaties or of additional protocol.

The Company decided to request a writ of mandamus from the 14<sup>th</sup> Federal Court of Rio de Janeiro, and, on September 30, 1999, obtained a preliminary court decision suspending the ability of the tax authorities to demand payment of the tax which is the subject of the above-mentioned consultation.

On December 23, 1999, the Federal Revenue Agency assessed the Company in the amount of R\$410,697 for not withholding the 25% income tax on payments made from December 1994 to October 1998. Such taxation did not take into consideration the analysis of bilateral double taxation treaties, which was specifically mentioned in the income tax authorities response to the formal consultation made. The Company also challenged this assessment and submitted its administrative defense, which is being analyzed by the tax authorities.

The Federal Union appealed the decision of the 14<sup>th</sup> Federal Court and, on April 10, 2000, the 2<sup>nd</sup> Federal Region suspended the effects of the above-mentioned court decision, which was confirmed by the Federal Authorities.

In relation to the main proceedings, where the litigation involves discussing the legitimacy of the request, the proceedings are concluded and awaiting sentence, to be issued by the Judge of the 14<sup>th</sup> Federal Court of Rio de Janeiro.

Responding to a request from the Ministry of Communications, the Federal Attorney General's Office issued on October 31, 2000, an expert opinion on the tax divergences in this matter and about income tax on inbound international revenues (item b.2 below). This opinion argues for the legitimacy of the payment and reflects the federal government's position, against the Company. However, the Company's Management and its legal counsel understand that this opinion does not introduce any new facts or arguments that could change the evaluation of the issue when the final decision is issued by the competent authorities.

Based on the understanding of the Company's Management and Legal Counsel, that consider the possibility of loss to be minimal, no loss provision was made in the financial statements with respect to this dispute.

#### b.2 - Income Tax on Inbound International Income

Based on its legal advisors' opinion, the subsidiary Embratel believes that the foreign operating income from telecommunications services (inbound traffic) is not subject to taxation, inasmuch as Law no. 9,249, of December 26, 1995, did not revoke the exemption established by specific legislation.

In connection with this matter, in late March 1999, the Federal Revenue Agency assessed the Company in the amount of R\$287,239 for failing to pay the related income tax for the years 1996 and 1997. In late April 1999, the subsidiary Embratel filed an administrative defense against this assessment which is pending judgement at the first level of the judicial system.

The Company, however, decided to pay such income tax for the period from August to December 1998, in the amount of R\$34,320 (including interest) and to continue paying such tax in the subsequent months until this issue is resolved. This practice avoids penalties and ensures the Company's right to claim, at the appropriate time, the amount of the taxes paid in excess. Such amount was paid in the first quarter of 1999 and recorded as an expense of that period.

On June 17, 1999, the Company was further assessed for nonpayment of income tax on net foreign source income for the year 1998 amounting to R\$64,396. The Company will continue paying income tax on the net foreign source income until the tax dispute is solved. The subsidiary Embratel also contested this assessment, filing an administrative defense, which was judged partially favorable due to the amount already paid as discussed above, and has appealed to the taxpayers' council, which, on July 12, 2000, ruled against the Company. Due to this decision, the Company appealed to the Higher Chamber on March 16, 2001.

The expert opinion of the Federal Attorney General's Office (Advocacia Geral da União - AGU) issued on October 31, 2000 (refer to item b.1 above) also expresses the position of the executive branch of the federal government, against the Company's position. However, the Company's Management and their legal advisors understand that this opinion does not introduce any new facts or arguments of any nature that would alter the issue.

The Company's Management and its legal counsel consider that the probability of loss in this case is only reasonably possible and consequently no loss provision was recorded in the financial statements.

### b.3 - ICMS for Services Provided

Until the introduction of Complementary Law no. 87 of September 13, 1996 (Official Gazette of September 16, 1996), the Local Telecommunication Operating Companies invoiced and collected State Value-added Tax ("ICMS") on Fixed Line Telecommunication Services, on a reduced basis equivalent to an effective rate of 13%, in accordance with ICMS Convention no. 27, of March 29, 1994.

With the above-mentioned Complementary Law entering into effect on September 16, 1996, the telecommunications operating companies of the Telebrás System were instructed by Telebrás to no longer invoice and collect such tax on international outbound telephone traffic.

Currently, certain state tax authorities are fining local telecommunications carriers for non-payment of ICMS related to international traffic.

The subsidiary Embratel received a number of fines for non-payment of ICMS for services provided, including international services and others, also considered by the Company as exempt or non-taxable. The Company's Management, based on the facts currently available, considered the probability of loss on this issue to be remote. The fines concerning facts that may lead to losses, according to the legal counsel, represent a total of approximately R\$179 million as of June 30, 2001. As a result of this evaluation, no provision was recorded in the financial statements.

Currently, the subsidiary is participating in efforts to demonstrate the detrimental economic effects to the industry and to the States of any such tax being charged on the mentioned services.

### c - Other Taxes

The determination of the manner in which Federal, State and Municipal taxes apply to the operations of the Company is subject to several interpretations due to the unique nature of such operations. Management believes that its interpretation of the Company's tax obligations is substantially in compliance with the current legislation. Accordingly, any changes in the tax treatment of these operations will result in new legislation or interpretative rulings on the part of the tax authorities.

#### d. Contingencies Related to Anatel and the State Government of São Paulo

As a result of the inconveniences caused to the telephony system users by the telecommunications carriers, on July 3, 1999, the implementation date for the new national dialing system, Embratel was officially notified by Anatel about its responsibility in the above mentioned inconveniences.

Anatel established that Embratel would pay a fine related to the period when the carriers implemented the change in dialing codes.

The Company filed suit contesting the validity of the fine, and was granted a temporary injunction for non-payment of the fine and a favorable opinion from Public Ministry. Nevertheless, on April 24, 2001, the first instance decision was announced, ordering the Company to pay the fine, but favoring the Company's request for lowering the amount to be paid from R\$55 million to R\$50 million. The Company will appeal against this decision and will try to obtain judicial instruments which may guarantee the non-payment of the fine while discussing this matter at the court of Justice.

Based on the same facts, the State of São Paulo and the Procon Foundation filed a public civil action at the 14<sup>th</sup> Court of Public Finances of the State of São Paulo. On March 30, 2000, a first instance decision was announced, ordering the Company and the local carrier to pay a fine of R\$30 million and to reimburse the users of telephony services in the State of São Paulo for the phone calls made from July 3 to 12, 1999. The Company appealed against this decision.

The Company's Management and its legal counsel consider that the probability of loss in these cases is only reasonably possible and consequently no loss provision was recorded in the financial statements.

#### 18. PENSION PLAN - TELOS

Telos - Fundação Embratel de Seguridade Social, a closed private pension entity, is a legal entity under private law, with the objectives of providing pensions, assistance and not-for-profit activities, with administrative and financial independence, based in Rio de Janeiro. The Company's subsidiary Embratel founded it on August 1, 1975.

Embratel sponsors two benefit plans: a defined benefit plan and a defined contribution plan, both managed by Telos. The rate of contribution to the first plan (the defined benefit plan) for the year of 2000, which is the same as that forecast for the year of 2001, is 19.8% of the active participants' salary.

Subsequent to the privatization, the subsidiary created a defined contribution plan, through Telos, which was reviewed and approved by the Brazilian Federal Government on November 19, 1998. All newly hired employees automatically adhere to the new plan, no further admittances to the defined benefit plan being allowed. For the defined contribution plan, the sponsor's contribution ranges from 3% to 8% of the participants' salary, in addition to the extraordinary contribution, foreseen in the plan's regulation, for financing administrative expenses, and the balance of the account designed for cases of incapacity and death.

On September 1, 1999, a statement of recognition, acknowledgement of debt, acceptance and amortization of actuarial insufficiency was signed between the subsidiary and Telos, and approved by Brazilian pensions regulator ("Secretaria de Previdência Complementar"). In accordance with this statement, the actuarial insufficiency recognized in favor of Telos will be paid over the next 20 years, based on the monthly flow of benefits to the employees covered by the defined contribution plan. The unamortized balance of the liability is increased monthly at the rate of remuneration of Telos assets. As of June 30, 2001, the outstanding balance payable to Telos amounts to R\$259,613 (R\$263,166 on March 31, 2001), which is not included in the total assets of the plans reported below.

As of June 30, 2001, Telos shows the following estimated balances (unaudited):

|                                     |           |
|-------------------------------------|-----------|
| Technical reserves-                 |           |
| Mathematical reserves               | 1,450,261 |
| Defined benefit plan-               |           |
| Benefits provided                   | 692,175   |
| Benefits to be provided             | 10,042    |
| Defined contribution plan-          |           |
| Benefits provided                   | 151,663   |
| Benefits to be provided             | 596,381   |
| Technical surplus                   | 12,848    |
|                                     | -----     |
| Total reserves                      | 1,463,109 |
|                                     | =====     |
| Assets of the plans-                |           |
| Fixed-income market                 | 1,132,142 |
| Variable-income market              | 251,899   |
| Real state market                   | 68,869    |
| Operations with participants        | 30,639    |
|                                     | -----     |
| Total assets of the plans           | 1,483,549 |
|                                     | =====     |
| Sponsor contributions in the period | 13,080    |
|                                     | =====     |

The above mentioned pension plans sponsored by the subsidiary Embratel represent the main post-employment benefits granted to employees.

Upon the issuance of CVM Deliberation number 371, on December 13, 2000 which approved the Ibracon pronouncement on accounting for employee benefits, new accounting guidelines were instituted for recording and disclosure of employee benefit plans. These guidelines are mandatory for all accounting periods starting on or after January 1, 2002. The effects of these new guidelines, if any, must be disclosed in the financial statements of the fiscal year ending December 31, 2001. The effects of applying these new guidelines must be recognized in the Company's financial statements. This may be done either as an adjustment to shareholder equity at December 31, 2001 on a prospective basis either over a five-year period, or, over the average period of service or the estimated remaining life of the employees, whichever is lower.

Considering the agreement signed with Telos on September 1, 1999 which acknowledged the pension liability and accepted the amortization of the actuarial deficiency, the Company does not believe that the compliance with the referred CVM Deliberation number 371 will have a material effect on the financial statements. Nevertheless, the Company, along with its actuaries, are examining this matter to determine whether there are effects resulting from it. As soon as this analysis is concluded, the Company will choose one of the above-referenced accounting alternatives to recognize this change.

## 19. SHAREHOLDERS' EQUITY

### a. Capital Stock

The authorized capital on June 30, 2001 and March 31, 2001 is comprised of 700 billion common or preferred shares. On May 28, 2001, the Shareholders' Meeting approved the increase of Capital Stock with Retained Earnings in the amount of R\$139,486 thousand, as required by article 199 of Law no. 6,404/76. The capital, subscribed and fully paid, amounts to R\$2,273,913 as of June 30, 2001. It is comprised of 334,399,028 thousand shares of no-par value, held (in-groups of one thousand shares) as follows: 124,369,031 common shares and 210,029,997 preferred shares. The book value per share (groups of one thousand shares, expressed in reais) as of June 30, 2001 and March 31, 2001, amounts to R\$18.00 and R\$18.12, respectively.

On June 29, 2001, Startel Participações Ltda., which held 19.3% of the Company's capital stock, transferred 2,350,575 ordinary shares (in thousands of shares) to a new shareholder, New Startel Participações Ltda., that now holds 0.7% of the Company's capital stock.

### b. Income Reserves

#### Legal Reserve

The constitution of this reserve is mandatorily based on 5% of net annual income up to the limit of 20% of the paid-in capital, or 30% of the capital stock taken together with capital reserves. After this limit, no further appropriation of this reserve is mandatory. The legal reserve may only be used for future capital increase or to offset accumulated deficits.

#### Unrealized Earnings Reserve

This reserve originates from the Telebrás spin-off (Note 1), and results from net gains on the monetary restatement of the balance sheet and from the equity pick up of investments. The reserve is realized when dividends are received from the subsidiaries, or to complement minimum dividends due to preferred shareholders.

### c. Treasury Shares

As of June 30, 2001, the Holding Company held 1,466,667 thousand, respectively, of its own preferred shares in treasury, at a weighted average cost, per thousand shares, expressed in reais, of R\$28.02.

During the first semester of 2001, the Company sold 13,333 thousand shares at an average price of R\$23.13 per lot of thousand shares, resulting in a discount of R\$65,000 charged to retained earnings

The sale of treasury shares was carried out privately to meet the requirements of the share purchase option plan (see Note 19.e), in conformity with CVM Authorization CVM/GEA no. 213/99.

#### d. Dividends

The preferred shares are non-voting, except under certain limited circumstances. They are entitled to a minimum non-cumulative dividend of 6% per annum on the amount resulting from the division of the subscribed capital by the number of shares of the Company, and have priority in relation to the common shares in the event of liquidation of the Company.

According to the Company's by-laws, dividends must be distributed for each fiscal year ended December 31. These dividends must be at least 25% of the adjusted net income. Dividends are calculated according to the Company's by-laws and in accordance with the corporate law. The proposed dividends are appropriated at year-end.

#### e. Stock Option Plan

The plan, approved at the Shareholders' General Meeting held on December 17, 1998, granted to the directors and employees the option of acquiring preferred shares in the proportion of 33% in each annual period, as from the granting date. The options must be exercised within 10 years of the grant date. The acquired shares will maintain all of the rights pertaining to the shares of equal class and type, including dividends. The summarized information on the plan is as follows:

|   |           |
|---|-----------|
| Number of preferred share purchase options (thousands of shares)-   |           |
| Options offered up to December 31, 1998   | 1,635,000 |
| Options offered in 1999   | 355,000   |
| Options exercised in 1999   | (173,333) |
| Options sold in 1999  | (9,000)   |
| Options cancelled in 1999   | (45,000)  |
|   | -----     |
| Open options as of December 31, 1999  | 1,762,667 |
|   |           |
| Options offered in 2000   | 2,048,265 |
| Options exercised in 2000   | (122,700) |
| Options sold in 2000  | (4,800)   |
| Options cancelled in 2000   | (130,000) |
|   | -----     |
| Open options as of December 31, 2000  | 3,553,432 |
| Options sold in 2001  | (13,333)  |
| Options cancelled in 2001   | (109,218) |
|   | -----     |
| Open options as of June 30, 2001  | 3,430,881 |
|   | =====     |
| Weighted average price of the purchase option updated to June 30, 2001,<br>based on IGP-M (per thousand shares, expressed in reais) - as follows- |           |
| Options granted in December, 1998   | 23.87     |
|   | =====     |
| Options granted in March, 1999  | 36.32     |
|   | =====     |
| Options granted in July, 1999   | 28.04     |
|   | =====     |
| Options granted in September, 1999  | 27.58     |
|   | =====     |

f. Reconciliation of Shareholders' Equity and  
Net Income of the Company to those  
of the Consolidated Financial Statements

As of June 30, 2001, the reconciliation between the Company's net loss for the period and net the Consolidated net loss is as follows:

|  | Net loss for<br>the six-month<br>period ended<br><u>June 30, 2001</u> | Net income for<br>the six-month<br>period ended<br><u>June 30, 2000</u> |
|--|---|---|
| Company  | (63,662)  | 273,579   |
|  | -----   | -----   |
| Deferred income - goodwill on subsidiary<br>Star One (note 11)   | (8,914)   | -   |
| Losses in subsidiaries BrasilCenter and Embratel Americas<br>(recorded directly to Shareholder's Equity in the Parent<br>Company Embratel) | -   | (109)   |
|  | -----   | -----   |
| Consolidated   | <u>(72,576)</u>   | <u>273,470</u>  |
|  | =====   | =====   |

## 20. TRANSACTIONS WITH RELATED PARTIES

After the privatization, the main transactions with related parties were carried out with WordCom, according to usual market conditions for these types of operations. Balances receivable and payable as of June 30, 2001 and March 31, 2001, resulting from such transactions are as follows:

|                                      | Company          |                   | Consolidated     |                   |
|--------------------------------------|------------------|-------------------|------------------|-------------------|
|                                      | June 30,<br>2001 | March 31,<br>2001 | June 30,<br>2001 | March 31,<br>2001 |
| <b>ASSETS:</b>                       |                  |                   |                  |                   |
| Current-                             |                  |                   |                  |                   |
| Foreign telecommunications operators | -                | -                 | 67,729           | 55,415            |
| Proposed dividends                   | 17,028           | 60,845            | -                | -                 |
| Interest on capital - Embratel       | 28,224           | 128,066           | -                | -                 |
| <b>LIABILITIES:</b>                  |                  |                   |                  |                   |
| Current-                             |                  |                   |                  |                   |
| Foreign telecommunications operators | -                | -                 | 48,542           | 30,129            |
| Interest on capital - Startel        | -                | 24,775            | -                | 24,775            |
| Proposed dividends - Startel         | -                | 11,771            | -                | 11,771            |
| Other liabilities                    | 10               | -                 | 21,186           | 10,083            |

Under the terms of the concession contract with Anatel and in accordance with the shareholders' approval on November 18, 1998, in the six-month periods ended June 30, 2001 and June 30, 2000, the amounts of R\$18,679 and R\$31,124, respectively, were charged to General and Administrative Expenses for consulting services rendered by WorldCom International, Inc., a subsidiary of WorldCom.

## 21. INSURANCE (UNAUDITED)

The Company's Management considers that all assets and responsibilities of relevant values and risks are covered by insurance policies.

## 22. FINANCIAL INSTRUMENTS

### a. Miscellaneous

The subsidiary Embratel carries out transactions with financial instruments designed to reduce the exposure to risks of fluctuation in currency and interest rates, which usually involve swap of indexes and/or earnings/interest rates of cash equivalents and marketable securities and loans. The management of such risks is conducted by means of operation strategies and determination of limits.

### b. Swap - Interest and Currency

The subsidiary Embratel used derivative operations to protect against the variation of foreign currency loan principal and interest against the Real. The par values of such operations, at the end of the first semester of 2001, totaled R\$1,052,131 (R\$796,039 in the first quarter) and were not recorded in the balance sheet.

The gains and losses on such operations result from differences of variations in contracted indices, and are recorded on an accrual basis under Financial Results.

### c. Criteria, Assumptions and Limitations in of the Market Value Calculation

Cash and Cash Equivalents, Trade Accounts  
Receivable and Accounts Payable - Current

The balances per books approximate market value because of the high turnover of these instruments.

Deferred Taxes - Assets and Liabilities

The market value was calculated through the discount of projected cash flows, indexed by the TJLP (a Brazilian benchmark long-term interest rate).

## Loans and Financing

The market value is calculated through the present value of the projected cash flows related to each instrument, using actual interest rates for similar instruments and maturity dates.

## Limitations

The market values are calculated on a specific date, based on relevant market information and financial instrument information. The changes in assumptions may significantly impact such estimates.

The financial instruments, including short-term amounts, which are recorded at amounts different from market values, are summarized below:

|                                | Consolidated  |              |
|--------------------------------|---------------|--------------|
|                                | June 30, 2001 |              |
|                                | Book value    | Market value |
| Deferred and recoverable taxes | 845,505       | 767,485      |
|                                | -----         | -----        |
| Assets                         | 845,505       | 767,485      |
|                                | =====         | =====        |
| Taxes and contributions        | 746,735       | 709,850      |
| Loans and financing            | 3,174,101     | 2,923,716    |
|                                | -----         | -----        |
| Liabilities                    | 3,920,836     | 3,633,566    |
|                                | =====         | =====        |

## 23. SUBSEQUENT EVENT

In the second semester of 2001, the subsidiary Acessionet Ltda. will be incorporated by the subsidiary Embratel. As of June 30, 2001, the subsidiary Acessionet Ltda. had unsecured liabilities in the amount of R\$19,521.

## 24. TRANSLATION OF THE REPORT ORIGINALLY ISSUED IN PORTUGUESE

The accompanying financial statements are presented on the basis of accounting practices established by the corporate law in Brazil. Certain accounting practices applied by the Company and its subsidiaries that conform with those accounting practices in Brazil may not conform with generally accepted accounting principles in other countries.

\* \* \* \* \*

## EMBRATEL PARTICIPAÇÕES S.A.

### COMMENTS ON THE CONSOLIDATED PERFORMANCE IN THE FIRST SEMESTER OF 2001 COMPARED TO THE MAIN VARIATIONS OCCURRED IN THE SAME PERIOD LAST YEAR

#### DATA AND INTERNET SERVICES

Second quarter data revenues rose 9 percent to R\$435 million compared to the same quarter of 2000. Lower data growth was mainly the result of the non-renewal of short-term wholesale leases to carriers. The devaluation of the Real, the slowdown of the economy and additional price reductions also impacted growth.

Wholesale leases represented 7 percent of total data revenues in the second quarter of 2001 compared to 15 percent in the same prior year quarter. We expect revenues from current contracts to decline throughout the year. The entrance of new telecommunications players next year could compensate some of these reductions.

Corporate data services revenue which includes corporate networks, frame relay services and Internet grew 21 percent when compared to the same quarter of the previous year. Core data services such as frame relay continue to show revenue growth and demand for data transmission by satellite remains strong. Internet revenues, which currently represent 30 percent of data revenues, grew more than 70 percent on an year-over-year basis. Data revenue growth has been pressured by price competition on broadband services to corporations in the busiest traffic routes of the country.

On an accumulated basis, data revenues reached R\$894 million representing a 20 percent growth from R\$748 million in the first half of 2000. Data now represents 24 percent of our net revenues.

Due to the decline in wholesale revenues, pricing pressures and the economic uncertainties associated with the energy crisis and the currency devaluation on the Brazilian economy, we now expect data growth to be within the 15-20 percent range.

#### DOMESTIC LONG DISTANCE VOICE SERVICES

Domestic long distance revenues rose to R\$1.1 billion in the second quarter of 2001 compared to R\$855 million in the second quarter of 2000, representing a strong 32 percent growth year-over-year. Growth in domestic long distance traffic, traffic mix, the discontinuation of some promotions and new alternative calling plans, which contributed to the increase in the average revenue per minute, were responsible for the increase.

Year-to-date, domestic long distance revenues were R\$2.2 billion, corresponding to a 27 percent increase when compared to the first half of 2000.

## INTERNATIONAL LONG DISTANCE VOICE SERVICES

International long distance revenues were R\$236 million, a 14 percent decrease compared to R\$274 million in the second quarter of 2000, primarily caused by lower outbound pricing in a more competitive market. Compared to the first quarter of 2001, revenues rose 7 percent as a result of the discontinuation of promotional pricing in the first quarter. International long distance revenues continue to be subject to price pressure and competition from illegal services.

On an accumulated basis, international long distance revenues were R\$456 million compared to R\$493 million in the first half of 2000.

## EBITDA

EBITDA reached R\$402 million compared to R\$443 million in the second quarter of 2000. EBITDA margin was 22 percent this quarter compared to 28 percent in the second quarter of 2000. In 2001, the Company absorbed the new regulatory taxes for universalization of services (FUST and FUNTTEL - approximately 1.5 percent of revenues). These were responsible for the increase in other cost of services and SG&A (excluding bad debt) to 22 percent of net revenues in the second quarter of 2001 from 21 percent in the equivalent quarter of the prior year. Cost control efforts enabled the Company to absorb these new taxes without raising these expenses in the same proportion. Provision for doubtful accounts was R\$160 million, representing 8.6 percent of net revenues (or 6.3 percent of gross revenues).

Year-to-date EBITDA was R\$824 million compared to R\$875 million in the same period a year ago. This decrease was mainly caused by additional taxes and increases in provision for doubtful accounts.

## NET INCOME

The net loss for the second quarter of 2001 was R\$39 million. The loss was created by the effect of the devaluation of the Real vis-a-vis the US dollar (6.6 percent in the quarter) on the Company's foreign currency debt (see Financial Position below).

On an accumulated basis, the net loss reached R\$73 million in the first half of 2001 compared to a net income of R\$273 million in the first half of 2000.

Excluding the effect of the devaluation of the Real and the foreign exchange losses (net of tax benefit), the net income for the second quarter would have been R\$28 million rather than a net loss of R\$39 million.

## FINANCIAL POSITION

Embratel Participações ended the quarter with a cash position of R\$398 million. Total debt outstanding as of June 30, 2001 was R\$3.2 billion. R\$1.3 billion corresponded to short term debt and current portion of long term debt. At the end of the quarter approximately R\$1.2 billion (notional amount) was hedged to the Real. These hedging transactions cover approximately 70 percent of the debt maturing in one year. The Company's policy is to hedge all new debt with maturity of less than three years. There was no change in the currency profile of the Company's debt during the quarter. The average interest on this debt is US dollar plus 9.3 percent p.a.. On June 30, 2001, Embratel's debt/equity ratio was 0.53.

Pre-tax negative foreign exchange variation on the Company's foreign exchange exposure was R\$160 million. This was offset by R\$58 million of gains from hedging transactions. Principal and interest maturing in the quarter was of approximately R\$201 million.

Since the beginning of 2001, of the total of R\$287 million (net of the hedge gains) of exchange variation losses arising from the devaluation of the currency R\$51 million was related to short-term debt and current portions of long-term debt. The remaining R\$236 million is related to long-term debt. Principal and interest paid in the past six months were R\$320 million.

## ACCOUNTS RECEIVABLES

The Company's net receivable position on June 30, 2001 was R\$2.6 billion. Gross receivables were R\$3.4 billion in the second quarter of 2001 compared to R\$3.2 billion in the first quarter of 2001. Accumulated provision for doubtful accounts was R\$825 million at the end of the second quarter of 2001.

Several actions taken by the Company to curb customer delinquency were delayed. Some, of the most effective measures, like sending non-payer names to credit scoring agencies, had to be halted due to unfavorable court decisions and reactions from, consumer protection agencies and the regulator. As a result, the Company does not expect to reduce the level of provisioning as fast as planned. Provisions for doubtful accounts will continue to remain at current levels for the remainder of the year. Embratel is following consumer behavior closely in order to detect whether current worsening of economic conditions may further impact delinquency levels.

The Company continues to pursue initiatives to improve the collections process.

## CAPITAL EXPENDITURES

During the second quarter, capital expenditures were R\$340 million. The breakout of this expenditure is the following: local infrastructure and access – 40 percent; data and Internet services – 19 percent; network infrastructure – 13 percent and others - 29 percent. The Company is monitoring capital expenditures closely to maintain capital expenditures within the planned amount of R\$1.5 billion despite the devaluation of the currency.

## PRICES

On June 25, 2001, tariff readjustments were authorized by Anatel. Domestic long distance tariffs rose 7 percent on average.

## CURRENT FINANCIAL GUIDANCE (FULL-YEAR 2001 GROWTH COMPARED TO 2000)

|                                 | Previous      | Current  |
|---------------------------------|---------------|--|
| Net DLD revenue                 | 10-15 percent | 10-15 percent  |
| Net ILD revenue                 | flat          | flat - (5 percent)   |
| Net Data revenue                | 20-35 percent | 15-20 percent (core<br>business 20-30 percent,<br>wholesale decline) |
| Net Total revenues              | 10-20 percent | 10-20 percent  |
| EBITDA margin                   | mid twenties  | low twenties   |
| Provision for doubtful accounts | 5-8 percent   | 8-9 percent  |

Embratel is the premier communications provider in Brazil offering a wide array of advanced communications services over its own state of the art network. It is the leading provider of data and Internet services in the country. Service offerings include: advanced voice, high-speed data communication services, Internet, satellite data communications and corporate networks. Embratel is uniquely positioned to be the all-distance telecommunications network of South America. The Company's network is has countrywide coverage with 28,388 km of fiber cables comprising 1,045,617 km of optic fibers.

\* \* \* \* \*

# STATEMENTS OF INCOME OF SUBSIDIARIES/AFFILIATES

## EMPRESA BRASILEIRA DE TELECOMUNICAÇÕES S.A. - EMBRATEL

### STATEMENTS OF INCOME

FOR THE SEMESTERS ENDED JUNE 30, 2001 AND JUNE 30, 2000

(In thousands of Brazilian reais, except for net earnings per thousand shares)

(Translation of the report originally issued in Portuguese.

See Note 24 to the financial statements.)

|  | June 30     |             |
|--|-------------|-------------|
|  | 2001        | 2000        |
| GROSS OPERATING REVENUE:                             |             |             |
| Telecommunications services                          | 5,013,804   | 4,140,353   |
| Gross revenue deductions                             | (1,310,598) | (1,029,122) |
|  | -----       | -----       |
| Net operating revenue                                | 3,703,206   | 3,111,231   |
| Cost of services                                     | (2,447,796) | (2,082,964) |
|  | -----       | -----       |
| GROSS PROFIT   | 1,255,410   | 1,028,267   |
|  | -----       | -----       |
| OPERATING REVENUES (EXPENSES)                        | (939,520)   | (565,711)   |
|  | -----       | -----       |
| Commercialization of services                        | (522,858)   | (252,663)   |
| General and administrative                           | (430,645)   | (299,680)   |
| Other operating revenue (expenses)                   | 13,983      | (13,368)    |
|  | -----       | -----       |
| OPERATING INCOME BEFORE INTEREST                     | 315,890     | 462,556     |
|  | -----       | -----       |
| Interest income (expense)                            | (362,239)   | (23,684)    |
|  | -----       | -----       |
| OPERATING INCOME                                     | (46,349)    | 438,872     |
|  | -----       | -----       |
| Nonoperating income                                  | (7,151)     | 11,885      |
|  | -----       | -----       |
| NET INCOME (LOSS) BEFORE TAXES<br>AND PARTICIPATIONS | (53,500)    | 450,757     |
|  | -----       | -----       |
| Income tax and social contribution on profits        | 8,859       | (155,644)   |
| Employees' profit share                              | (23,115)    | (15,420)    |
| Minority interest                                    | (4,889)     | -           |
|  | -----       | -----       |
| NET INCOME (LOSS) FOR THE YEAR                       | (72,645)    | 279,693     |
|  | =====       | =====       |
| QUANTITY OF OUTSTANDING SHARES (IN THOUSANDS)        | 4,723,844   | 4,723,844   |
|  | =====       | =====       |
| NET EARNINGS (LOSS) PER THOUSAND SHARES              | (15.38)     | 59.21       |
|  | ===         | ===         |

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

\*\*\*\*\*