



# → 2006







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# chairman's message

In 2006, Metro do Porto, S.A. achieved one of the most important purposes, if not its major single goal, under its metro light rail concessionary rights from the Portuguese State: and that was the completion of the First Phase of the Light Rail System of the Porto Metropolitan Area.

The mandate to design, build, and equip Porto's Metro Light Rail Network was fulfilled upon completion of the construction of a network of five (5) lines, extending for approximately 60 kilometres, and featuring nearly seventy (70) fully operational stations.

On March 18th, we inaugurated the Red Line between Pedras Rubras and Póvoa de Varzim Stations, at a ceremony presided by the Minister of Public Works, Transport, and Communications, Mr. Mário Lino, who was accompanied by the Secretary of State for Transport, Ms. Ana Paula Vitorino. Thus, Metro services were extended to a further two neighbouring Counties, Vila do Conde and Póvoa de Varzim. Thousands of residents in the northern reaches of the Porto Metropolitan Area can now commute by Metro.

On March 31st, the stretch of the Green Line between Fórum Maia and ISMAI stations and the stretch of Yellow Line between University Campus and São João Hospital stations entered operations. As from that date, the geographical reach of those two lines was vastly enhanced and both lines are now directly servicing two key areas of demand.

By May 27th, we completed the First Phase of the Light Rail Project by inaugurating the – Violet Line — Airport to Dragão Stadium. Prime Minister, Mr. José Sócrates honoured us greatly by presiding to the inauguration ceremony, in which he was accompanied by the Minister of Public Works, Transport, and Communications, Mr. Mário Lino, the Secretary of State for Transport, Ms. Ana Paula Vitorino, and the Secretary of State for Treasury and Finance, Mr. Carlos Costa Pina. As was widely publicised at the time, Porto's Francisco Sá Carneiro International Airport is the first Portuguese airport, and the second in the entire Iberian Peninsula, to be connected to a metro light rail network.

Only the ISMAI – Trofa connection remains now outstanding in order to fully and finally complete the projected network extension as awarded in 1998, a project which it is no longer possible to include in the First Phase of the Light Rail Project. Its implementation awaits definition on the part of the Government.

Metro do Porto, S.A. recorded capital investments totalling 301.5 million Euros with respect to its 2006 financial year, and its total cumulative capital investment has now reached 2,031 million Euros. Such numbers are clear evidence of the unique magnitude of this tremendous endeavour while simultaneously fully demonstrating our ability to achieve a high rate of project execution, a fact which is a hallmark of this Company.

We managed to successfully fulfil an ambitious and daring mission in only six (6) years and, by building the First Phase of the Light Rail Project, we were able to contribute to a veritable revolution in the lifestyle of citzens within the Porto Metropolitan Area. The impact of this tremendous change in the daily routine of citizens and the elimination of borders and limitations to resident's mobility is even more apparent from the fact that we have already transported close to 40 million passengers during 2006 – a volume which represents a rate of growth of over



100 percent when compared with 2005. This data is also to be viewed in the light of the fact that our levels of client satisfaction turned out at 79.3 percent, as established by a Metro do Porto "Client Profile" survey. Should no other indicators be available – which they most certainly are – an increasing rate of utilisation of Porto's Metro Light Rail Network is, per se, the best possible indicator of the fact that this project has been a tremendous success, and that the underlying investments were unquestionably of great public interest.

Ultimately, and well beyond the shallowness of some criticism, what really counts is our citizen's own evaluation – a fact which is important to stress. And what our citizen's evaluation shows – either quantitatively or qualitatively, whether in absolute terms or even more so when compared with the results of other transport operators – is that their views on Metro do Porto are extremely positive. More important than demonstrating our merit and vindicating the exacting and skilled manner in which this Company has been conducting its business, such figures are cause for great satisfaction and pride for the entire Northern Region of Portugal and the Country. We knew that was, and is, our obligation. As it is the obligation of many others, who are responsible for similar tasks. The difference is that we delivered.

We have thus completed this task in 2006 and continue to work on developing the required studies and project planning to launch new Lines. It has also been a year of change which saw far-

reaching internal restructuring of our Services with a view to redirect our main focus into ensuring that our Metro System operates regularly and into improving our Network's operational performance. We are ready, and so remain, to face the new challenges ahead. The Second Phase of Porto's Metro Light Rail System has already been researched, planned, and projected. What we now need in 2007 is clear definition of objectives, means, and implementation schedules. Or, in other words, to get to know what we are going to do, with what means, and when can we start implementing the new Phase.

These are questions that only the shareholders of Metro do Porto, S.A. can answer. It falls on our shareholders to clarify the goals of this Company for the future. Being acquainted with the various Studies and Project Plans for the envisaged Network development, on the one hand, while being surely aware of the natural expectations of residents of the Porto Metropolitan Area towards the implementation of those developments, on the other, our shareholders will surely be able to take the best possible decisions in upholding the interests shared by the Area's population. The Board of Directors – whether in its present composition or in any other composition – shall be always available to fully cooperate with shareholders with unchanged commitment and loyalty, as it has unquestioningly always demonstrated. What the Board has long been awaiting is that the shareholders of Metro do Porto, S.A. – the Porto Metropolitan Commission, the Portuguese Government, and several Municipalities – can now proceed to take the most convenient and responsible decisions required to further the development of this major project of Metro do Porto.

Valentim Loureiro



# 1 metro do porto indicators

Network	2003	2004	2005	2006	06/05
Extension (meters)	11 826	15 649	34 505	58 877	70.6%
N°. of stations	18	23	45	69	53.3%

Human Resources	2003	2004	2005	2006	06/05
Total staff (end of year)	150	133	137	118	-13.9%
Average staff	206	141	137	123	-10.4%

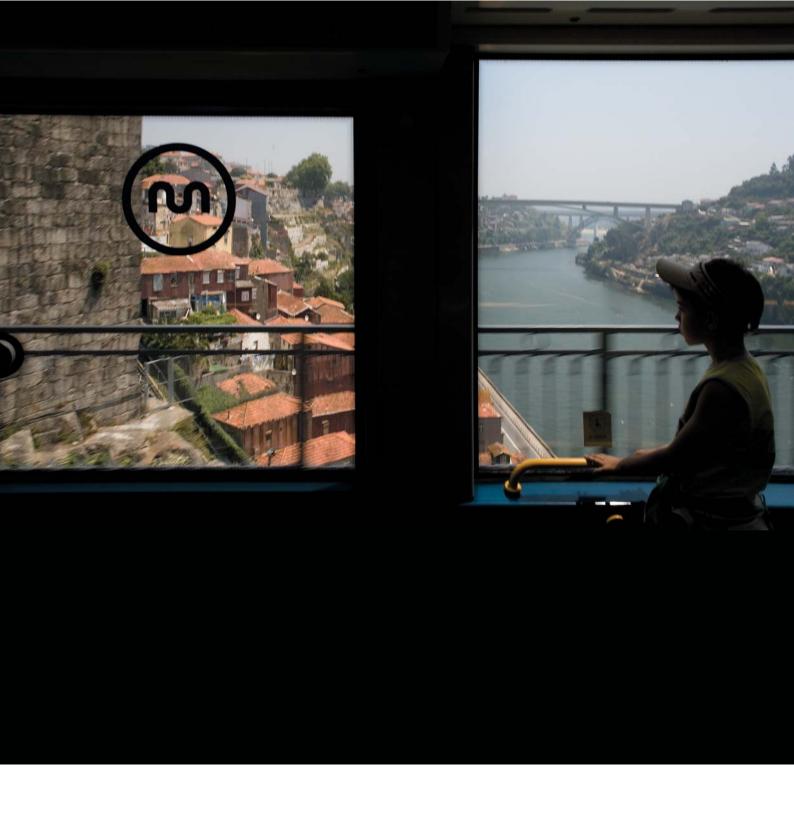
(Units: thousands)

Demand	2003	2004	2005	2006	06/05
Metro System					
Passengers	5 960	9 843	18 481	38 637	109.1%
Passengers kms	26 476	46 506	95 978	202 473	111.0%
Average travelling distance (meters)	4 443	4 725	5 193	5 240	0.9%
Guindais Funicular					
Passengers	-	224	244	315	29.4%
Passengers kms	-	63	68	88	29.4%

(Units: thousands)

Supply	2003	2004	2005	2006	06/05
Metro System					
Vehicle kms	1 343	1 941	3 398	6 562	93.1%
Seat kms	290 076	419 285	733 945	1 417 434	93.1%
Commercial speed (km/h)	-	-	-	26.70	-
Load factor	9.1%	11.1%	13.1%	14.3%	1.2 pp
Guindais Funicular					
Trips	-	28	35	37	4.0%
Seat kms	-	392	496	516	4.0%
Load factor	-	16.0%	13.8%	17.1%	3.3 pp

Income	2003	2004	2005	2006	06/05
Metro System					
Income (€ millions)	2 752	5 235	10 212	21 096	106.6%
Income/Passenger kms (€ cents)	10.39	11.26	10.64	10.42	-2.1%
Income/Seat kms (€ cents)	0.95	1.25	1.39	1.49	7.0%
Guindais Funicular					
Income (€ millions)	-	122	138	176	27.4%
Income/Passenger kms (€)	-	1.94	2.02	1.99	-1.5%
Income/Seat kms (€)	-	0.31	0.28	0.34	22.5%



(Units: Euro thousands)

Results	2003	2004	2005	2006	06/05
Operating results	-9 674	-20 680	-46 234	-81 434	-76.1%
Before operating subsidies	-9 674	-25 411	-48 479	-83 837	-72.9%
Financial results	-16 192	-18 421	-25 696	-41 457	-61.3%
Extraordinary results	-110	1 186	636	759	19.5%
Net income	-26 032	-37 949	-71 335	-122 155	-71.2%



# Completion of the system's approved configuration

During the first half of 2006, all approved projects were completed and became operational within the term envisaged under the Concessionary Conditions'. An additional 24.4 km of network extension serviced by 24 new stations were made operational. Currently, the System's network extends for 58.9 km and features a total of 69 stations.

Launch	Line	Stretch Exte	nsion (m)	Stations
1/Jan/03	Blue	Trindade - Sr Matosinhos	11,826	18
5/Jun/04	Blue	Dragão Stadium - Trindade	3,823	5
13/Mar/05	Red	Senhora da Hora - Pedras Rubras	6,744	5
30/Jul/05	Green	Fonte do Cuco - Fórum da Maia	5,984	6
17/Sep/05	Yellow	Gaia Town Council - University Campus	5,723	10
10/Dec/05	Yellow	João de Deus - Gaia Town Council	405	1
Launches in 2005			18,856	22
18/Mar/06	Red	Pedras Rubras - Póvoa de Varzim	17,228	15
31/Mar/06	Green	Fórum da Maia - ISMAI	4,484	4
31/Mar/06	Yellow	University Campus - S. João Hospital	1,180	2
27/May/06	Violet	Airport Branch	1,480	3
Launches in 2006			24,372	24
Operational network			58,877	69

This cost of the System's configuration, as approved in July 2003, was estimated for the first time in the Company's 2004 budget (at a time when the accumulated financial execution – including advances – had not yet reached the 1,000 million Euros mark). The following table details the evolution in the System's total cost (as estimated in successive annual budgets), together with the evolution of its execution. In addition, the table shows the progress in extending the operational System as well as of its demand. In this way, the table below provides an illuminating summary of progress achieved along the Company's various work fronts:

	2002	2003	2004	2005	2006	2007 (forecast)
Total Multiannual Budget based on Current Perimeter*			2,226	2,155	2,332	2,375 ** Euro millions
Cumulative execution, end of year	703	1,002	1,348	1,704	2,031	2,246 Euro millions
Extension of double-track line in operation, end of year	11.8	11.8	15.6	34.5	58.9	59.5 Km
Demand for the year	-	26	47	96	202	244 million per km

<sup>\*</sup> Budgeted value as at December of each year, based on the investment perimeter for 2007 (exclusive of projects being prepared)

<sup>\*\*</sup> Including estimated costs for two track stretchs pending construction: João de Deus - St. Ovídeo and ISMAI-Trofa as a single-track line

<sup>&</sup>lt;sup>1</sup> The only exception is the ISMAI – Trofa connection, as Metro do Porto is waiting for a decision on the project for duplicate the existing layout as presented in August 2003, and the finalisation of the Yellow Line at its southern end, whose completion had been suspended, pending a definition of the new network expansion programme within the Vila Nova de Gaia County.







The average cost per kilometre of a surface, double-track line, excluding special stations, amounts to 16.5 million Euros; the average cost per kilometre of an underground line rises to 75.9 million Euros (30.0 million Euros per station + 24.3 million Euros per km for tracks).

Such unit cost levels account for a share of 1,575 million Euros out of the total 2,375 million Euros multiannual budget, prepared in December 2006, as a part of the process leading to the 2007 budget. The remaining amount pertains to items which do not vary directly in line with network length<sup>2</sup>.

The launch of the final stretch of the Yellow Line on March 31st was of particular relevance since in addition to servicing patients and visitors commuting daily to the S. João Hospital, that infrastructure is adjacent to a terminus for dozens of other STCP and private operator bus services.

On May 27th, the Light Rail System reached the Francisco Sá Carneiro International Airport following construction of a branch to connect it to the Póvoa Line. In this way, Portugal saw its first true intermodal transport system connection to European transport systems. The Francisco Sá Carneiro International Airport is the first Portuguese airport providing both a direct interface with a light rail network (Porto's Metro System), and an indirect interface with a heavy railway system (via the Metro network connection to the Campanhã, S. Bento and General Torres national railways stations, which can now be accessed through the Metro).

## Record levels of validations

The rate of utilisation of the Metro System has been reflecting sustained growth, and this is not only a result of the significant expansion of the Metro network but also of increasing reliance thereon by residents of the Porto Metropolitan Area, and its incorporation into their pattern of mobility habits.

The volume of validations recorded for 2006 was 12.7% greater than the total volume of validations recorded for the whole of the Metro System's first three years of operation.

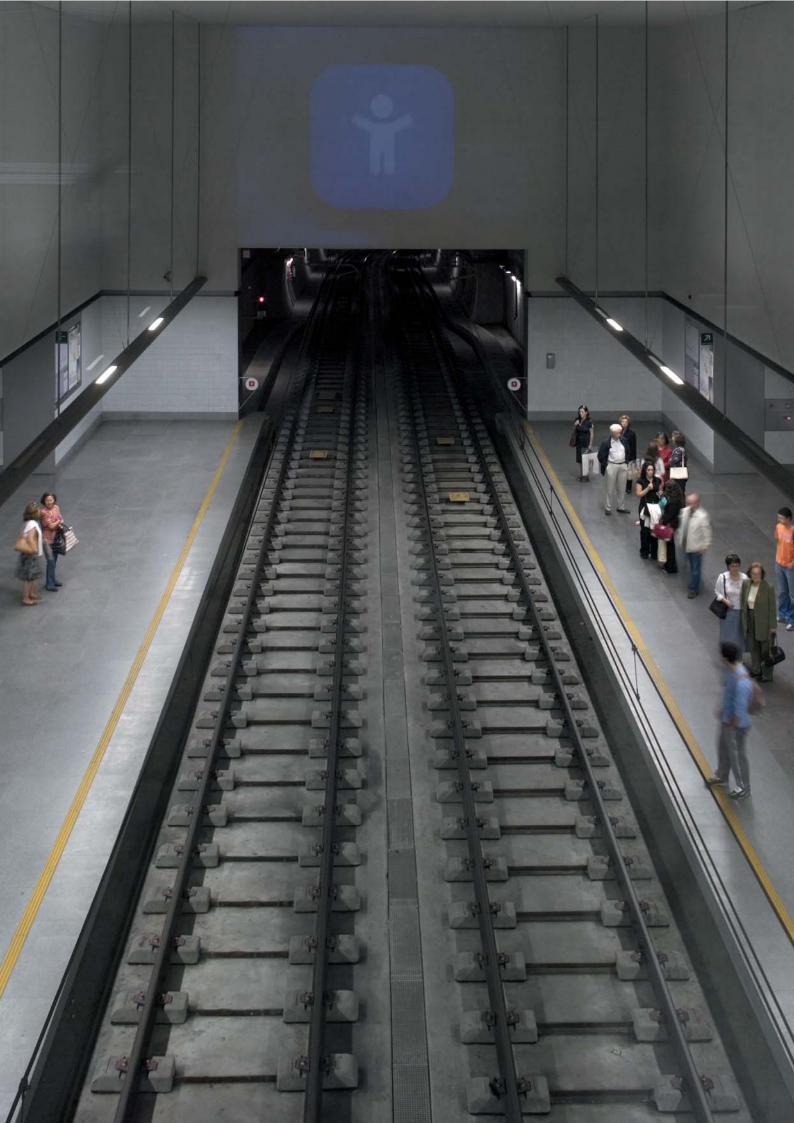
# Progress in intermodal passenger transport

Further to the expansion of the city's intermodal transport network subsequent to the new Light Metro Rail System connections coming into operation, the Andante intermodal transport network travel card now includes an additional four STCP bus routes, also launched during the year.

On January 1st, 2007, the city's main public transport operator, Sociedade de Transportes Colectivos do Porto, completed the implementation of a new bus route network. This revamp addressed the new features of commuter mobility within Porto Metropolitan Area, and now articulates with the Light Metro Rail System, in particular.

On a par with the implementation of the new bus network, the Andante fares are now valid for that entire network, a key factor for the success of Porto's intermodal project in covering its entire Metropolitan Area. Nevertheless, the STCP's single-mode tariffs remain valid within that operator's own network.

<sup>&</sup>lt;sup>2</sup> Among the items which do not vary with network extension, we highlight the rolling stock, the Guifões machinery and workshop repairs centre (PMO), the Infante D. Henrique Bridge, and overhead expenses.



## **Joint Ordnance**

The Company became aware of Ordnance n°. 925/2005, of October 20th 2005, which was jointly issued by the Minister of State and Finance and the Minister of Public Works, Transport, and Communications, as published in the "Diário da República" of November 14th, 2005. This Ordnance was a constraining factor on the management of the Company throughout its 2006 financial year by limiting the scope of action of the Board of Directors of Metro do Porto, S.A. to running operations and effecting only the investments required to proceed with projects that were in course of development.

In this way, our expectations that the Government would be in a position to define the manner in which "the required construction for completion of the projects already approved by the Government and consolidation of the Company's financial structure will be funded", and to present its announced proposal for an "alteration of the concessionary's legal framework with a view to frame its long-term operation, namely with respect to entering into a Contract with it for the provision of public passenger transport services" failed to materialise during the course of the 2006 financial year.

At its session of July 7<sup>th</sup> 2006, the Board of Directors approved a document titled "Metro do Porto, S.A.'s Integrated Corporate Strategy", which is a contribution for the development of an integrated strategy for Metro do Porto, S.A while the Company and its Concessionary System are operating under this transitional stage. The aforementioned document was forwarded to the Government on July 12<sup>th</sup>, 2006.

The objective of this document is to define:

- a) Terms of reference for defining and developing the Company's strategy within a time horizon of fifteen to twenty years;
- b) Strategic objectives referenced to a land management and urban development framework; to the fostering of urban and regional mobility; to the promotion of efficiency in resources consumption; to securing the economic and environmental sustainability of the Porto Metropolitan Area's Light Rail System; and to achieve a consistent project finance model.

In addition, and in an integrated manner, the document considers:

- a) A set of criteria which are to be applied in evaluating potential network expansion projects under current Concessionary Conditions;
- b) Economic and environmental sustainability evaluation criteria applying to such network expansion projects, including their respective external impact, with such criteria being specified according to both economic and social risk-benefit analysis;
- c) The undertaking of market research with a view to ensure continuous operation under efficient contractual conditions of new network extensions, jointly or separately, as may be approved under a concessionary contract;
- d) Analysis of a refinancing strategy with respect to the investment that has gone into developing the current operational network of the Light Rail System of Porto Metropolitan Area, together with or separately from the funding of new network extensions. The new financing structure shall promote the restructuring of the Company's share capital, a rebalancing of its sources of funding, namely as concerns EU co-funding, and the rescheduling of the maturity structure of the Company's debt, whilst promoting an efficient consolidated financing cost.



# Relevant events subsequent to financial year-end

## **Extraordinary Shareholders Meeting**

An extraordinary Shareholders Meeting has been convened for January  $31^{\rm st}$  2007 with the following agenda:

- 1. To consider the recommendation of Portugal's "Tribunal de Contas" to the effect of correcting the Company's accounting for its investment financing (value of investment funding by the Portuguese State and the European Union in Metro do Porto), as recorded under Account 58 Concedent Instalments, to be reflected under Account 2745 Investment Subsidies. Since by doing the aforementioned accounting movements following the "Tribunal de Contas" recommendation more than half the Company's shareholder funds would be regarded as having been lost, shareholders are required to consider the implementation of measures with respect to conformance with and for purposes of Article 35, Paragraphs 1 and 3, of the Companies Act;
- 2. To consider the recommendation of Portugal's "Tribunal de Contas" to the effect of mandating the Board of Directors to undertake a study to assess the Company's present financial standing, namely considering sources of funding required to cover its current funding shortfall and to meet envisaged expenditure for full completion of the project, while also providing income projections during the various future operational stages of the system, up to December 31st, 2030;
- 3. To consider the recommendation of Portugal's "Tribunal de Contas" to the effect of demanding that shareholders comply with the required supplementary funding and eventually supplying new supplementary funds either in cash or cash-equivalent means, as per the foregoing under Article 10, Paragraph e) of the Statutes of Metro do Porto, S.A.;
- 4. To take a position on the remuneration attributed to the Company's Executive and Non-executive Directors, pursuant to the presentation of an analysis by the Remuneration-Setting Committee, as well as of the conclusions expressed by the "Inspecção Geral de Finanças" in that regard; to consider whether to renew their decisions concerning the Company's Directors' remuneration and ancillary asset allocation packages since the 2000 financial year and up to the end of 2006.



# 3 sustainability report

The goals of sustainable development are "the satisfaction of current needs without compromising the capacity of future generations in satisfying their own needs."

Source: Gro Harlem Brundtland (org.) Report of the World Commission on the Environment and Development

Metro do Porto has been preparing its first Sustainability Report for presentation in 2007, with the objective of advising its clients, the community, investors, and other strategic stakeholders on its environmental, social, and financial performance.

The Sustainability Report aims to be an expression of the Company's strategic commitment to achieve sustainable development in the medium to long run.

The Report shall abide by the guidelines of the Global Reporting Initiative (GRI). Those guidelines constitute a worldwide framework of reference in compiling sustainability reports, and thus enable comparison of the performance of various companies through standard performance indicators, as well specific indicators pertaining to each sector of activity.

Light rail systems are, by definition, "environment-friendly" means of passenger transport but the notion of sustainable development calls for the Company to go further than conforming to such an advantage alone, and to actively minimise all negative environmental impact arising from its activities while maximising positive impacts. For that reason, and already at the System's design stage, the Company has endeavoured to minimise the negative environmental, social, and economic impact of its operations, as well as has promoted solutions that maximised its positive external impacts. Environmental issues have always been taken as relevant issues when drawing up construction specifications for all its works, and Metro do Porto promotes strict inspection of construction sites with a view to ensure efficient management of natural resources and waste treatment, thereby always preserving the country's built-up and archaeological legacy. It also always consults with residents and traders that might be affected by the construction works.

The social and environmental benefits associated to a light rail system's operations originate from various sources and have a very significant impact. The increase in mobility within the Porto Metropolitan Area, the achievement of urban compatibility between the Metro lines and their urban surrounds, the gains in time, and the general improvement in air quality are but a few of the examples.

Based on a 2003 study by a specialised independent company, and taking a conservative view of its conclusions, cumulative environmental benefits since the system was launched (in 2003) and up to the end of 2006, have translated into reductions of:

- 89 tons in carbon monoxide (CO) emissions;
- 44 tons in hydrocarbonates (HC) emissions
- 553 tons in nitrogen oxides (NOx) emissions;
- 33 thousand million particle emissions.

The implementation of the Metro do Porto System is estimated to have achieved energy savings of approximately 7,500 TEP (Petrol-Equivalent Tons), in 2006, and for a gain in time estimated to be

valued at almost 11 million Euros, being equivalent to savings of 3 million hours. Considering the estimates of the aforementioned study for 2007 and comparing effective demand with forecast demand, a total of almost six thousand vehicles a day would have ceased to enter and park within the central areas of Porto since then, as a result of passengers switching from private to Metro transport.

The concept of universality, and consequently, accessibility, is also integrated in the definition of sustainability. The goal of Portugal's National Accessibility Promotion Plan (PNPA), which was approved on December 21<sup>st</sup> 2006, is to establish the groundwork for integrated, concerted policies to promote accessibility in Portugal until 2015. That document proposes a set of concrete measures to be applied between 2007 and 2010 in respect of signaling, passenger information, maintenance, and safety. Our Company is already fully applying those recommendations.

Porto's Metro System is fully accessible to people with impaired mobility, and it promotes their social integration within Porto Metropolitan Area. The System's underground stations are fitted with lifts; aboveground stations feature access ramps; the floor of each vehicle coach stands flush with passenger platforms; and all stations and vehicle coaches are fitted with information conveyed through signage and via the sound system. Still within the field of accessibility, our Navmetro and Infometro projects, which are scheduled for implementation during 2007, are innovative and useful projects which have been integrated within Portugal's Operational Programme for the Knowledge-based Society (POS\_Knowledge)<sup>3</sup>. Both projects are being developed through a partnership with the Faculty of Engineering of the University of Porto (FEUP) and with the Portuguese Association for Ambliopy and the Blind (ACAPO).

The Navmetro project is a system geared to assist poorly-sighted people allowing the user to access local information on the station and physical access thereto via a phone equipped with Bluetooth technology.

Thanks to the Infometro project, a user will - equally have access to operational information through an interactive, automatic, voice-enabled system.

2006 was marked, both financially and in terms of social development, by the implementation of new social fares under the Andante Travel Card, applicable to children, students, the elderly, retired people, and pensioners. The new social fares provide discounts of 25% for children and students and 47% for the elderly, retired people and pensioners on monthly travel cards. Trends in the number of validations since the new social fares were introduced in July 2006 highlight the important role of that system in enhancing commuter mobility within Porto Metropolitan Area.

Internally, the Company has also embarked on a number of paper-saving practices during the year. It is estimated that by using recycled paper Metro do Porto will be facilitating the saving of 120 trees, 594 thousand litres of water, and 15,000 KW/h in energy, per annum. Containers to collect paper for recycling purposes are already installed at the premises of Metro do Porto, and the Company has generalised the use of digitalisation techniques and IT systems as a means of reducing the circulation of paper.

These and many other themes are catered for in depth in our Sustainability Report, to be launched during 2007. Such initiatives amply demonstrate the Company's commitment to steadily remain on the path of sustainability.

<sup>&</sup>lt;sup>3</sup> Set within the framework of European Union goals towards becoming a knowledge-based society, the POS\_Knowledge programme, which was approved by the European Union on December 27th 2004, facilitates and finances projects that are conducive to materialise Portugal's national strategy for developing into a knowledge-based society.



# 4 operational performance

## 4.1 clients

## Light Rail System

During 2006, validations reached 38,637,488, more than double the number of validations recorded in 2005 - reflecting the increased use of the new mean of transportation by the people, as well as the expansion of our commercial metro network.

The network extensions which entered operation during the first semester of 2006 represent 70.6% of the total extension of the network in operation as at the end of 2005.

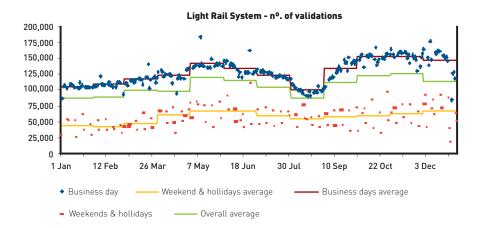
When taking into account the schedule of new station openings in 2006, two entirely distinct operating stages are evidenced during the financial year, namely before and after the start of operations of the Red Line extension between Pedras Rubras and Póvoa de Varzim together with the Green Line extension between Fórum da Maia and ISMAI.

An equally relevant development was the introduction of the Andante social fare, in July 2006. The immediate impact of the lower fares under this new tariff system is likely to have been dampened by seasonality associated with falling demand during the July-August holiday period. As from September 2006 onwards, the daily number of validations increased noticeably (with the exception of December, on account of the Christmas school break).

The average daily number of validations on a business day being recorded prior to the opening of the Pedras Rubras – Póvoa de Varzim extension (amounting to 109,172) reflects an increase of 7.7% when compared with an average daily number of 101,345 validations on a business day in December 2005. The average daily number of validations on a business day recorded for 2006 prior to the extension

to Póvoa de Varzim entering operations grew by 21% to 132,142 validations per day, when compared with the daily average recorded between that date and up to the end of June, immediately prior to the introduction of the new social fares. The average daily number of validations on a business day for the last quarter of 2006 amounted to 151,601 validations per day, which is 14.7% higher than the number recorded between March and June.

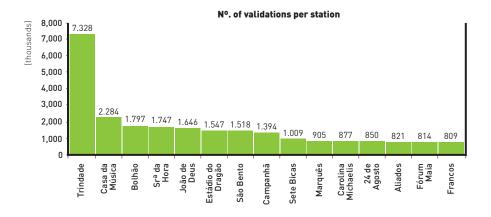
In total, the number of validations recorded for 2006 averaged 128,547 validations on a business day and the overall average recorded is 105,856 validations for the year. On weekends and national holidays, the average number of validations amounted to 57,150 validations.



On a daily basis, a peak in the number of validations was reached on the May 9<sup>th</sup>, with a record 184,758 validations. Demand peaked as well on the December 6th and the October 17<sup>th</sup>, with 178,136 validations and 168,460 validations, respectively. The first of those dates falls in the period of traditional University Graduation celebrations, and the other two dates corresponded to important football matches being held at the Dragão Stadium.

Trindade Station, which lies at the centre of the network and features two platforms (giving access to the Yellow Line and to the common stretch of the other System Lines), remains the preferred station for passengers entering the System, having recorded 7.3 million validations, which represents 19.0% of total annual validations. In order of number of validations, Casa da Música (5.9%), Bolhão (4.7%), Senhora da Hora (4.5%) and João de Deus (4.3%) were the next busiest stations.

In total, validations recorded by the ten main stations of the System represent 54.8% of total annual validations.

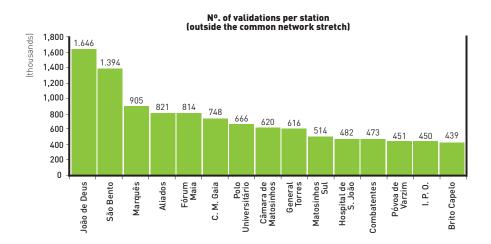




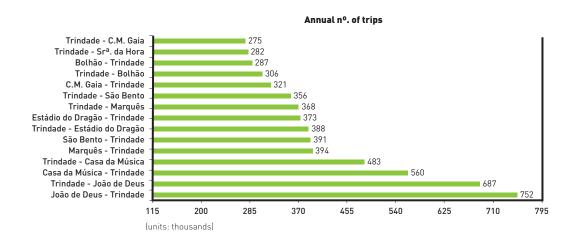


The preceding graph highlights that ten of the main fifteen stations are sited along the common stretch of the network – between Dragão Stadium and Fonte do Cuco. If validations at stations located on the stretch of common track, which are responsible for 57.4% of the System's validations, are excluded, one is left with a total of 16.5 million validations for the remainder of the network. Among these stations, the four main stations are located on the Yellow Line, namely João de Deus (10.0% of all validations outside the stretch of common track), São Bento (8.5%), Marquês (5.5%) and Aliados (5.0%).

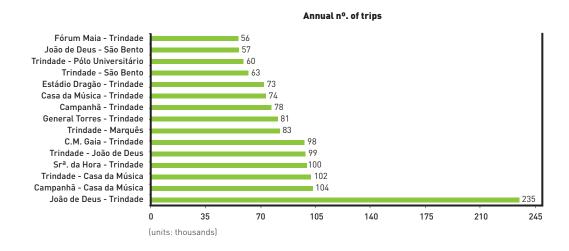
Fórum da Maia, representing 4.9% of validations outside the common stretch, is the main station along the Green Line. The Matosinhos Town Council station is the busiest station of the Blue Line, representing 3.8% of validations outside the common stretch. As concerns the Red Line, the Póvoa de Varzim terminus station leads, with 2.7% of annual validations outside the common stretch.



Similarly, the important role of Trindade station stands out when trips are analysed in terms of the main origin–destination combinations. Of the fifteen origin–destination combinations recording the highest number of trips, we have noted that Trindade station features (either as origin or destination) in every one of those combinations. All fifteen combinations correspond to a combination of Trindade station with eight other stations, namely: Senhora da Hora, João de Deus, Casa da Música, Marquês, São Bento, Dragão Stadium, Gaia Town Council and Bolhão. Of those eight stations, four belong to the Yellow Line. In the case of two of the remaining four stations, there are important interfaces with bus services, namely through Parque Metro at the Dragão Stadium station and through the bus services interface at Casa da Música station.



By analysing the time period between 7:00 and 9:00 AM, which is the morning peak-hour period, it can be noted that there are important volumes of passenger traffic coming into the city of Porto, namely originating from Gaia and from the stations that interface with the suburban railways system (Campanhã and General Torres, in particular).



There was also significant growth in the average distance travelled per passenger between the first quarter (4,776 metres) and the second (5,475 metres) and third (5,526 metres) quarters. This indicator dropped slightly during the last quarter of 2006 (5,134 metres).

On an annual basis, the average distance travelled per passenger within the System amounted to 5,240 metres, which equates to a total of 202,472,687 Passenger kms. The System's Passengers kms indicator reflects growth of 111.0% when compared with 2005.

The number of zones travelled with Metro do Porto was, on average, 1.95 zones per validation (less 0.7% than in 2005), which equates to a cumulative 75.5 million Passenger zones.



# Client profile 2005 (ECSI)

In 2006, a report by the National Client Satisfaction Index (ECSI) was made available, based on research which evaluated and compared various types of passenger transport and transport operators, and comparing commuting in Porto Metropolitan Area and in Lisbon's Metropolitan Area as well. The sample included 2,028 interviews to passengers distributed among the various operators, and the results obtained were highly positive with respect to client evaluation of Metro do Porto services.

According to the results of the study, Metro do Porto is the preferred transport service for the residents of Porto Metropolitan Area, and it gathered the preference of the vast majority of regular public transport passengers. The fact that 96% of Metro do Porto clients are satisfied overall with the services rendered deserves a highlight as well. When comparing the transport sector operating within Lisbon's and Porto Metropolitan Areas, the study reached the conclusion that the performance of the transport sector in Porto Metropolitan Area was superior with respect to the majority of the indicators.

The study concluded that Metro do Porto significantly outdistanced the average operator in the passenger transport sub-sector, reaching a peak when it came to image, client satisfaction, handling of complaints, and client loyalty indices.

As concerns the "Metro do Porto Image" indicator, the study highlighted above average figures with respect to four of the five indicators being evaluated. As concerns the quality of service indicator, our performance was equally rather positive: Metro do Porto's average indicators exceeded the average operator in the passenger transport sub-sector.

Furthermore, and now as concerns the "Metro do Porto Perceived Quality" indicator, our Company performed above the average of the transport sector within Porto Metropolitan Area. Metro do Porto's cleanliness and hygiene, travelling times and waiting times at stations, reliability of services, diversity in operating hours, and vehicle comfort deserved particular highlight as well.

Latent variables	Metro do Porto	Porto MA Transport	Lisbon MA Transport
Image	80.5	71.2	68.4
Expectations	72.7	68.0	65.2
Perceived quality	75.2	68.9	66.5
Perceived value	62.7	56.1	52.6
Satisfaction	78.0	66.9	64.3
Complaints handling	58.3	51.6	46.5
Loyalty	78.4	67.4	65.7

## User profile and level of satisfaction

Speed of travel, price-effectiveness, punctuality, and train frequency are the top strengths of Metro do Porto's service, according to the results of the "User Profile and Level of Satisfaction" research by the IDIM (Marketing Research and Development Institute). The conclusions of this study – which was based on field work (comprising of 1,358 interviews) undertaken between December 12th and the 18th 2005 – indicate an overall level of client satisfaction in the region of 79.3%. It is to be noted that this also represents an increase of 1.5 percentage points vis-à-vis the value recorded by a previous study, reported to 2004.

Female, under 25, single, middle-class income, residing within Porto County – this is the predominant "Typical client" profile of a Metro passenger, as revealed by the data researched by the IDIM. In fact, females account for 62% of the universe of clients, with males accounting for 38%. The weight of young passengers within the total number of commuters is equally rather significant: 45% of Metro commuters are between 13 and 25 years old, 27% are between 25 and 35 years old, and 14% are between 35 and 45 years old.

In terms of social classes, the study identified a majority of middle-class clients (40%), followed by upper-middle-class clients (30%), lower-middle-class clients (19%), lower-class clients (8%), and upper-class clients (3%). In this particular case, and when comparing with statistical indicators for the District of Porto, the authors of the research highlight that middle-class and upper-middle class passengers are overrepresented while lower-class passengers are underrepresented. The fact that the social fare system had not yet been introduced as of the date of the research surely does not fail to have a bearing on those results, a fact which has since been addressed.

As regards County of residence, 42,6% of Metro clients reside in Porto, 28% reside in Matosinhos, 14% reside in Vila Nova de Gaia, and 7.5% reside in Maia.

The introduction of the Metro system has surely brought about a revolution in the habits of citizens within the Porto Metropolitan Area: 64% of interviewees declared that they use the bus less often, 49% declared that they use their car less often, and 13% declared they travel on foot less often. The Metro is preferentially used for travelling to and from work (52%), to go shopping (49%), for leisure (38%), and to travel to an from school (31%). Motivation to travel by Metro is predominantly linked to using that transport service on business days (69%) and to using monthly travel cards (54%).

As regards the main advantages brought about by the Metro, the interviewees gave particular emphasis to speed of travel (51%) and cost-effectiveness (22%), with respect to saving on the cost of transport. Punctuality, train frequency, and accessibility were pointed out as equally relevant features.

#### Park & Ride

The Light Rail System features a total of 18 parking lots with capacity for 1,332 vehicles, in total, located along the entire System currently in operation. The great majority of those facilities are located along the suburban stretches of the Network, namely along the Póvoa and Trofa Lines. As concerns urban parking facilities, the largest facilities are located at the Senhora da Hora (85 bays), Pedro Hispano (159 bays), and Dragão Stadium (850 bays) interfaces.

A duplication of parking capacity along the System is at project stage, which project envisages the construction of 10 new parking facilities providing an additional 1,358 parking bays, in total.

With the exception of Parque Metro at the Dragão Stadium station, access to those parking facilities is free of charge, and their respective access control system is being implemented.

The novel Park & Ride system integrates the metro fare plus a parking ticket, and its introduction in Portugal is a pioneering system.

Users of any transport operator that has subscribed to the Andante travel card system are entitled to avail of the parking facilities for a period of 12 consecutive hours by paying a token fare (lower than one Euro), and the intention is to foster usage of public transport within Porto Metropolitan Area as the preferred means to enter the city of Porto. Introduction of a park-only feature at a higher cost is also being envisaged, for users wanting to avail of the parking facilities alone without riding on any of the transport operators that integrate the Andante system.

Controlled access to the Parque Metro facility at the Dragão Stadium station has been in place since August 15<sup>th</sup> 2006, and, since then, the facility has recorded 35,111 Park & Ride entries and 7,040 entries only for parking (at a significantly higher cost).

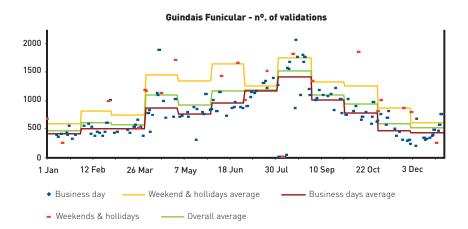
#### Guindais Funicular

The Guindais Funicular recorded 315,283 validations during 2006, which corresponds to 88,279 Passenger kms. This reflects a growth rate of 29.4% when compared with the same period of 2005.

The pattern of use of the Guindais Funicular was unchanged during this period, with 41.7% of all validations occurring during weekends and holidays. On a daily basis, an average of 1,124 validations was recorded with respect to weekends and holidays, while the total average number of validations per day is 878. The average number of validations for a business day was 764, which represents 68.0% of the value recorded for weekends and holidays.

Peak usage of the Guindais Funicular occurs in summer, with 36,905 validations recorded in July, followed by 36,403 validations for August, and 35,042 validations for June. validations recorded for those three months account for 34.4% of total annual validations.

A volume of 4,167 validations recorded during the city's S. João celebrations (between 7:00 PM of the 23<sup>rd</sup> of June and 6:00 AM of the 24th of June) deserves a highlight.

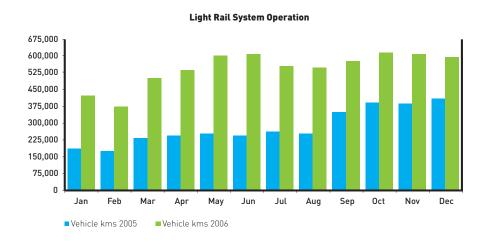


## 4.2 service

#### **Light Rail System**

During the first half of the financial year, the System's operational network expanded from a total of 34.5 km in extension featuring 45 stations to a total of 58.9 km in extension featuring 69 stations. Thanks to the network expansion, the neighbouring Counties of Vila do Conde and Póvoa de Varzim could be integrated into the System.

Throughout 2006, a total of 6,562 thousand vehicle kms (on a single-vehicle equivalent basis) was offered to passengers. Having capacity to transport 216 passengers per coach (sitting 80 passengers per coach), the total capacity on offer equates to 1,417 million seat kms. When compared with the capacity on offer during 2005, a growth rate of 93.1% in kilometres offered is evidenced. This indicator has naturally been determined by the timing of the openings scheduled for 2006, as had already been the case with respect to 2005. It is to be noted that, during the first half of 2005, the Gaia and Maia Lines were not yet in operation, and the extension to Pedras Rubras was open to the public only by the end of the first quarter of that year.

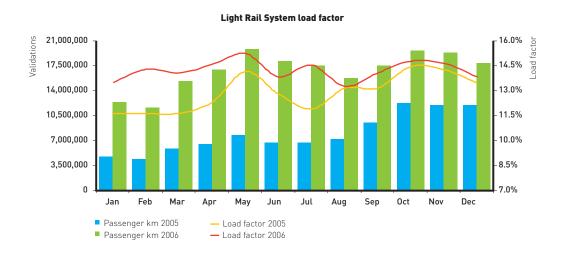


Considering the kms offered throughout the year, 19.3% were on the Matosinhos Line service, 35.6% on the Póvoa Line, 21.5% on the Trofa Line (with terminus at Maia), 17.6% on the Gaia Line, and 5.9% on the Airport Line.

The total number of passenger kms transported was 202.5 million for 2006, equating to an overall load factor of 14.3% and reflecting an increase of 1.2 percentage points vis-à-vis the same period of 2005. The monthly peak in occupation was recorded in May, when the load factor rose to 15.3%. On an hourly basis (and except for the month of August), the peak in occupation is reached in the morning period between 7:00 and 8:00 AM, with load factors greater than 20% (monthly average, considering a 7-day week) being recorded, and load factor peaks during the month of November reaching 26.4% for that hourly period. In the afternoon, the peak in occupation alternates between the 5:00 to 6:00 PM and the 6:00 to 7:00 PM periods, when figures are consistently above the 22% mark.

The above figures correspond to the System's average load factors considering all directions of travel and both directions of travel per stretch. By analysing peaks in occupation per hourly period per stretch of track per direction of travel, it can be established that load factors greater than 50% are consistently reached.

The following graph illustrates stability in the pattern of occupation between 2005 and 2006.



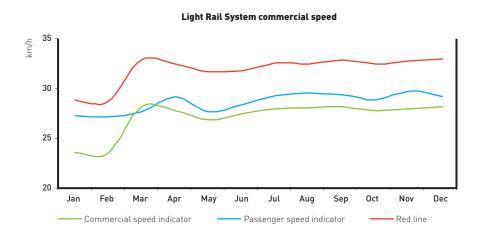
The overall average commercial speed calculated from sensor records was 26.70 km/h for 2006. The average passenger speed (commercial speed weighted by the occupation per stretch of track) rose to 28.03 km/h for the same year.

The following table reflects those figures with respect to each of the Lines offered by Metro do Porto:

Commercial speed	2006
Yellow Line	21.58 km/h
Blue Line	23.54 km/h
Violet Line	27.02 km/h
Green Line	27.48 km/h
Red Line	31.16 km/h
Total	26.70 km/h

The calculation of this speed indicator takes into account the time taken to travel between stations and stoppage times at stations (except for stoppage time at the terminus stations).

On a monthly basis, and thanks to the Pedras Rubras-Póvoa de Varzim stretch coming into operation on March 18<sup>th</sup> 2006, average commercial speed started increasing as from that date. The average passenger speed indicator shows an identical pattern, but this indicator reflects higher fluctuation as a result of varying patterns in ticket validation.

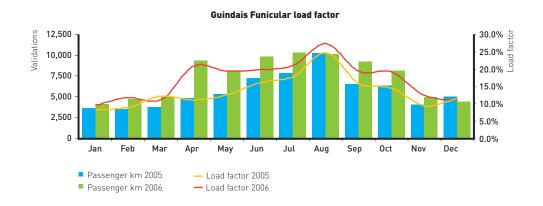


Sixty two accidents were recorded throughout the year, but all of those were minor accidents which only resulted in damage to materials, in most cases. Considering the level which the offer of services has already reached, the accident rate equates to 0.09 accidents per 10,000 km offered, and this figure is 52.9% higher that the accident rate for 2005.

#### **Guindais Funicular**

The Funicular's installed transport capacity is, on a normal duty basis, one thousand five hundred passengers per day and per direction of travel. Train frequency works out at every ten minutes, throughout the entire operating hours schedule, and travelling time is approximately two minutes. During 2006, the number of trips reached 36,858, which corresponds to a service offering of 516,012 seat kms. This indicator rose by 4.0% compared to the figure with respect to the same period of 2005.

The Funicular's average load factor was 17.1% during 2006, 3.35 percentage points higher than the 2005 load factor. On a daily basis, load factors are higher during weekends and national holidays, when the annual average rises to 22.0% on Sundays and national holidays (to compare with 19.2%, for 2005), and to 19.7% on Saturdays (to compare with15.6%, for 2005) both figures comparing to 15.2% on business days (to compare with 11.9%, for 2005).



# 5 completed construction

# Work progress

# Line 📵 – Dragão Stadium – Póvoa de Varzim:

The Pedras Rubras – Póvoa de Varzim stretch of track was completed, featuring an extension of 17.2 km serviced by 15 stations. The inauguration and start of commercial operations of this line took place on March 18<sup>th</sup> 2006.

## Line 💿 – Dragão Stadium – Fórum da Maia:

The Fórum da Maia – ISMAI stretch of track was completed and has been in commercial operation since March 31st 2006. With the introduction of that stretch, an additional 4.4 km and 4 stations were added to the Light Rail System's network.

# Line 0 - St.º Ovídeo - São João Hospital:

On March 31st 2006, the University Campus – São João Hospital stretch of track went into commercial operation, and it was redesigned between the IPO station and the Trincheira/Terminus station of the São João Hospital by Government decision. As a consequence of having to re-design that stretch, the train frequency at the São João Hospital Terminus, where the largest interface between the rail network and public bus services is located, was reduced to half of the train frequency practiced throughout the rest of that line.

# Line 📵 – Dragão Stadium – Airport:

Once the construction of the stretch of track connecting the Violet Line between the Os Verdes Station and the Airport (for an extension of 1.5 km) was completed, its commercial operation started on May  $27^{\text{th}}$  2006.





## Airport station

The Airport station is integrated within the complex of the Francisco Sá Carneiro International Airport and provides perfect connectivity between the light rail system and air transport, passenger bus services, and private transport facilities.

This terminus station plays a unique role within the entire network of Metro do Porto, as it is a specific node for intermodal transport systems providing multiple connections between external and internal car parking facilities, the passenger terminal, and, in future, the projected high-speed railway system. The station was designed with due consideration to architectural and structural integration with the existing infrastructure, and as a consequence, the passenger terminal was extended and covered with a vast glass roof over the station platforms, thereby establishing a strong formal and volumetric relationship with the central body of the Airport structure. The curved glass cover is framed by a steel profile structure lined with glass, to match the façades and landing terminals of the Airport, supporting and prolonging the metallic structure of the existing facade. The glass structure provides transparent roofing over the station's platforms, which are paved with stone and grass.

The lower halls were adapted for passenger circulation and to facilitate user access between the Metro station and the inside of the Airport through fixed stairs and escalators and lifts, leading from the platforms.

#### Credits:

**Proprietors:** Metro do Porto, S.A / ANA – Aeroportos de Portugal, S.A. **Architectural project:** ANA/DIA - Architects João Leal and Patrícia Fernandes

Project planners for the remaining areas:

Structures: Tal Project, Lda

Electric installations and utilities: ANA/DIA - Engineer José Godinho

Drainage and sewerage: ANA/DIA - Engineer Miguel Lopes, Engidro, Lda - Engineer João Gonçalves

**Contractors:** ACE Somague – Engenharia, S.A. / Soares da Costa, S.A. (general contractor)

Inspection: Consórcio EGF – Consulgal, Ferconsult, SENER

Date of inauguration: May 27th 2006

## Improvement in the constructed network's safety

During 2006, significant improvements were introduced on the network with a view to enhance its operational safety, namely with respect to procedures towards the elimination of level crossings (LC) at the Red and Green Lines. It is to be noted that the Red Line, while in operation under REFER and with respect to an extension of a little over 20 km, featured no less than 48 railway level crossings without pedestrian crossing. Once the project to duplicate that line was completed, the number of level crossings was reduced to only 9 road level crossings and 4 pedestrian level crossings, and including 6 roundabout level crossings with respect to intersections with the metro lines servicing the urban areas of Vila do Conde and Póvoa de Varzim

#### Urban integration

The construction work to integrate the Light Rail System within its urban surroundings was completed at the Porto, Maia, Matosinhos, and Vila do Conde Counties, and the same type of construction has already begun at the Vila do Conde County (in the area north of the Ave River) and at the Póvoa de Varzim County.

Urban integration works with respect to the underground stations of the Yellow Line, namely the Salgueiros, Combatentes, Marquês, Faria Guimarães, Trindade, Aliados and S. Bento stations were also completed during 2006. New access features with respect to the University Campus station were also initiated and completed during the year.

Contracts were put out to tender for urban integration works within the surrounding areas adjacent to the I.P.O. station and to cover the ditch that has been excavated at the São João Hospital. The ditch is destined for building the scheduled extension of the Yellow Line to Maia, and is to be covered until construction of that extension can start.

The most significant component of the urban integration works pertaining to the Parque da Maia station were completed, namely parking facilities on the western side of the station, and redesigned new access features on the eastern side of the station.

The construction contract for the areas adjacent to the Industrial Zone station and on the southern side of the Parque da Maia station has been awarded.

#### Legacy buildings and archaeological patrimony

The "Ramp Retaining Wall at the S. Bento Station - REFER" was cleaned with a view to remove all its markings without damaging the stonework.

During the first quarter of 2006, archaeological monitoring action was a feature at the completion of the Red Line extension to the Airport branch.

Within the scope of the urban integration works with respect to the Póvoa Line, in the Vila do Conde County, four pillars of the Santa Clara Aqueduct were cleaned, conserved and restored, where the aqueduct intersects the new Rua D.

The technical specifications for a tender for conservation and restoration works with respect to the most significant archaeological legacy material excavated at the Campo 24 de Agosto were drawn.

# 6 projects being prepared

### New Metro do Porto lines

Without prejudice to the conclusions reached by the strategy survey commissioned to FEUP – Faculty of Engineering of the University of Porto in October 2006, and with a view to further Bases VI of the Concessionary Bases per Resolution no. 126/2003 of the Council of Ministers of August 28<sup>th</sup> 2004 and Law n°. 129/2003, of August 28<sup>th</sup> 2003, the Company is researching the introduction of a set of new metro lines.

Among this set of projects being researched, four respect to extensions to existing lines already in operation and two projects concern new autonomous lines, although necessarily connecting them to the existing light rail network.

# Maia – Trofa Line (Extension of Line 1) 10 Km – 7 Stations

This stretch of the Green Line had already been projected under the initial project configuration. This stretch of track is intended to connect the Counties of Porto and Trofa, crossing Matosinhos and Maia, and is envisaged to use the old railway tracks of the of Minho Line of CP.

The original layout of the Green Line projected the construction of a single-track Fonte do Cuco – Trofa connection. As concerns the project to rather build a double-track connection for this stretch, as originally presented by Metro do Porto between January and August 2003, only the double-track stretch extending to the ISMAI station, located in the Maia County and currently operating as the northern terminus of that line, has been approved to date.

# Dragão Stadium – Gondomar Line (Extension of Line 1.6 Km – 17 Stations

This line is a northwards extension of the Blue Line starting at the Dragão Stadium terminus station extending to Gondomar County, crossing Rio Tinto. It was one of the first projected extensions based on this county's strong population density and given the limited availability of road infrastructure connecting it to its neighbouring counties, which leads to significant constraints on mobility within its Metropolitan Area.

## Gaia - Porto Line (Orange Line (G)) 7.5 Km - 9 Stations

This line will be the second connection between the Counties of Porto and Vila Nova de Gaia, and its purpose is to serve commuters residing west of the Yellow Line.

At its southern end, the new line will begin at the Quinta do Cedro interface and then veer north towards the Douro River, travelling through some of the shopping facilities that attract a large number of visitors. A new mixed bridge to cross the Douro River is being projected. Within Porto County, this new line will serve the University of Porto's Node I zone and the Campo Alegre and Bom Sucesso zones, and it will end at the Casa da Música station, which infrastructure has already been configured to cater for the new line.





# Porto – Gaia Line (Southwards extension of the 1 Line) 2 Km – 4 stations

Originally, the Yellow Line was projected to terminate at Laborim next to its Machinery and Workshop Repairs Centre, travelling along the full extent of Av. da República and then cross south of the A1 highway node (IC2 route).

Although that was the intention, the Yellow Line ended up having its terminus at João de Deus station. In this scenario, the existing project was revised to allow for phased expansion. The first phase considered only an extension to National Road 222, of which construction has already been put out to public tender. Subsequently, it is envisaged that the line be extended to the Laborim terminus station. Throughout that extension, it is envisaged that two new stations be built: the Cravel station, to be located at the current location of the Santo Ovídeo Rotunda, and a second station designated Quinta do Cedro station, which shall be integrated with the construction of a major Metro/public transport/private transport interface being projected together with construction of an associated property development.

# Porto – Maia Line (Northwards extension of the Line) 9 Km – 2 stations

Under the System's current configuration, the Green Line provides a connection between the Counties of Porto and Maia. By expanding the Yellow Line northwards, beginning at the S. João Hospital terminus station, the System will then enable more direct connection between the central areas of both counties, and will service towns located to the south of the Maia County.

Within this context, we projected a line that manages to detour all the main roadways barriers along its extension, namely the N12 ring road, and the A3 and A4 highways, without detracting on the quality of service to the main population centres and the major residential growth areas such as: Milheiros, Gueifães, Lavrador, Chantre and Parque da Maia. The terminus of this line will be the Parque da Maia station, where passengers can switch to the Green Line.

The projected layout for this line already contemplates an option to possibly expand the line to the Airport in future, by connecting it to the current Violet Line.

## Leça – Boavista Line (Pink Line (F)) 10 Km – 16 stations

The Boavista – Matosinhos stretches lies where the tracks of the old tramways system, which has been deactivated since May 29<sup>th</sup> 2000, once were.

The Matosinhos – Leça stretch refers to an extension of the current Blue Line starting at its terminus Senhor de Matosinhos station and extending to the centre of Leça. This town, which is located in the Matosinhos County, has recorded exceptionally strong population growth over the last few years.

From a strategic perspective, this line becomes rather relevant for the network's operation, not only because it will service one of Porto's main thoroughfares, with a high density of housing and commerce and service facilities, but also due to the fact that it represents an alternative to the current Blue Line connecting the Counties of Matosinhos and Porto. Such an alternative will allow for decongestion of the common track stretch, which is currently shared by the Blue, Red, Green, and Violet Lines.

# 7 communication and image

#### 7.1 institutional events

The 2006 financial year will undoubtedly always be linked to strong expansion of the operating network and to the inauguration of the System's new stretches of track.

The Metro TV channel pilot project was launched in March 2006, with experimental broadcasts at the Trindade and University Campus stations. Still in that regard, a cooperation agreement between Metro do Porto and the Fernando Pessoa University was signed, in order to produce content for the new TV channel.

In October, Metro do Porto sponsored the organisation of a Partner Congress, an organisation that groups a range of transport operators and municipalities from all over Europe.

The most senior staff of *Railway Procurement Agency*, from the Republic of Ireland, which is the entity responsible for the construction and management of Dublin's subway system, visited Metro do Porto. The occasion led to negotiations to possibly establish a partnership between the two companies, with a view to Metro do Porto providing consultancy services to that institution.

Two issues (nos. 22 and 23) of the "Infometro" newsletter were published in May and November, respectively, of which a total of 250,000 copies were printed, while 52 issues of our "Vaivém" newsletter were also issued on digital media.

The Company's website, www.metrodoporto.pt, remains highly dynamic, having recorded over 486 thousand hits and more that 4 million pages viewed.

#### 7.2 awards

*ENOR Award*: This award was attributed to Architect Eduardo Souto de Moura for his designs of Metro do Porto stations. ENOR Awards are recognised as an important distinction for architectural achievement in the entire Iberian Peninsula

*FAD'2006*: This Award was equally attributed to Architect Eduardo Souto de Moura by the Catalan Interdisciplinary Space Design Association of Catalonia, Spain, and Metro do Porto's stations were distinguished in the City and Landscape category.

Cycling Mobility National Award: Metro do Porto was distinguished by the Portuguese Cycling Tourism and Bicycle Riders Federation with an award in the Public Transport Company category. The aim of this award is to distinguish companies that promote bicycle use in a variety of ways by creating cycling facilities or improving conditions thereto. According to the Portuguese Cycling Tourism and Bicycle Riders Federation, Metro do Porto contributes to strengthening awareness of this sustainable, non-polluting, ecological, and healthy means of transport.

In that respect, it is to be noted that Metro do Porto is one of very few companies in the public passenger transport sector in Portugal that allows the transportation of bicycles on its network

freely and free of charge, being only constrained to respect the comfort of its clients. The same procedures for bicycle transport are in place at the Guindais Funicular.

Good Environmental Practices Award: attributed by Portugal's National Engineering, Technology, and Innovation Institute (INETI), an entity within the fold of the Ministry of the Economy, this award distinguished Metro do Porto with respect to Best Practices on Environment-friendly Public Procurement. Metro do Porto submitted its candidacy based on its integration of environmental practices evaluation at the various stages of its public construction tenders (from supplier qualification to the projects' technical specifications), at a concrete project entitled "Light Rail System of the Porto Metropolitan Area – environmental performance criteria in the design and construction of its System".

### 7.3 marketing campaigns

University Graduation Celebrations 2006 (May): this promotional campaign advertised special services by Metro do Porto featuring extended hours of operation and reinforcement of capacity at most of its lines during the celebrations. The aim of this promotion was to consolidate the System as a first choice for passengers in avoiding city congestion during the celebrations. During the "academic week" extending from the 6<sup>th</sup> to the 14<sup>th</sup> of May, Metro do Porto recorded 1,028,000 validations. The annual peak in utilisation of the System coincided with that campaign, when a peak number of 184,758 validations was recorded on May 9<sup>th</sup>.

Senhor de Matosinhos and São João celebrations (May and June): these promotional campaigns advertised special services during these annual city celebrations and included direct client information actions aiming at geographic area of high potential. In the case of the São João celebration night, from the 23<sup>rd</sup> to the 24<sup>th</sup> of June, and only during the extended hours period, over 60 thousand validations were recorded.

Dragão Stadium Football Events: special services were offered throughout the whole year with respect to football matches at the Dragão Stadium, by reinforcing train frequency and transport capacity and by providing additional client support and security staff, both before and after the matches. It is estimated that about 20% of all spectators attending matches of Futebol Clube do Porto used the Metro to travel to and from the Dragão Stadium throughout the year.

Rolling Stones Concert at Dragão Stadium (August): reinforcement of capacity and increased articulation with other types of public transport, in order to meet the expected boost in demand. It is estimated that about 20% of a total of over 12 thousand spectators attending the concert travelled by Metro, to and from the concert.

European Mobility Week and Car-free Day (September): campaign to promote use of the Metro instead of a private car, with particular focus on the main entrances to the city of Porto and with the objective of directing clients towards the parking facilities sited along the light rail network. Ten thousand Andante travel cards were distributed together with an information leaflet on the light rail network and its parking facilities, with the aim of promoting commuting by Metro. The set of actions planned around the event culminated in a bicycle tour combining bicycle rides with Metro rides, which event was attended by over one hundred people.







Metro at the Universities: joint promotion of Metro do Porto and TIP – Intermodal Transport Services of Porto with a view to increase awareness and to sell Student travel cards, which is part of the set of Andante social fares, at ten university education institutions within the Counties of Porto, Matosinhos and Maia. This campaign ran simultaneously with the start of the 2006/2007 school year.

Christmas Season 2006: campaign focused on promoting the Metro service as the most convenient means for going about Christmas shopping, based on attracting clients using private transport. Fifty thousand contacts were accomplished during an information campaign to attract new clients. Demand over weekends recorded growth of around 20% in December, when compared to November.

New Year's Eve: this promotion focused on provision of extended service during the 2006/2007 New Year's Eve, highlighting the convenience and safety of using the Metro on December 31st. The System network recorded over 20 thousand validations during the extended hours of operation.

# 8 human resources

### 8.1 organisation chart

When compared with preceding years, the focus of the Company's operations changed as implementation of the Metro do Porto network is complete and practically the entire network, in its current configuration, has entered into commercial operation. In essence, its activities are now marked by a significant increase in the importance of its commercial operations and it has embarked on ancillary activities complementing its passenger transport services.

The need to cater for new activities with respect to providing preventive and corrective maintenance of its equipment, to promoting quality of service and the safety of its infrastructure, equipment, and passenger transport system, as well as the need to provide company-wide IT systems in support of its business activities, have led the Company to adopt an organisation chart that would be congruent with the increased relevance of those areas of activity.

Under those circumstances, the Company has implemented the following organisation chart:



### 8.2 composition of the statutory bodies

During 2006, there were no changes in the composition of the Company's statutory bodies. The current composition was appointed at the General Assembly of March 10th, 2004.

#### General Assembly chair

**Chairman** António Gonçalves Bragança Fernandes

Vice-Chairman José Macedo de Vieira Company Secretary José Barbosa Mota



#### **Board of Directors**

**Chairman** Valentim dos Santos de Loureiro

**Directors** Rui Fernando da Silva Rio

Mário Hermenegildo Moreira de Almeida José Narciso Rodrigues de Miranda

Manuel de Oliveira Marques (Chairman of the Executive Committee)

José Manuel Duarte Vieira (Executive Committee member) Juvenal Silva Peneda (Executive Committee member)

**Auditors** 

Effective Chartered Accountants: António Magalhães & Carlos Santos, SROC,

represented by Dr. Carlos Alberto Freitas dos Santos

**Alternate** José Rodrigues de Jesus – R.O.C.

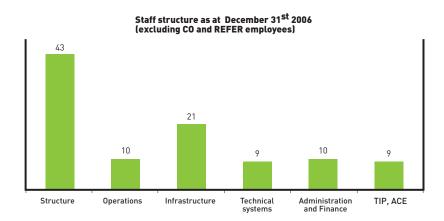
### 8.3 human resources

As at the end of 2006, Metro do Porto's total staff numbered 118 employees (of which only 93 were effectively operating at the Company), and its average staff complement was 123 throughout the year. When compared with December 2005, the average staff complement decreased by 10.4%.

	2003	2004	2005	2006	06/05
Total staff (as at 31/12)	150	133	137	118	-13.9%
Excluding CP / REFER	98	112	121	102	-15.7%
Excluding CP / REFER & seconded to TIP, ACE	90	103	111	93	-16.2%
Average staff	206	141	137	123	-10.4%
Technical staff	34%	61%	61%	71%	10.61 pp

The total staff as at December 31<sup>st</sup> 2006 includes 9 employees that are seconded to the TIP, ACE. There are also 16 pending cases with CP and REFER employees, who had been transferred to Metro do Porto under an agreement signed in September 1998, between the Portuguese State, the Porto Metropolitan Area, CP and REFER. Under the agreement, Metro do Porto has borne a total cost of 14.1 million Euros to date (in the form of salaries and retrenchment compensations) on that account. This agreement contemplates the availability of State funding "to cover the cost of actions which are the object of this agreement".

Considering the changes in the Company's organisation chart during 2006, the distribution of staff among the various departments, as at December 31st 2006, was as follows:



Metro do Porto has highly qualified staff, and graduates represent 66.9% of staff (or 76.5% of staff, if the CP/REFER employees are excluded).

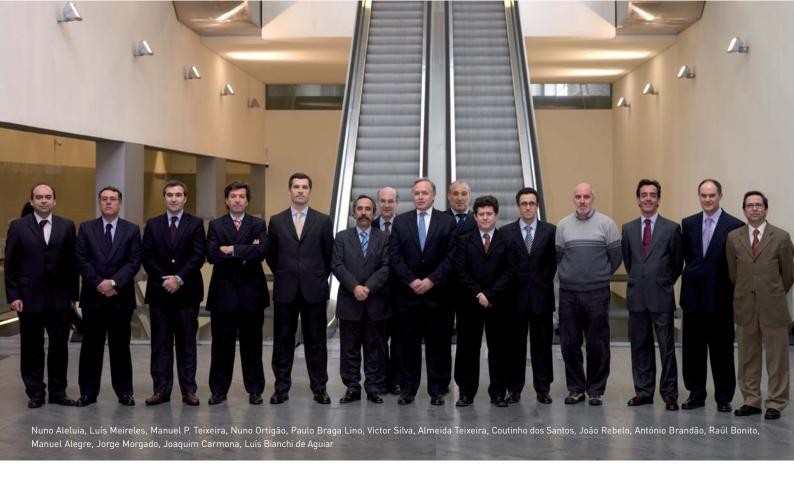
Youth is another characteristic of Metro do Porto's staff. The average age of its staff, in 2006, was 36.9 years of age (36.2 years if the CP / REFER employees are excluded). Excluding the CP/REFER personnel, 66.7% of the employees are up to 40 years old.

Age structure as at 31/12	2003	2004	2005	2006	06/05	06 (%)
20 to 29	37	37	48	26	-45.8%	25.5%
30 to 39	34	43	43	42	-2.3%	41.2%
40 to 49	15	20	20	23	15.0%	22.5%
over 50	12	12	10	11	10.0%	10.8%
Total	98	112	121	102	-15.7%	100.0%
Average age	35.4	35.8	33.9	36.2	6.8%	-

#### **Agreements**

In 2006, Metro do Porto integrated in the Company two trainees graduating in Electro-technical Engineering and Computer Sciences, under an agreement signed with the Faculty of Engineering of the University of Porto, in 2005.

Following on an agreement with the Professional Rehabilitation Centre of Gaia, one additional traineeship opportunity was awarded, and, as at December 31<sup>st</sup>, the traineeship programme has been extended to include a second traineeship in addition to the first, under the same agreement.



# 9 shareholding structure

The Porto Metropolitan Commission, an entity that comprises all the Municipalities of Porto Metropolitan Area, is the major shareholder of the Company. The Municipalities of the neighbouring counties served by the Light Rail System – Gondomar, Maia, Matosinhos, Porto, Póvoa do Varzim, Vila do Conde and Vila Nova de Gaia – have a token shareholding in the Company.

The Portuguese State is the third major direct shareholder, holding 10% of its share capital. The Public Transport Society of Porto (STCP) and the Portuguese Railways (CP), which are companies fully held by the Portuguese State and strategic partners of Metro do Porto on the intermodal project on course of being implemented in Porto Metropolitan Area, hold 25% and 5% of its share capital, respectively.

The Company's shareholding composition remained unchanged during the financial year, and its share capital continued to be represented by 1,000,000 shares with a nominal value of 5 Euros each, distributed as follows:

Shareholder	%
Porto Metropolitan Commission	59.9993
STCP	25.0000
Portuguese State	10.0000
CP	5.0000
Gondomar Town Council	0.0001
Maia Town Council	0.0001
Matosinhos Town Council	0.0001
Porto Town Council	0.0001
Póvoa de Varzim Town Council	0.0001
Vila do Conde Town Council	0.0001
Vila Nova de Gaia Town Council	0.0001

# economic and financial performance

### 10.1 macroeconomic background

Despite more demanding macroeconomic conditions, arising out of a global increase in the cost of finance and a general rise in raw material prices, namely the increase in the oil price, the world economy grew above its historical average growth rate for the third year in a row.

According to the Autumn Forecasts of the European Commission, world GDP is forecast to grow by close on 5%, very much on a par with growth of 5.3% and 4.9% recorded for 2004 and 2005, respectively. The European countries – the Euro Zone, the United Kingdom, the Scandinavian countries, and Eastern Europe – contributed to maintenance of sustained economic growth in 2006, in contrast with poorer performances by the United States of America and some of the emerging market economies.

After a 5-year period marked by average annual growth at a pace of 1.4% per annum, the Euro area is finally showing signs of a reversal in its recent cycle of weak economic growth. The Autumn Forecasts of the European Commission point to a growth rate of 2.6% for the Euro Zone (2.8% growth for the EU). Even the most optimistic growth forecasts published at the beginning of 2006 were largely exceeded by the area's actual economic performance.

The European Union's higher than expected growth relied on the performance of its domestic demand. Investment growth, in particular, was noticeably robust, growing at an annual rate of 6% during the first half of the year, while private consumption growth fluctuated between quarters of highly exuberant growth and quarters of more modest growth. Based on the available information, and namely on trends in the consumer confidence index of the European Commission and the coincident private consumption indicator calculated by Portugal's Central Bank, Banco de Portugal, expectations for 2007 are for a rise in private consumption.

According to the Winter Bulletin of Banco de Portugal, Portugal's GDP is expected to grow by 1.2% in 2006 (following 0.4 % in 2005). A recovery in economic activity is also being expected, and GDP growth is being forecast to grow by 1.8% in 2007 and by 2.1% in 2008. In 2006, growth was characterised by a poor contribution from domestic demand (+0.1 percentage points), reflecting the strong fall in investment and a deceleration in private consumption growth, while the contribution of net exports would have recorded an increase slightly above the 1 percentage point mark, as a result of significant export growth going hand in hand with moderate import growth.

Inflation in the Euro Zone remained above the 2% mark for the seventh year in a row. Albeit only by a small margin, the ECB's price stability goal was thus once more not reached with respect to every year of its existence (except for its inception year, 1999). According to Eurostat, the annual inflation rate for the entire Euro Zone reached a level of 2.2% in 2006. Inflation should remain slightly higher than 2% in 2007, dropping to less than 2% by 2008.

On a harmonised basis, the European Statistics Office indicates an annual inflation rate of 3% for Portugal, in 2006. The Winter Bulletin of Banco de Portugal points to an inflation rate of 2.3% for 2007, and of 2.4% for 2008, as measured by the year-on-year change in the Consumer Price Index.

The process of world monetary policy standardisation has not been homogeneous – the Bank of England was the first to raise its base interest rates (in November 2003), followed by the Federal Reserve (in June 2004), the European Central Bank (in December 2005) and, finally, the Bank of Japan (in July 2006) – which has implied a substantial tightening in monetary policy on a global scale with a consequent concentration of a major portion of the required adjustment in interest rates taking place during the course of 2006.

Since December 2005, the ECB has been adopting an aggressive monetary stance which has seen six increases in interest rates before the latest rise in December 2006. From a trough of 2.0%, the ECB has increased its discount rate (refi rate) to 3.5% by year-end. The market is anticipating that the current cycle of rising interest rates has still not run its full course.

From the beginning of 2006 and until mid-May, the interest rate market of the Euro Zone was marked by quick rises in long-term bond rates for public debt. During that period, the yields on 10-year German Government bonds rose from 3.20% to 4.15%, i.e., an increase of 95 basis points.

As from May, and in tandem with the ECB's tightening of the cycle of interest rate rises, demand for long-term public debt skyrocketed for the longer maturities, bringing down their respective interest rates, which, in turn, resulted in a sustained fall in German bond (Bunds) yields, dropping to a 3.70% to 3.80% range. As a consequence, the slope of the interest rate curve started to flatten throughout the year until it became almost flat by year-end.

Public finance is in better shape than what was being forecast in Spring, with an average budget deficit at a level of 2% of GDP for 2006 (EU and Euro Zone), lower than the 2.3% of GDP recorded by the EU and the 2.4% recorded by the Euro Zone in 2005. To a large extent, the improved performance was attributable to higher than expected tax collections.

In its Stability and Economic Growth Programme of June 2005, the Portuguese Government committed to lowering Portugal's budget deficit from the 2005 level of 6% of GDP to less than 3% of GDP by 2008, without resorting to extraordinary items. The State Budget for 2006 forecast the deficit to reduce to 4.6% of GDP, and it is to be expected that this target will be reached.

The Portuguese labour market performed in tandem with the country's modest economic growth, and it is estimated that employment grew by about 0.6% in 2006. According to the IMF and the European Commission, Portugal's unemployment rate should be hovering between 7.5 and 7.7% for 2006 and 2007, close to the 7.5% unemployment rate recorded for 2005.

Standard & Poor's maintained the Republic of Portugal's debt rating at AA- throughout 2006. This rating agency maintained its stable long-term outlook for 2007, but highlights the fact that the rating is currently vulnerable, although it did not foresee a change in the medium run.

#### 10.2 investment

Metro do Porto's investment expenditure amounted to 301.5 million Euros in 2006. On a cumulative basis, total investments into its project have now reached 2,031 million Euros.

### 10.3 financing

The Light Rail System project has been confronted with major funding constraints during the last few years. Given that almost the entire construction that has been on course throughout 2006 has now been completed, those constraints have even greater adverse impact.

The deadlock on approval of various structured finance solutions presented by the Company, hand in hand with the Government approving new projects (namely the approval of a proposal for strengthening the train fleet without subsequent approval of the respective funding, for which the Company has already submitted firm proposals), has left Metro do Porto with no option but to increase utilisation of bridging finance lines.

Since such finance attracts terms and conditions which are clearly maladjusted to project imperatives, the Company has been incurring in funding costs which are rather higher than what would be justifiable when compared with the best solutions available in the marketplace.

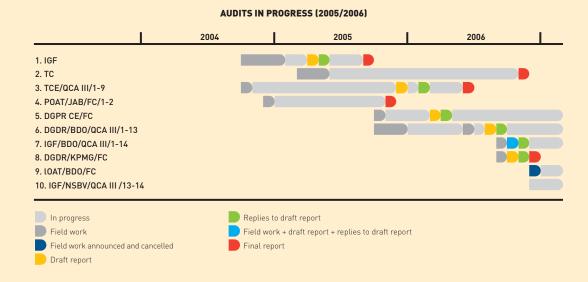
The position is further worsened by the shortness of the project's non-recoverable grants component. The trend in investment expenditure being approved, on a par with rigidity in obtaining funding from those sources (i.e., the ERDF – European Regional Development Fund, the Cohesion Fund, and funding available under Chapter 50 of Portugal's State budget, as allocated under its PIDDAC – Central Administration Investment and Development Expenditure Programme), results in a reduction – from 43.9%, as was originally envisaged, to only 24.7% – of the share of investment to be financed out of those sources within the project's funding structure.

We highlight that the need to allocate funding to the project by means of non-recoverable grants is not only still in place but becomes even more pressing in order to ensure its future sustainability. Metro do Porto had been reiterating the pertinence of reprogramming its ERDF funding within the scope of CSF III, but no reply whatsoever has been forthcoming from the entities involved.



### Metro do Porto, S.A. audits

The Company has been the object of numerous audits, often taking place simultaneously, and both with respect to the various projects being co-financed under EU funding mechanisms, as well as outside that scope.



Within the scope of our applications under EU funding mechanisms, the following audits have been conducted to date:

# 1. Audit of the Investment Project – Light Rail System of the Porto Metropolitan Area – 1st Phase by the Community Support Framework II, being conducted by the "Inspecção Geral de Finanças", in 2001.

This audit concerned expenditure that was incurred into between 1994 and 2000, as submitted per seven Drawings under this project. The Audit Report reads "Based on the considerations hereof, we reach the conclusion that the organisation and operation of the implemented management control system is able to ensure that the allocated public funds are being adequately managed, and in accordance with domestic and Community standards". The report recommends that a number of procedural improvements be introduced, which were promptly implemented by the Company. There were accounting changes with impact on eligible expenditure, which decreased from 28 to 22 billion Escudos (from 140 to 110 million Euros). The amount of advances (allocated to the Normetro and CGK consortiums) accepted under the CSF II programme was defined, and the report determined that the remainder of those advances should fall under the CSF III programme.

# 2. Audit to the Light Rail System of the Porto Metropolitan Area – 2<sup>nd</sup> Phase, 1<sup>st</sup> Level Control, conducted by Chartered Accountants Carlos José, Victor José e Valente, SROC and Santos Vaz & Trigo de Morais, SROC, in 2003.

Expenditure submitted under the first four Drawings, which had been incurred between October 2000 and March 2002, was analysed and the audit team refers that the "technical and administrative application file had been adequately prepared, although its perusal was somewhat complex given the size of the project". The Audit report does not recommend any type of financial correction.

## 3. Audit to the Light Rail System of the Porto Metropolitan Area – 2<sup>nd</sup> Phase – CSF III, conducted by the European Court of Auditors, in 2004.

The audit team of the European Court of Auditors visited the Company on October 13th to 14th 2004 and analysed a set of supporting documentation with respect to the eligible expenditure (incurred between October 2000 and July 2003) as submitted with the first nine Drawings, as well as the respective technical and administrative application file. The results of the audit were advised during June 2006, and a number of expenditure items was identified as non-eligible by the European Court of Auditors:

- Expenditure submitted prior to the starting date of the period of eligibility (for an amount of 21,264,988.67 Euros) which amount respects to invoices for advances, dated 1998 and 1999, which the "Inspecção Geral de Finanças" audit referred under paragraph 1 had considered eligible for Community Support Framework III funding;
- Expenditure with consultancy (for an amount of 38,227.22 Euros) which, following justification by Metro do Porto, S.A., was eventually considered eligible.

# 4. Monitoring audit – POAT – Cohesion Fund – Project: Connection to the Francisco Sá Carneiro Airport, conducted by Júlio Alves Batista, SROC in 2004.

This audit by a team of four members, which took place between December 7th and 10th 2004, analysed the information supporting expenditure incurred between October 2003 and June 2004 (incorporating the first two Drawings), as well as compliance to regulations in terms of advertising, public tender awarding, and environmental impact analysis. A physical verification of the investment was also carried out. The Audit Report, received on November 30th 2005, concluded that all the aforementioned regulations had been conformed to. The expenditure related to compensations payable for expropriated land was the object of financial adjustments with respect to differences between the purchase price of the land and the values indicated on valuations by experts, since it was considered that such expenditure was not eligible. The absolute or relative value of those differences was therefore not taken into consideration, nor was the loss arising to the overall project should the agreement that was negotiated in each instance not materialise, taking into account the concrete development of the construction works. This adjustment was effected with the fifth Drawing.

#### 5. Cohesion Fund audit, conducted by the "Direcção Geral do Desenvolvimento Regional", in 2005.

The main objective of this audit was to ascertain compliance on the part of the Company to regulations concerning advertising and public tender awarding within the scope of the construction project to connect the Francisco Sá Carneiro Airport to the Póvoa Line co-financed by the Cohesion Fund. As concerns information and advertising measures, the Company was found to have complied with all requirements under Regulation (EU) no. 621/2004 of the European Commission, of April 1st 2004. As concerns the requirements on public tender awarding, the Company was found to have complied in two procedures: International Public Project Tender, Construction and Operation of a Light Rail System for the Porto Metropolitan Area and respective amendments (relating to the duplication of the Póvoa Line); and the Public Tender Contract for Construction of the Connection of the Light Rail System to the Francisco Sá Carneiro Airport - Airport Line. Clarification was also requested and formally given on the unpredictable character of the circumstances dictating the need to duplicate the Póvoa Line (Amendment), which constituted a different focus of analysis with respect to the one underlying the information which had been supplied with the application that was approved by the Cohesion Fund - a difference which, in turn, was due to the prevailing evolution of concepts concerning the justification for the so-called "additional works". The draft Audit Report was presented to Metro do Porto, S.A., on March 2006, and the Company has already replied thereto in April of the same year. To date, the final report has not yet been presented, while a new audit conducted by the same entity has, in the meantime taken place during 2006 on the same issues, as presented below (under paragraph 8).

# 6. Audit to the procedures for public tender contracting subjacent to expenditure on the Light Rail System of the Porto Metropolitan Area project – 2<sup>nd</sup> Phase, conducted by BDO e Associados (on instructions from the "Direcção Geral do Desenvlovimento Regional"), starting 2005.

This audit by a 3-member audit team, which took place between October 17<sup>th</sup> 2005 and November 17<sup>th</sup> 2006, checked the public tender awarding procedures with respect to the project relating to the first thirteen Drawings under CSF III. Clarification was requested and formally given on the inseparability and unpredictability of the works awarded under the 1<sup>st</sup> Amendment to the Construction and Operation of a Light Rail System for the Porto Metropolitan Area project, which were due to a change in concepts, as mentioned under the preceding paragraph. This 1<sup>st</sup> Amendment had already explicitly integrated the application for CSF III co-funding (via the Accessibility and Transport Operational Plan) as presented in June 2001, and as approved in June 2002.

On August 22<sup>nd</sup> 2006, a draft report was received, according to which the clarifications that were given did not prove the unpredictable nature of the extra-contractual work that was awarded by Metro do Porto, with respect to work for a total value of 63,458,845.20 Euros. This total amount corresponds to an amount of 28,400,764.20 Euros in extra-contractual work included in the 1<sup>st</sup> Amendment to the Contract entered into by Metro do Porto and Normetro, and to an amount of 35,058,081 Euros reported to extra-contractual work which was labelled as "work unsupported by contract". The aforementioned Report reads: "As expected, the "Inspecção Geral de Finanças" should conduct an audit to the "Metro do Porto" project during 2006. That audit should investigate the expenditure that is being part-financed by ERDF and the Cohesion Fund since inception of the project. The conclusions of that audit are to be advised to the Directorate-General for Regional Policy".

The Company replied to the assertions under that audit report on September 25<sup>th</sup> 2006, structuring its reply to address two main contentions:

- The draft audit report is not substantiated, insofar as it merely contends that it did not agree with the "justifications that were presented" and does not clarify at all the reasons why the aforementioned justifications were found unacceptable; therefore, it only states an unsubstantiated conclusion;
- Once proof of the inseparability of the work in question was accepted, the Company proceeded to clarify in more detail the inherent unpredictability both of the work awarded under the 1st Amendment to the contract with the Normetro consortium (which was explicitly included in the application approved by the Commission in June 2002), and of a set of another 32 works listed as "unsupported by contract".

To date, the final report has not yet been received.

# 7. Audit to the public tender awarding procedures applied to expenditure on the Light Rail System of the Porto Metropolitan Area project – 2<sup>nd</sup> Phase, conducted by BDO e Associados (on instructions from the "Inspecção Geral de Finanças"), starting 2006.

This audit is a repeat and an extension of a similar audit mentioned under paragraph 6, although it was now requested by the "Inspecção Geral de Finanças". The object of the audit was an analysis of the expenditure submitted with the fourteen Drawings and it took place between August 30<sup>th</sup> and October 10<sup>th</sup> 2006. The audit was conducted by a team of 4 auditors from BD0 e Associados and 2 auditors from the "Inspecção Geral de Finanças", focusing on the following issues: (i) verification of the organisation of the technical and administrative application file; (ii) verification of compliance with domestic and Community regulations on public tender awarding procedures for the construction and services contracts that were entered into; (iii) verification of other legal and contractual requirements (regular compliance to tax and social security obligations, regulations pertaining to advertising, information, and environmental impact); (iv) analysis of effective investment and its comparison with investment projected under the application for finance; (v) analysis of eligibility of the expenditure incurred; (vi) verification of advances effected; (vii) confirmation of banking records on payments effected; (viii) verification of internal control procedures.

On October 18<sup>th</sup> 2006, the draft report was received, and it highlighted the following conclusions: the existence of "anomalies", which "imply an adjustment to expenditure which is considered eligible in an amount of 136,894,315.45 Euros, of which 27,043,743.26 Euros arise out of anomalies detected within the scope of the analysis of the supporting documentation with respect to expenditure, while an amount of 109,850,572.19 Euros arises out of anomalies detected within the scope of the analysis of the respective public tender contracting procedures ..." Of the 27 million Euros, an amount of 21.3 million Euros respects to advances made to Normetro and CGK, an amount of 1.8 million Euros respects to excessive allocation payable for expropriated land, and an amount of 3.9 million Euros respects to excessive allocation. In turn, the amount of 110 million Euros is distributed in the following manner: an amount of 34 million Euros relative to the 1st Amendment with Normetro; an amount of 48 million Euros relative to so-called extra-contractual work "unsupported by contract" undertaken by Normetro, and an amount of 27.5 million Euros relative to an advance for extra-contractual work listed under the arbitrage commission's decision. No other irregularities were found with respect to any of the other issues analysed by those auditors.

The Company submitted its reply within the originally stipulated deadline of October 30<sup>th</sup> 2006 and again subsequently (under extended terms) by November 17<sup>th</sup> 2006, which, in essence, focused on the following aspects:

- The advances to the two Consortiums were expressly stipulated in their respective contracts and followed procedures recommended by the "Inspecção Geral de Finanças" within the context of the closing of the CSF II programme (see paragraph 1);
- The concept of unpredictability, even under the more restrictive applicability conditions now being adopted, was subjacent to all decisions and execution of the entire project which was the object of the 1st Amendment to the contract with Normetro, both from a factual as well as from a legal perspective;
- The aforementioned 1<sup>st</sup> Amendment had already been explicitly a part of the application under the CSF II programme (via the Accessibility and Transport Operational Plan) as approved in June 2002;
- The execution of the extra-contractual work "unsupported by contract" corresponded to unpredictable circumstances and the formalities that were followed for its contracting integrate the legal concept of "documentary evidence", and therefore, such work cannot be considered as "unsupported by contract";

The final report has not yet been received.

## 8. Cohesion Fund Audit, conducted by KPMG (on instructions from the "Direcção Geral do Desenvolvimento Regional"), starting 2006.

This audit is a repeat and an extension of the similar audit mentioned under paragraph 5, this one conducted, in turn, by KPMG. This audit to the 2003/PT/16/C/PT/012 "Connection of the Sá Carneiro Airport to the Póvoa Line on double track" project was undertaken by a team of four auditors, at the head offices of Metro do Porto, S.A., between the 18th and 22nd of September 2006 and focused on the following issues: (i) checking the physical and financial execution of the investments and (ii) checking for application of the ruling regulations on public markets matters.

On October 19th 2006, a draft report was distributed. In this report, the auditors reached the conclusion that they did not agree to the justifications put forward with respect to an amount of 41,895,081.75 Euros in expenditure on extra-contractual work awarded by Metro do Porto. This total is made up of an amount of 39,564,215.48 Euros with respect to extra-contractual work included in the 3rd Amendment to the contract entered into by Metro do Porto and Normetro, plus an amount of 2,330,866.27 Euros relative to extra-contractual work that was classified as "unsupported by

contract", all such with respect to the duplication of the Póvoa Line. The report concludes that although the duplication of the Póvoa Line is of a complementary character with respect to the object of the Contract, and that the duplication of the Póvoa Line is technically or financially inseparable from the object of the Contract, under penalty of serious inconvenience, the requirement for the duplication of the Póvoa Line is, however, not a consequence of unpredictable circumstances.

Our reply, submitted on November 17<sup>th</sup> 2006, which discussed the reasons for the entering into the 3<sup>rd</sup> Amendment by direct contract amendment, focused on the analysis of the following requirement: the need to duplicate the Póvoa Line was required for the execution of the object of the Contract following on the emergence of unpredictable circumstances. The main contentions of the report are:

- The concept of unpredictability, even under more restrictive conditions of applicability now being adopted, was subjacent to all decisions and execution of the entire project under the 3<sup>rd</sup> Amendment to the Contract with Normetro;
- It is not the place of Metro do Porto, S.A. to define public passenger transport strategies, which is the prerogative of the ceding entity awarding the metro services concession (the Portuguese State), nor to plan for works that are beyond the object of its Concessionary Conditions;
- The need to duplicate the Póvoa Line was a consequence of the decision to build a connection to the Airport, which decision was taken by the Portuguese State and included in the Public Transport Strategy of the European Commission, as well as a result of the emergence of a set of new variables which were entirely extraneous to the control of Metro do Porto, between 1994 and 2002, such as: safety issues the probability of train collisions due to human error or signalling failure increases significantly when only single tracks are available and intervals of train circulation are reduced (which reduction became a necessity between 1994 and 2002, due to the decision to connect the light rail network to the Airport, and also on account of the increase in expected demand between those dates), while, in fact, it became almost impossible to undertake that operation under such conditions; strong urban growth in the cities of Vila do Conde and Póvoa, demonstrably well in excess of demographic and urban trends known as at the date of the original research into potential demand; the consequent need to reformulate the network's operational model by introducing various types of train service and higher operating speeds (express service); and a strong international trend regarding light rail services. All such issues were documented in reports issued by specialists on each of those areas;
- The part-financing approved by the Cohesion Fund was for the project exactly as it was executed, i.e., following the tender procedures by direct contract amendment with Normetro ACE for the duplication works (as explicitly presented on the application and as abundantly discussed prior to approval), since all legal requirements had been complied with.

The final report was distributed on December 18<sup>th</sup> 2006 and it differs from the draft report only insofar as adding the following passage: "However, we cannot fail to mention that the Amendment in question was expressly mentioned on the application to the European Commission, giving that institution the opportunity to have ascertained its ineligibility right at the outset, based on the information that was made available."

## 9. Cohesion Fund Audit, conducted by BDO e Associados (on instructions from IOAT), announced in 2006.

On November 2<sup>nd</sup> 2006, the Company's cooperation was asked for this audit, scheduled to start on November 6<sup>th</sup>. Its objective was to analyse expenditure allocated under the nine Drawings that had been submitted to the sector manager up to the end of 2006, as well as the respective public tender contracting procedures subjacent to that expenditure. The audit was, however, suspended on the day that it was scheduled to start, and the Company is not aware of whether it has been rescheduled.

# 10. Audit to the procedures for public tender contracting subjacent to expenditure on the Light Rail System of the Porto Metropolitan Area project – 2<sup>nd</sup> Phase, conducted by the "Inspecção Geral de Finanças", as announced in 2006.

On December 18<sup>th</sup> 2006, the Company's cooperation was asked for this audit. The "Inspecção Geral de Finanças" appointed external chartered accountants Noras Silvério e Bizarro do Vale, Sociedade de Revisores Oficiais de Contas, to check expenditure included in the certification of expenses with respect to the 13<sup>th</sup> and 14<sup>th</sup> Drawings. No news have been forthcoming on this audit subsequent to that date.

In addition to the Audits arising on the project's Community co-financing arrangements, the following audits have also been conducted:

## 1. Technical and accounting audit conducted by the "Inspecção Geral de Finanças" and the "Inspecção Geral de Obras Públicas, Transportes e Comunicações", in 2004

In conformance to Ordnance n°. 432/2004, jointly issued by the Ministers of State and Finance and the Minister of Public Works, Transport, and Communications, of June 30<sup>th</sup> 2004, the Company was the object of a technical and accounting audit in 2004, conducted by the "Inspecção Geral de Finanças" and the "Inspecção Geral" of the Department of Public Works, Transport, and Communications. The audit covered the financial years 2003 to 2004, and including up to date information as available.

The draft report, dated March 21<sup>st</sup> 2005, was replied to by the Company on April 5<sup>th</sup>. The final report, dated June 14<sup>th</sup>, was distributed to the Company on September 28<sup>th</sup>. All specific recommendations of a procedural nature put forward by the report have already been implemented by Metro do Porto, S.A.

There were instances of convergence already with respect to the draft version of the report and the following, inter alia, are recapped below, in order to establish that the opinions of the "Inspecção Geral de Finanças" have not yet been implemented, for the reason that those are not dependent on a decision from the Company's Board of Directors:

- The "Inspecção Geral de Finanças" emphasises the need to regulate by contract the metro services, as envisaged under the Concessionary Conditions;
- It supports a reinforcement of the non-refundable component of the project's total funding;
- It proposes the creation of a specific "financial envelope" with respect to the urban integration works:
- It reminds that the costs borne by the Company between 2001 and 2003 with respect to the exemployees of CP and REFER, in the amount of approximately 11 million Euros, should be absorbed by the State.

The remaining instances of convergence, as well as the issues on which there were divergent opinions, have already been mentioned in our Annual Report 2005.

#### 2. Audit of the "Tribunal de Contas", starting 2005

Within the scope of action of the "Tribunal de Contas", the auditing programme of the Audit Department VIII/Technical Support Unit 2, for 2005, envisaged an audit to the management of the Company, with reference, in essence, to the financial years 2003 and 2004. The field work took place between March and May 2005, and was conducted by a team of four members. Their audit report was finalised on December 21st 2005, to which the Company responded on February 1st 2006. The final report was distributed to the Company on November 9th 2006.

Both the report and the replies of the Company concern too many issues to be covered herein or even to be summarised in this report. In that regard, we advise that both the report and our replies thereto are available at <a href="http://www.tcontas.pt/pt/actos/rel">http://www.tcontas.pt/pt/actos/rel</a> auditoria/2006/audit-dgtc-rel033-2006-2s.pdf

(the replies start on page 112 of the document published therein). We shall only refer to (in separate sections) two illuminating issues.

Among the decisions of the Judges of the "Tribunal de Contas", we highlight the following:

- Notification to the report of the Assistant Attorney General seconded to the "Tribunal de Contas". According to the his decision of November 13<sup>th</sup> 2006, this Magistrate determined that the proceedings be filed with immediate effect.
- That the Chairman of the Shareholders Meeting board and of the Board of Directors inform the "Tribunal de Contas", within a term of 180 days, of the Company's follow-up on the "Recommendations" under Paragraph 303 of the aforementioned report.

On December 6<sup>th</sup> 2006, during a meeting also attended by the Company's Auditor, the Board of Directors considered the recommendations that had been addressed to it. It then decided to follow up accordingly on all the recommendations which were within its reach to implement. Nevertheless, it noted that some of the Court of Auditors' recommendations to the Board of Directors were dependent on consideration and decision by the Shareholders Meeting and therefore requested the Chairman of the Shareholders Meeting, on December 22<sup>nd</sup> 2006, to convene an extraordinary meeting to consider such issues that were exclusively within the its capacity to deliberate on, namely:

- The obtaining and realisation of supplementary funds from shareholders;
- Accounting for the funding of the investment. Should the Shareholders Meeting approve the recommendations of the "Tribunal de Contas", it shall decide on the measures to be taken in order to conform to the terms and for the purposes of Article 35, Paragraphs 1 and 3, of the Companies Act.

At the same meeting, the Board of Directors recognised that the recommendations of the "Tribunal de Contas" addressed to the Shareholders Meeting suggested that that body consider as well the following additional matters:

- An appraisal of the financial standing of the company;
- The remuneration of its Directors and the controls of the timing for the execution of that task by the Remuneration-setting Committee.

Such meeting was convened by the Chairman of the General Assembly forthwith and took place on January 31st 2007, as has already been detailed under the section of this report dedicated to events occurring after the close of the financial year.

# 3. Inspection of the VAT collection services by the "Direcção Geral de Contribuições e Impostos", for the purpose of analysing "a number of issues identified in the Audit Report of the "Tribunal de Contas", concerning VAT".

This inspection took place on December 11<sup>th</sup> and 12<sup>th</sup> 2006, and it should resume during 2007. It has not been possible to understand what the issues under analysis are.

### 4. Audits to the Tangible Fixed Assets Register, conducted by PriceWaterhouseCoopers in 2000, 2002 and 2004

As per the foregoing under Decree-Law no 394-A/98, of December 15<sup>th</sup> (Condition VII, n°. 3), the Company is to implement an audit of its Tangible Fixed Assets, Intangible Fixed Assets, and Fixed assets in progress, by external Auditors, every second year.

The following can be read on those reports: "In our opinion, the schedules of fixed assets referred under the first paragraph of this report reflect the Company's Tangible Fixed Assets, Intangible Fixed Assets, and Fixed assets in progress in an appropriate manner and for all materially relevant aspects..."

These procedures are also being developed with respect to our 2006 financial year.

#### ERDF - European Regional Development Fund

During January, the 15<sup>th</sup> Drawing under the Third Community Support Framework programme was submitted, envisaging the obtaining of co-financing in the amount of 16.7 million Euros. The request was reformulated in November, in order to correct a number of shortcomings which had been identified pursuant to an audit of the project, and the amount of the claim was adjusted to 14.4 million Euros. To date, no amounts whatsoever have been paid to Metro do Porto.

In April, 27.6 million Euros were received with respect to part-financing under the 14<sup>th</sup> Drawing, which had been submitted in September 2005. That request claimed part-financing to the tune of 31.5 million Euros and the difference arose due to the fact that the entity managing the cofinancing programme ignored the rescheduling of certain expenditure items which had, in the meantime, been agreed to, having returned to the original scheduling without any further advices (which were promptly requested).

The 16<sup>th</sup> Drawing, claiming a total of 10.5 million Euros in co-financing, was submitted in August, but, to date, no funds have been received.

In the light of the maximum permissible amount of 315.7 million Euros in co-funding (a co-financing rate of 38.5%), 99.3% of the project finance has been executed, as at the end of 2006. The following table reflects the performance of the funding obtained under ERDF – CSF III:

(Units: Euro thousands)

Drawings	Period of	Eligible	Co-funding	Disbursement	Amount
	Investment	Investment			Outstanding <sup>1</sup>
Position as at 31/12/2005	Oct00-Aug05	750,008	288,378	256,868	31,510
15 <sup>th</sup> drawing	May05-Aug05	37,553	14,439	0	14,439
16 <sup>th</sup> drawing	Sep05-Apr06	27,409	10,539	0	10,539
		814,971	313,356	256,868	28,875

<sup>1</sup> Amount outstanding as at the end of 2005 with respect to the 14th Drawing. The amount was partially received during April 2006

#### PIDDAC - Central Administration Investment and Development Expenditure Programme

On August 17<sup>th</sup> 2005, Metro do Porto was advised of the allocation of 67 million Euros under the PIDDAC 2006 programme. According to the guidelines of the Ministry for Public Works, Transport, and Communications, an amount of 60 million Euros was to be utilised during the first phase of the System's implementation, and an amount of 7 million Euros was to be allocated to the Airport Line. On September 14<sup>th</sup> 2005, the allocation was adjusted to a total of only 10 million Euros to be utilised for implementation of the first phase of the System. On January 13<sup>th</sup> 2006, Metro do Porto was advised that 7.5% of the allocation under Chapter 50 of the State Budget had been blocked.

Metro do Porto then requested the allocation of 9.25 million Euros which made available on May  $4^{th}$  2006, and the amount was received during that same month.

(Units: Euro thousands)

Project	1996/03	2004	2005	2006	Total
Light Rail System	53,389	12,750	12,252	9,250	87,641
Infante Bridge	33,760	0	0	0	33,760
Total	87,148	12,750	12,252	9,250	121,400

#### **Economic studies**

1. Under Paragraph 1, sub-paragraph 1, of its request for documentation, which was, besides, the document where it announced its Audit (on March 3<sup>rd</sup>, 2005), the "Tribunal de Contas" requested:

"the economic studies and other documentation on which the launch of the Company was based"

2. The Company was launched on August 6<sup>th</sup> 1993 and began its activity on April 1<sup>st</sup> 1994. Decree-Law n°. 71/93 took effect as from March 10<sup>th</sup> 1993. Any feasibility studies subsequent to 1993 are, therefore, by definition, subsequent to the launch of the Company which is today designated as Metro do Porto, S.A.. Even so, on March 16<sup>th</sup>, the "Tribunal de Contas" was supplied with an economic study undertaken in 1998 (which was an integral part of the application for the first loan granted by the European Investment Bank as well as of the file analysed by the Treasury within the process of issuing the Republic's garantee backing that same loan).

That study included economic and financial projections for the period 1998 - 2016 and research on the expected demand and accruing social and environmental benefits (conducted by a specialist consultant) – all such information was forwarded to the "Tribunal de Contas" on March 16<sup>th</sup>. Such studies met the standards of both the EIB and the Treasury, which granted the loan and issued a guarantee, respectively, based thereon.

3. On Paragraph 43 of the draft audit report of the Court of Auditors it is stated that:

"With respect to the start-up phase of the metro system of the GAMP, under the ruling Decree-Law  $n^{\circ}$ . 71/93, the legislator did not rule on the compilation of any economic study on the system to be implemented, or even on the compilation of mere cost estimates and the financing thereof. Similarly, the team could not obtain copies of any documentation of that nature which might have been produced on the initiative of the project's proponents."

4. On its reply, the Company stated that this statement:

"needs to be rectified because it is untrue (in addition to the fact that any eventual omissions on the part of the legislator cannot be ascribed to the Company or its shareholders under any circumstances). (...)

Obviously, various economic studies were done of the project to be implemented, and namely the following 25 studies: (...)"

The reply proceeds to list those 25 studies (which were made fully available to the Court of Auditors forthwith, including again the 1998 feasibility study which had already been ignored by the draft report), which number as follows, per year of completion:

- 5. As a matter of fact, the EIB would not have been able to approve loans, the Treasury to issue guarantees, and the services of the European Commission to approve co-financing programmes without such studies (as all such entities did in this instance, between 1998 and 2000).
- 6. In its final report, the Court of Auditors once again ignored the Company's replies having rather stated (and for instance) on its Paragraph 63 that:

"In this way, an overall economic study preceding the launch of the "Metro do Porto" project that could have served as a basis for its execution was not made available (...)"

On the September 21<sup>st</sup>, Metro do Porto was advised of an allocation of 8 million Euros under the PIDDAC 2007 programme. That amount was to be allocated for the acquisition of an additional 30 vehicles. On January 16<sup>th</sup> 2007, Metro do Porto was advised of the blocking of 7.5% of the allocation under Chapter 50 of the State Budget.

#### EIB - European Investment Bank

The facility contracted with the European Investment Bank has been fully drawn, in a total 743.7 million Euros.

(Units: Euro thousands)

Facility	Date of Loan	Value
EIB I		
Tranche A	16 Nov 98	99,760
Tranche B	26 Mar 01	100,000
Tranche C	05 Nov 01	100,000
Tranche D	15 May 02	243,930
sub-total		543,690
EIB II		
Tranche A	29 Nov 04	120,000
Tranche B	16 Dec 04	80,000
sub-total		200,000
Total		743,690

Paragraph 5 of Base XIII of the Concessionary Base for the Light Rail System stipulates a limit of 200 billion Escudos (1,000 million Euros) for the value of the guarantees and other security to be provided by the Portuguese State to the project. If we assume that, when interpreting this amount, the EIB loans and the structured leasing operations that were entered into with respect to the metro vehicles (in an amount of 250 million Euros) would be included therein, any debt that might require the provision of a guarantee or other type of security by the Portuguese State would be dependent on an alteration to the Concessionary Bases.

It is to be noted that, under the terms of Paragraph 5 of Condition XIII, the limit to the guarantees and other security to be provided by the Portuguese State is applicable to loans in addition to finance referred under Paragraph 1 of that same Condition. The guarantees and other security already provided are destineted to guarantee finance envisaged under Paragraph 1 of Base XIII.

Nevertheless, Metro do Porto has already requested on June 21<sup>st</sup> 2005, and again reiterated that same request on October 26<sup>th</sup> 2006, that the aforementioned limit be altered in order to enable utilisation of the undrawn facilities approved by the EIB (in an amount of 60 million Euros) and to raise additional finance to fund the approved projects.

The facility under which the undrawn 60 million Euros were availed of had been granted on October 29th 2002. According to the EIB's internal regulations, such facilities expire if undrawn after four years from date of approval have elapsed, i.e., they would have expired by October 29th 2006. Subsequently, the Board of Directors of the European Investment Bank approved an extension of the facility for an additional term of two years.

During 2005, we applied for a new drawing to fund approved projects which had not yet been financed by the EIB, namely for the purpose of financing the extension between Campanhã and the Dragão Stadium and the network stretch connecting to the Airport, and including the Campanhã and the Dragão Stadium interface.

In order to facilitate the EIB's credit approval process for the proposed drawing, the Secretary of State for Treasury and Finance was requested to issue a "Declaration of Non-Objection" by the Portuguese State on June 23<sup>rd</sup> 2005, which has not yet been secured.

#### **Cohesion Fund**

During the financial year, three Drawings under the project for the construction of the connection of the double track Póvoa Line to the Airport, which is being part-financed by the EU's Cohesion Fund up to a total of 14.7 million Euros in co-financing, were submitted for settlement.

Our latest request (being the tenth Drawing), which was submitted during May 2006, is still pending analysis by the Operational Transport Infrastructure Programme authority. In turn, this entity's analysis and subsequent approval of co-financing funding are dependent on the results of the audit to that Project being undertaken by KPMG on instructions from Portugal's "Direcção Geral do Desenvolvimento Regional", which started in 2006 (see paragraph 8 of the separate box on audit reports of Metro do Porto, S.A.). For the same reason, our eleventh to thirteenth Drawings with respect to funding for capital investment reported to the period November 2005 to February 2006, which are ready for submission, were also not yet submitted.

During May, the settlements reporting to our fifth to ninth Drawings, which had been submitted between June 2005 and April 2006, with respect to capital investment for the period November 2004 to October 2005 totalling 23.8 million Euros, were duly received.

In November 2006, Metro do Porto, S.A. was advised of a reduction in the extent of Cohesion Fund support for the project in an amount of 6,327,182 Euros, "since it is not expected that the conclusions of the audit to compliance on public tender contracting procedures can be timely produced" (letter from the "Direcção Geral do Desenvolvimento Regional" sent on November 8<sup>th</sup> 2006 to DG Régio).

In view of the maximum permissible amount of co-funding, now set at 67.7 million Euros (which was originally 74.0 million Euros being co-financed at a level of 75.0%), only 59.5% of the project finance has now been executed, as at year-end.

The following table reflects the performance of funding obtained from the Cohesion Fund:

(Units: Euro thousands)

Drawings	Period of	Eligible	Co-funding	Disbursement	Amount
	Investment	Investment			Outstanding <sup>1</sup>
Position as at 31/12/2005	Oct03 - Mar05	34,088	25,566	19,004	6,562
8 <sup>th</sup> Drawing	Apr05-Oct05	12,156	9,117	9,117	0
9 <sup>th</sup> Drawing	Mar05-Oct05	2,624	1,968	1,968	0
10 <sup>th</sup> Drawing	Mar05-Oct05	4,852	3,639	0	3,639
		53,720	40,290	30,089	-2,528

<sup>&</sup>lt;sup>1</sup> Amount outstanding as at the end of 2005, with respect to the 5<sup>th</sup> to 7<sup>th</sup> Drawings. The amount was received during May 2006. The negative value as at June 30<sup>th</sup> 2006 is due to an advance being provided in September 2004.



#### Supplementary funds

With a view to fund the set of alterations to the project, as approved by the Government in 2001, the shareholder State, through an Ordnance of June 28<sup>th</sup> 2001 issued jointly by the Ministers of Finance and of Social Infrastructure committed to "provide supplementary funds in the amount of 10 (ten) billion Escudos, up to 2004, expected to be distributed as follows":

(Units: Euro thousands)

2001	2002	2003	2004	Total
7.482	12.470	14.964	14.964	49.880

Taking into consideration the referred Ordnance, the Company accounted for the expected supplementary funds for that year in its 2001 financial year. Since the amounts were never received nor were the subsequent expected supplementary funds ever received, that entry was reversed during the financial year 2002.

#### **Bridging finance**

Faced with total investment needs of 301.5 million Euros throughout the year and an availability of 64.8 million Euros in structured finance (including non-recoverable grants), representing only 21.5% of the amount of investment required, Metro do Porto had to renegotiate and reinforce its short-term credit facilities.

By year-end, the Company could avail of up to 328.3 million Euros in short-term credit facilities, including advances on drawings under Community co-funding, having utilised 265.4 million Euros thereof (to compare with 285.0 million Euros outstanding as at December 31st 2005).

Metro do Porto has held discussions with its banking partners to the effect of refinancing its short-term bridging finance needs. In 2006, four medium-term debt rescheduling operations took place, involving a total amount of 380 million Euros.

In addition to the gap between funding and investment, insufficient compensation has been attributed to the Company as compensation for the rendering of a public transport service. Such compensations attributed with respect to 2006 have only grown by 7.0% when compared with the amount that had been paid in 2005. However, the volume of the services supplied grew 93.1% and demand volumes grew 109.1%, during the same period. As of date of publication of this report, the amount that might be attributed to the Company on that account for 2007 is unknown.

Furthermore, the Portuguese State has failed to compensate the Company for making its infrastructure available, and namely with respect to covering the cost of the EIB finance contracted, and of the operational leasing rentals which have amounted to 24.9 million Euros and 12.2 million Euros, respectively, for the 2006 financial year.

#### Public programme contract

The Concessionary Base of the Light Rail System, as approved by Decree-Law n°. 394-A/98, and namely Paragraph 1 of Base XV, establish that the State will pay "compensation to the extent that might become required to ensure the operation of its transport system on a public service provision basis, after accounting for revenue earned on its operations, which is to be derived according to efficiency and cost-effectiveness criteria". Such compensation, and according to Paragraph 2 of Base XV, "shall be the object of the following Contracts to be entered into by the State and the Concessionary: a) An initial Public Programme Contract to be entered into for a period of 18 months counting from the date of publication of the act approving these Concessionary Base, and with respect to the early operational stage of the System".

Of its own initiative, and following an informal presentation in July 2002, Metro do Porto submitted its first formal proposal for the aforementioned Public Programme Contract in September 2002. That proposal was reformulated still during 2002, but the Company has received no advices on its proposed reformulation.

In 2003, which was the System's first year of commercial operation, no compensation whatsoever was received on that account. The amounts which were, in the meantime, attributed to the value of such compensation with respect to our 2004 to 2006 financial years are mere token values, and, to date, the way in which they were determined remains difficult to objectively explain. The amount of compensation that is to be attributed for 2007 is still unknown.

In this context, and in order to comply with the recommendations of the technical and financial audit of Metro do Porto, S.A. conducted by the "Inspecção Geral de Finanças", according to which Metro do Porto should "submit to the Government and to the Porto Metropolitan Public Transport Authority, a proposal on its obligations as a public service provider and the respective financing thereof, in 2005", Metro do Porto indeed submitted a new proposal for the aforementioned Public programme contract in December 2005. The new proposal was handled in exactly the same way as the prior proposals.

#### International Rating of the Company

With a view to resolve the constraints in obtaining finance for the Company's operations, and in particular given the prevailing interpretation of the limit to the value of guarantees and security which the Portuguese State might supply, in 2004, Metro do Porto started a rating process to obtain an international rating from two reputed international rating agencies. The option for a financing structure based on the Company's debt rating would also bring additional important benefits when the current level of indebtedness of the public sector is taken into account.

Since August 2004, the rating process has been pending the availability of the Portuguese State shareholder to talk to the rating agencies on this subject, as has been repeatedly requested.

#### Funding of the Antas-Gondomar Line

As per Resolution n°. 126/2003, of August 28<sup>th</sup> 2003, of the Council of Ministers, Metro do Porto was instructed to present a public-private partnership financing model for the construction of its Antas – Gondomar Line. The Monitoring Committee which was stipulated under Decree-Law n°. 86/2003, of April 26<sup>th</sup>, was appointed by Ordnance n°. 49/2004, of January 30<sup>th</sup> issued jointly by the Ministers of Finance and of Public Works, Transport, and Housing.

On March 31st 2004, Metro do Porto proceeded to issue the notification required under Paragraph 6 of Article 8 of that Decree-Law. To the effect, Metro do Porto submitted the full file on the envisaged Antas – Gondomar public-private partnership to the Monitoring Committee, which included the respective Technical Specifications for the construction and the respective Tender Programme. The views of the Committee and the Government's decision thereon are still being awaited.

#### Interest rate risk exposure management policy

Within the scope of our on-going active management of interest rate risk exposures, the performance of financial markets has been actively monitored, with a view to optimise the risk management policy being applied. Particular attention was given to the performance of the structure of interest rate risk cover instruments contracted, and namely to our decisions taken in 2003 to:

- Enter into a plain vanilla swap, in March, to cover interest rate risk on the operational lease contract that had been entered into in 2002, by covering the full maturity of the underlying operation with an interest rate swap;
- Conversion, with effect as from March 2003, to revisable rate on tranches B and C of the first EIB loan, up to March 2009 and up to September 2009, respectively;
- disbursement, in April 2003, on a revisable basis, of a portion of Tranche D of the first EIB loan, up to March 2010.

In August 2006 the interest rate on the last transaction above was reviewed, and the disbursement, of the remainder of Tranche D of the first EIB loan was done on that basis, up to the termination of those contracts.

An interest rate risk restructuring operation was contracted after the end of the financial year, with effect as from December 15<sup>th</sup> 2006, of the plain vanilla swap that had been contracted during March 2003.

### Interest rate risk management

1. Paragraph 157 of the draft report of the "Tribunal de Contas", included the following comment:

"On 27/03/03, an interest rate swap [...] was entered into, with respect to the operational lease dating to 2002.

The swap aims to effectively reduce the cost of finance which (sic) has not performed satisfactorily nor (sic) have proved more competitive, in relative terms, in the market.[...] "

2. In its reply, the Company stated that:

"The aforementioned interest rate swap was not entered into with the objective of effectively reducing the cost of finance. Quoting Brealey and Myers (1998), "Principles of Corporate Finance", McGraw-Hill, Fifth edition, page 707:

"Insurance and hedging are seldom free: At best they are zero-NPV transactions. Most businesses insure or hedge to reduce risk, not to make maney."

It is also incorrect to state that the swap was not the most competitive that could have been obtained on the market. It was a "plain vanilla" swap for which we had obtained quotes from five financial institutions, of which the most competitive was selected. Should such evidence have been requested, it would have been produced, and it is not reasonable to presume otherwise with no objective information on which to base such a statement.

When valued on a "marked to market" basis today, the position of the Company on that contract appears negative. What that means is that if the future interest rates conform to what is implicit in the interest rate curve as it exits today, then the Company will have lost money at the end of the swap contract. Whether it loses money or not depends on the effective performance of those interest rates over the next 16 years."

3. In its final report, the "Tribunal de Contas" ignored the reply from the Company (which is not mentioned in this particular at any point of the report), and rather stated the following (and for instance) in its Paragraph 206:

"Considering the macro-economic context for future interest rate trends, and judging by the trend in variable interest rates, the option to convert variable rates to fixed interest rates has not been the best option, since the company has been incurring in higher costs."

In its recommendations to the Board of Directors it is stated that.

- "5. Proceed to re-evaluate the fixed-rate options that it has negotiated with the EIB and its interest rate swap with respect to the operational lease contract."
- 4. In order to implement that recommendation, an international financial institution, which is independent from all the parties involved and was no party to any of the contracts referred in recommendation n°. 5, was requested to evaluate the Company's interest rate risk management practices.

The report produced by that financial institution reads as follows:

"An evaluation of whether a decision to fix interest rates was correct or not cannot be done within the term for which the interest rate is fixed – it can only be done as at the date on which the decision was taken and based on data available at that point in time, or ex-post, at the end of the cover period, when uncertainty on the performance of short-term interest rates is no longer an issue."

#### Further on, the report reads:

"Throughout the term of the swap, one may only question whether it is justified to maintain the decision taken (based on new information — i.e., the latest market expectations) or whether it is rather justified that the original decision be "restructured". Given that the macro-economic context is dynamic, any financial strategy (based on a mix of fixed-and variable-rate items) should be the object of on-going management, with a view to optimise the cost of funds and the risk and sensitivity of financial debt."

With respect to framing the decisions to fix interest rates at the time such decisions were taken, the same financial institution reached the conclusion that:

"The minimal interest rates (at the time that the decisions were taken, long-term interest rates had reached historical minima), associated to a macro-economic context of great uncertainty constituted a clear window of opportunity to fix the cost of funds from a financial planning perspective and for the adoption of more conservative strategies with respect to the fixed/variable interest rate mix".

#### 10.4 balance sheet

The on-going investment effort, the completion of the main construction activity for implementing the System, and the financial constraints which the Company is facing, are the direct reasons underlying the main trends in the performance of Metro do Porto's balance sheet.

(Units: Furo thousands)

Balance sheet	2004	2005	2006	06/05
Fixed assets (net)	1,104,047	1,434,112	1,690,847	17.9%
Current assets	147	162	272	68.1%
Short term debtors	61,293	63,890	52,329	-18.1%
Cash and banks	17,547	5,061	2,565	-49.3%
Accruals and deferrals	299,328	286,698	272,674	-4.9%
Assets	1,482,362	1,789,923	2,018,688	12.8%
Share capital	5,000	5,000	5,000	0.0%
Called-up share capital	179	179	179	0.0%
Concedent instalments	332,128	402,883	463,561	15.1%
Retained earnings	-29,632	-67,581	-138,916	-105.6%
Net income	-37,949	-71,335	-122,155	-71.2%
Net capital value	269,726	269,146	207,669	-22.8%
Provisions	18,000	10,766	10,766	0.0%
Medium and long term debt	898,875	970,948	1,341,246	38.1%
Short term debt	179,672	423,396	343,213	-18.9%
Accruals and deferrals	116,089	115,667	115,794	0.1%
Liabilities	1,212,636	1,520,777	1,811,019	19.1%
Net capital value and liabilities	1,482,362	1,789,923	2,018,688	12.8%

On the asset side, the most noteworthy change was the increase in fixed assets, which was a consequence of the maintenance of strong investment activities, and namely following completion of the construction projected for the Red and Green Lines. Gross fixed assets increased by 20.0% when compared to December 2005.

As concerns short term debtors, the amounts outstanding from the Portuguese Sate and other public entities decreased by 10.4 million Euros, as a consequence of speedier VAT refunds and an increase of 4.5 million Euros in other client debtors (consisting almost in its entirety of receivables outstanding from TIP and ACE).

As concerns shareholder funds, Concedent Instalments increased by 15.1%. The variance is due to an amount of 60.7 million Euros received in 2006, arising out of the PIDDAC Light Rail programme, the ERDF and the Cohesion Fund.

The trend in long term debt reflects the aforementioned utilisation of medium term credit facilities to the tune of 380 million Euros.

Short term banking debt decreased by 19.6 million Euros when compared with December 31st 2005.

In aggregate terms, and excluding the loans from the European Investment Bank, the level of indebtedness of Metro do Porto grew by 360.4 million Euros, to reach a total of 645.4 million Euros (including 44.4 million Euros in advances on account of drawings under Community co-funding).



There are no amounts outstanding due to the Portuguese State or other public entities, including social security contributions.

#### 10.5 results

The strengthening of public transport services offered and the lack of sufficient compensation being afforded by the Portuguese State to such social services rendered by the Company explain the main trends in the performance of Metro do Porto's revenue and expenditure structure.

The inadequate structure of the project's funding, which has implied excessive resort to bridging finance in the absence of financial structured solutions, has constrained the management of the Company, and has had a significant impact on the overall cost of financing the project.

(Units: Euro thousands)

Profit & Loss Account	2004	2005	2006	06/05	% Budget
Third party supplies and services	43,100	58,098	75,130	29.3%	103.5%
Staff costs	6,168	5,965	5,708	-4.3%	102.3%
Depreciation	16,600	22,659	40,815	80.1%	64.8%
Financial costs	19,291	26,532	42,334	59.6%	87.2%
Taxes	488	1,216	4,048	232.9%	-
Other costs	361	467	304	-34.8%	-
Costs	86,008	114,936	168,339	46.5%	88.8%
Income	8,822	14,435	25,854	79.1%	96.2%
Operating subsides	4,730	2,246	2,403	7.0%	2.2%
Light Rail System operation	4,730	2,246	2,403	7.0%	5.8%
Infrastructure rent	0	0	0	-	0.0%
Own work capitalised	31,950	24,920	15,789	-36.6%	91.9%
Financial income	870	836	877	4.9%	-
Additional revenue	93	59	47	-20.8%	64.5%
Other income	1,592	1,105	1,214	9.8%	-
Income	48,058	43,601	46,184	5.9%	30.1%
Net income	-37,949	-71,335	-122,155	-71.2%	338.3%



The transportation income includes 21.3 million Euros earned on passenger transport services provided by the Light Rail System and the Guindais Funicular. When compared to 2005, this revenue item grew by 105.5%.

In addition, this item includes an amount of 3.7 million Euros with respect to revenue on maintenance services rendered under operational lease contracts for vehicles. An additional 465.0 thousand Euros respects to other revenue and an amount of 388.7 thousand Euros arises as a result of proportional consolidation with respect to TIP, ACE participation.

Metro do Porto's budget for 2006, which was forwarded to the State in January 2006, envisaged attribution of State compensation to the tune of 109.4 million Euros, which amount was broken down in two components as follows:

- 1. State compensation for passenger transport services, in the amount of 41.3 million Euros (of which 7.3 million with reference to adjustments between the effective value received for the three-year period 2003-05 vis-à-vis the envisaged amount as per the new proposal that had been submitted to the State during December 2005);
- 2. Rentals for the availing of the infrastructure in the amount of 68.1 million Euros.

Resolution n°. 158/06, of November 9<sup>th</sup> 2006, of the Council of Ministers approved the allocation of State compensation for 2006 with respect to the various companies rendering such public services, and the value of State compensation attributed to Metro do Porto for passenger transport services amounted to 2,402,806.27 Euros. This sum, which calculation should have been based on a services contract between the Company and the State, is clearly insufficient when faced with the Company's needs. On the other hand, the inflows of such compensations have been particularly maladjusted vis-à-vis developments in the Company's activities.

The value of State compensation attributed to Metro do Porto corresponds to an average contribution of 1.2 cents per passenger km.

A reduction in the Company's construction activities together with the associated reduction in its personnel were responsible for a decrease of 4.3% in personnel costs incurred during the 2006 financial year.

The variance in third party supplies and services grew in tandem with operation volumes. Payments with respect to the operational contract of the Light Rail System reached 44.0 million Euros for the financial year. This item includes as well 15.8 million Euros with respect to the rentals for the operational lease contract.

The variance in interest expense results from the Company financing model, both with respect to the System's construction as well as to its operation, whose trend was adversely impacted by the constraints that have been referred to under various sections of this report. Such restrictions constrain the Company into having to avail of less efficient financing solutions, with a consequent increase in the cost thereof.

The Profit & Loss Account of the Light Rail System for 2006 reflects more adverse gross and net margins, decreasing by 58.3% and 77.4%, respectively, when compared to 2005. In absolute terms, its gross margin amounted to -21.3 million Euros and its net margin amounted to -76.5 million Euros. Such performance was a consequence of the growth in the operational network.

(Units: Euro thousands)

Metro Profit & Loss Account	2005	2006	06/05
Sales	10,326	21,263	105.9%
Cost of sales	23,792	42,586	79.0%
Gross margin	-13,466	-21,323	-58.3%
Net margin	-43,143	-76,536	-77.4%
Operating result	-60,458	-119,082	-97.0%
Sales to cost of sales ratio	43.4%	49.9%	6.53 perc. points

As a result of a higher average load factor in 2006 when compared with 2005, there was significant improvement in the cost of sales to services rendered cover ratio, and the year closed with a cover ratio of 50%. This ratio compares the revenue on fares with the Normetro operating costs and commission paid to the managing company of the sales network, TIP, ACE.

Revenue arising out of the public passenger transport services of the Light Rail System (net of advertising costs) amounted to 21.1 million Euros in 2006, (an increase of 106.6% compared to the previous year). These figures translate into revenue rates of 54.60 cents per validation (being a decrease of 1.2% when compared with the same period of the previous year), of 10.42 cents per passenger km (a decrease of 2.1%), and of 1.49 cents per seat km (an increase of 7.0%).

The cost of sales and services rendered amounted to 42.6 million Euros, of which 97.9% respect to the operating contract with Normetro. When compared with 2005, an increase of 79.0% in the Cost of sales and services rendered was recorded (being an increase of 78.7% in the cost of the Normetro services and of 95.5% in the cost of the TIP, ACE services).

For 2006, the operational cost per seat km of the Light Rail System was 3.00 cents (being a decrease of 7.3% compared to same period of 2005) and 21.03 cents with respect to the operational cost per passenger km (being a reduction of 15.1%).

The Profit & Loss Account breakdown per System Line, below, reflects net margins of -16.5 million Euros (Line ), -26.0 million Euros (Line ), -15.5 million Euros (Line ), -12.9 million Euros (Line ), and -5.6 million Euros (Line ).

(Units: Euro thousands)

Net margin	2006	%
Blue Line	-16,451	21.5%
Red Line	-26,042	34.0%
Green Line	-15,538	20.3%
Yellow Line	-12,943	16.9%
Violet Line	-5,563	7.3%

The Profit & Loss Account of the Guindais Funicular reflects a negative gross margin of -412.8 thousand Euros and a negative net margin of -427.6 thousand Euros, for 2006.

(Units: Euro thousands)

Funicular Profit & Loss Account	2005	2006	06/05
Sales	137.9	175.7	27.4%
Cost of sales	356.0	588.6	65.3%
Gross margin	-218.1	-412.8	-89.3%
Net margin	-410.2	-427.6	-4.3%
Operating result	-659.3	-792.0	-20.1%
Sales to cost of sales ratio	38.7%	29.9%	-8.88 perc. points

Revenue derived from the Guindais Funicular passenger transport service amounts to 175.7 thousand Euros, which translates into revenue of 34.06 cents per seat km and 1.99 Euros per passenger km (which figures varied by 22.5% and -1.5%, respectively, when compared with the same period of the previous year).

The Guindais Funicular's operational cost is 1.14 Euros per seat km offered and of 6.67 Euros per passenger km, on a cumulative basis (which figures varied by 58.9% and 27.8%, respectively, when compared with the same period of the previous year).

Since the introduction of controlled access at the Parque Metro parking facilities at the Dragão Stadium station, this infrastructure has reflected a marginally positive gross margin and a negative net margin to the tune of -154.3 thousand Euros.

(Units: Euro thousands)

Parque Metro Profit & Loss Account	2006
Sales	25.0
Cost of sales	17.9
Gross margin	7.1
Net margin	-154.3
Operating result	-218.3
Sales to cost of sales ratio	139.6%

## prospects for 2007

Now that the term stipulated under Metro do Porto's Concessionary Conditions for the full System to come into operation, with exception of the ISMAI – Trofa connection, has been complied with, Metro do Porto awaits the State's decision on the project for duplication of that stretch, as submitted in August 2003.

For 2007, the southwards extension of the Yellow Line, starting at the João de Deus station (which is already in operation) and up to the EN222 route is being projected, and the respective public tender process for its construction is still taking its course. Finishing works with respect to the extension of the Yellow Line will also be proposed to the State, to be executed in two stages. The first stage will propose the extension of that line from the EN222 route up to Santo Ovídeo, following the configuration which is currently envisaged under the Concessionary Conditions; and a second proposal, presenting a solution for an extension from Santo Ovídeo up to Laborim.

In the meantime, the works for the elimination of level crossings at the Red and Green Lines shall proceed in 2007, which will contribute to further improve the already high level of safety of the Light Rail System. Other work is also being projected with a view to effect the necessary adaptations to the Guifões machinery and workshop repairs centre (PMO) for handling new Flexity Swift P4500 tram-trains which are in the process of being acquired.

Following approval, on July 7<sup>th</sup> 2006, of the document titled "Metro do Porto, S.A.'s Integrated Corporate Strategy" by the Board of Directors of Metro do Porto, the preparation of tender(s) to secure the continuity of the commercial services operation will take place throughout 2007. The guidelines for a refinancing operation of the investment already made on the network currently operating the Light Rail System of the Porto Metropolitan Area, together with or separately from the financing of new network extensions, will also be defined.

Completion of the works and the proposals of the task force appointed under Ordnance no. 925/2005, of October 20<sup>th</sup>, jointly issued by the Ministers of Finance and Public Administration and of Public Works, Transport, and Communications, is eagerly expected, as they are highly relevant on account of their potential impact on the Company's corporate governance and on the consolidation of the financing structure of the Metro do Porto system.

Government authorisation is being awaited on formalising three further amendments already negotiated with the System construction consortium, with respect to:

- Duplication of the Trofa Line between Fonte do Cuco and ISMAI, of which the partial Fonte do Cuco Fórum da Maia stretch was already inaugurated in July 2005 at a ceremony attended by the Minister of Public Works, Transport and Communications;
- Withdrawal of the works pertaining to the single-track ISMAI Trofa stretch, for which construction Metro do Porto will select a company by international public tender to be announced for the effect;
- Renegotiation of the operating contract, arising out of the fact that the original contract did not include alterations to the network configuration which were subsequently approved by the State.

Having submitted a new Public programme contract proposal during December 2005, following on the recommendation of the "Inspecção Geral de Finanças" in its Audit Report of June 14<sup>th</sup> 2005, it is now expected that the 2007 contract with the State for the obligations stipulated under Paragraph 2 of



Condition XV can materialise within the stipulated terms for the State and the concessionary to enter into such contracts, as follows:

- a) the first contract to be entered into within term of 18 months counting from publication of the Act approving these Concessionary Conditions, with respect to the System's initial operating period;
- b) the second contract to be entered into within a term of 18 months counting from the date on which the system becomes fully operational, and with respect to the 5 years subsequent to the end of the System's initial operating period.

In addition, clarification on interpretation of the limit stipulated under the Concessionary Conditions to the value for which guarantees and security may be issued by the State, or the review of that limit, are also expected, which will enable the unblocking of the third Tranche of the second loan facility of the European Investment Bank and the obtaining of a third loan facility.

In order to meet the financing needs arising out of alterations to the original project, Government authorisation is being awaited so that the process of restructuring the Company's long-term debt may continue.

Also with a view to reinforce the non-recoverable grants component within the project's finance structure, Metro do Porto will be applying for funding on relevant projects under the National Strategic Reference Framework (QREN) programme.

During 2007, Metro do Porto will be applying for certification of its Integrated Quality, Environment, and Safety Management System for conformance to the NP EN ISO 9001 :2000, NP EN ISO 14001:2004 and OHSAS 18001 international standards.

# proposed net income distribution

The Board of Directors proposes that the net loss for the year, in the amount of -122,155,435.25 Euros, be fully transferred to the Retained Earnings Account.

Porto, January 31st 2007.

#### The Board of Directors

#### Chairman

Valentim dos Santos Loureiro

#### **Members**

Rui Fernando da Silva Rio José Narciso Rodrigues de Miranda Mário Hermenegildo Moreira de Almeida Manuel de Oliveira Marques José Manuel Duarte Vieira Juvenal Silva Peneda



# financial statements 2006

### Balance Sheet at December 31st, 2006

Units: Euros

Account			Year			
Code				2006		2005
POC		Notes	Gross Assets	Depreciation	Net Assets	Net Assets
	Assets					
	Fixed assets					
	Intangible fixed assets					
431	Set-up costs		74,572,204	4,054,022	70,518,182	47,037,57
441	Fixed assets in progress		87,000,363		87,000,363	147,571,86
		10	161,572,567	4,054,022	157,518,545	194,609,43
	Tangible fixed assets					
421	Land and natural resources		109,973,103		109,973,103	49,701,89
422	Buildings and other structures		1,128,302,745	71,439,561	1,056,863,185	797,527,16
423	Basic equipment		180,809,781	11,992,780	168,817,001	89,838,28
424	Transport equipment		1,033,869	506,191	527,677	413,54
425	Tools and utensils		257,659	214,907	42,752	90,13
426	Office equipment		2,251,516	1,893,069	358,447	397,29
429	Other tangible fixed assets		6,063,305		6,063,305	6,063,30
442/6	Fixed assets in progress		186,526,908		186,526,908	287,805,97
448	Advances on account of fixed assets		3,940,764		3,940,764	7,486,01
		10	1,619,159,650	86,046,509	1,533,113,142	1,239,323,62
	Financial assets					
4111	Holdings in group's companies		2,250		2,250	2,30
4112	Holdings in associated companies		213,263		213,263	176,98
		16	215,513		215,513	179,28
	Current assets					
32	Stocks					
	Raw & subsidiary materials and consu	mables	272,077		272,077	161,83
			272,077		272,077	161,83
	Short-term debtors					
211	Costumers		10,037,242		10,037,242	5,518,78
229	Advances to suppliers		356,687		356,687	6,437,04
24	State and other public entities	49	41,285,772		41,285,772	51,652,88
25	Shareholders		1,784		1,784	1,78
264	Subscribers to equity		177,250		177,250	177,25
261/2/6/7/8	Other debtors		470,042		470,042	102,07
			52,328,776		52,328,776	63,889,82
	Cash and banks					
12/3/4	Bank deposits		2,450,584		2,450,584	5,005,02
11	Cash		114,864		114,864	56,43
			2,565,448		2,565,448	5,061,45
	Accruals and deferrals				· · ·	
271	Accrued income		13,889		13,889	1,01
272	Deferred costs	51	272,660,184		272,660,184	286,696,54
			272,674,073		272,674,073	286,697,56
	Total depreciations			90,100,531		, ,
	Total provisions					
	Total assets		2,108,788,104	90,100,531	2,018,687,573	1,789,923,01

### Balance Sheet at December 31st, 2006

Units: Euros

Account			Ye	Year		
Code			2006	2005		
POC		Notes				
	Net capital value and liabilities					
	Shareholders equity:					
51	Share capital		5,000,000	5,000,000		
53	Called-up share capital		179,033	179,03		
59	Retained earnings		-138,916,283	-67,581,09		
	Subtotal		-133,737,249	-62,402,05		
88	Net income/loss		-122,155,435	-71,335,19°		
	Subtotal		-255,892,684	-133,737,249		
581	Concedent instalments (Article No.4 of Basi		463,561,360	402,883,442		
	Net capital value	40	207,668,676	269,146,193		
	Liabilities					
	Provisions for contigencies & liabilities					
298	Other provisions for risks and charges	34	10,765,525	10,765,525		
			10,765,525	10,765,525		
	Medium and long term debt:					
231	Amounts owed to credit institutions	52	1,123,689,708	743,689,70		
262/3/4/5/7/8	Other creditors	53	217,556,186	227,258,70		
			1,341,245,894	970,948,41		
	Short term debt:					
231	Amounts owed to credit institutions	52	265,372,082	284,988,430		
221	Suppliers		5,385,158	10,573,18		
261	Fixed assets suppliers	53	57,529,095	115,113,43		
24	State and other public entities		284,005	266,584		
262/3/4/5/7/8	Other creditors	53	14,643,073	12,454,010		
			343,213,413	423,395,648		
	Accruals and deferrals					
273	Accrued costs	54	25,915,101	20,785,255		
274	Deferred income	55	89,878,965	94,881,978		
			115,794,066	115,667,233		
	Total liabilities		1,811,018,897	1,520,776,823		
	Net Capital value & liabilities		2,018,687,573	1,789,923,015		

#### **Chartered Account & Registered Auditor**

Vitor Manuel Gomes Castelo de Carvalho

Board of Directors

Chairman Valentim dos Santos Loureiro

Members

Rui Fernando da Silva Rio José Narciso Rodrigues de Miranda Mário Hermenegildo Moreira de Almeida Manuel de Oliveira Marques José Manuel Duarte Vieira Juvenal Silva Peneda

## Profit & Loss Account by Nature at December 31st, 2006

Units: Euros

Account code		Year			
POC		20	106	200	5
	Costs and losses				
61	Cost of goods sold & materials consumed:				
	Goods	200,645	200,645	315,330	315,330
62	Third-party supplies & services		75,130,461		58,097,61
	Staff costs				
641 + 642	Remunerations	4,418,458		4,198,305	
	Social security				
643 + 644	Pensions	0		0	
645/6/7/8/9	Other	1,289,395	5,707,853	1,766,214	5,964,519
662+663	Intangible and tangible fixed assets depreciation	40,814,606		22,659,126	
67	Provisions	0	40,814,606	0	22,659,126
63	Taxes	4,047,515		1,215,943	
65	Other operating costs & losses	22,590	4,070,104	8,006	1,223,949
	(A)		125,923,670		88,260,539
682	Losses on group & associated companies		88		963
681/5/6/7/8	Financial costs & losses				
	Others	42,334,285	42,334,373	26,530,966	26,531,929
	(c)		168,258,043		114,792,468
69	Extraordinary costs & losses		57,262		102,51
	(E)	_	168,315,305	_	114,894,979
86	Corporation tax for the year		23,953		41,433
	(G)	_	168,339,258	=	114,936,412
88	Net income		-122,155,435		-71,335,191
			46,183,823	_	43,601,221
	Profits and gains				
71	Sales				
	Goods	396,912		355,133	
72	Income	25,854,038	26,250,950	14,435,112	14,790,245
75	Own work capitalised		15,788,971		24,919,569
74	Operating subsidies	2,402,806		2,245,613	
73	Additional revenue	47,034		59,420	
76	Other operating income & gains	0	2,449,840	11,900	2,316,934
	(B)		44,489,762		42,026,747
782	Gains on group & associated companies	36,279		9,132	
7811/3/4/6/8	Other interest and similar gains				
	Others	841,079	877,358	827,081	836,213
	(D)		45,367,119		42,862,961
79	Extraordinary income & gains		816,704		738,260
	(F)	_	46,183,823		43,601,221
Summary					
Operating resu	ilts: (B) - (A) =	-8	31,433,908		-46,233,791
	ts: (D-B) - (C-A) =	- 4	41,457,015		-25,695,716
Current results	s: (D) - (C) =	-1	22,890,923		-71,929,507
Pre-tax profit/l	oss: (F) - (E) =	-1	22,131,482		-71,293,758
Net income for	the year: (F) - (G) =	-1	22,155,435		-71,335,191

#### **Chartered Account & Registered Auditor**

Vitor Manuel Gomes Castelo de Carvalho

**Board of Directors** 

Chairman Valentim dos Santos Loureiro

#### Members

Rui Fernando da Silva Rio José Narciso Rodrigues de Miranda Mário Hermenegildo Moreira de Almeida Manuel de Oliveira Marques José Manuel Duarte Vieira Juvenal Silva Peneda

#### Profit & Loss Account by Function at December 31st, 2006

Units: Euros

	Y	ear
	2006	2005
Income	26,250,950	14,790,245
Cost of service loss	-95,769,474	-64,185,638
Gross results	-69,518,524	-49,395,393
Other operatingl income & gains	2,449,840	2,316,934
Distribution costs	-2,807,315	-1,154,929
Administrative costs	-5,099,823	-4,459,988
Other operating costs & losses	-5,273,626	-1,868,792
Operational results	-80,249,447	-54,562,169
Net financing costs	-41,918,226	-16,739,759
Gains (losses) in branches and associated undertakings	36,191	8,169
Gains (losses) in other investments	0	0
Current results	-122,131,482	-71,293,758
Taxes on current profits	-23,953	-41,433
Current results after taxes	-122,155,435	-71,335,191
Exceptional profit/loss	0	C
Taxes on exceptional profits	0	0
Net income	-122,155,435	-71,335,191
Results per share	-122.16	-71.34

#### Chartered Account & Registered Auditor

Vitor Manuel Gomes Castelo de Carvalho

#### **Board of Directors**

Chairman Valentim dos Santos Loureiro

Members Rui Fernando da Silva Rio José Narciso Rodrigues de Miranda Mário Hermenegildo Moreira de Almeida Manuel de Oliveira Marques José Manuel Duarte Vieira Juvenal Silva Peneda

#### Cash Flow Statement at December 31st, 2006

Units: Euros

	2006	2005
Operatings activities		
Received from costumers	19,814,581	10,099,251
Payments to suppliers	-70,785,347	-47,600,449
Payments to employees	-5,693,402	-6,036,279
Inflow/outflow from operating activities	-56,664,168	-43,537,478
Payment/receipt of corporation tax	-46,996	-35,524
Other receipts in respect of operating activity	-15,106,836	-10,760,069
Inflow/outflow before exceptional items	-71,818,000	-54,333,070
Receipts related to exceptional items	0	(
Payments related to exceptional items	-56,690	-80,565
	-56,690	-80,565
Net cash inflow/outflow from operatings activities	-71,874,690	-54,413,636
Investment activities		
Receipts from:		
Financial assets	0	(
Tangible and intangible fixed assets	6,230,147	464,415
Investment subsidies	60,677,918	70,755,576
Dividends	0	61,277
Dividends	66,908,065	71,281,267
Payments in respect of:		, , , ,
Financial assets	87	56
Tangible fixed assets	309,604,363	329,121,030
Intangible fixed assets	11,497,494	21,880,984
Leasing rentals	0	, ,
	321,101,944	351,002,070
Net cash inflow/outflow from investiment activities	-254,193,878	-279,720,803
Financing activities		
Receipts from:		
Loans	360,383,652	347,556,430
20013	360,383,652	347,556,430
Payments in respect of:	300,000,002	547,000,400
Loan	0	(
Interest similar losses	36,811,088	25,908,005
meresconfillar (05555	36,811,088	25,908,005
Net cash inflow/outflow from financing activities	323,572,564	321,648,424
-		. ,
Increase/decrease in cash & cash equivalents	-2,496,004	-12,486,015
Cash & equivalents at the beginning of the period	5,061,452	17,547,467
Cash & eequivalent at the end of teh period	2,565,448	5,061,452

#### Chartered Account & Registered Auditor

Vitor Manuel Gomes Castelo de Carvalho

#### **Board of Directors**

Chairman Valentim dos Santos Loureiro

#### Members

Members Rui Fernando da Silva Rio José Narciso Rodrigues de Miranda Mário Hermenegildo Moreira de Almeida Manuel de Oliveira Marques José Manuel Duarte Vieira Juvenal Silva Peneda

#### Notes to the cash flow statement

The following notes follow the numbering order set out under Accounting Directive n°. 14/93. All the items which are not applicable to the Company or whose content is not relevant for the full understanding of the presented statements are not included.

#### 2 - Breakdown of cash components and equivalents:

		_
- 11	Inite.	Euros

	2006	2005
Cash	114,864	56,431
Cash deposits	2,450,584	5,005,022
Cash equivalents:		
Cash and equivalents	2,565,448	5,061,452
Cash and banks in the balance sheet	2,565,448	5,061,452

#### 3 - Information on non-cash financial activities:

Within the framework of the second credit facility approved by the EIB, an amount of 60 million Euros in undrawn facilities was made available up to October 31<sup>st</sup> 2006. The undrawn facilities were not taken up for lack of Strate guarantee. Therefore, and following on a decision of the Board of Directors of the EIB, as advised to the Company in December 2006 and as formally confirmed in January 2007, the term for availing of the undrawn facility was extended for a further two years.

An amount of 63 million Euros under credit facilities contracted with financial institutions is available for future utilisation (of which 8 million Euros pertain to short term credit facilities).



# notes to the balance sheet and profit & loss account

## introduction

Metro do Porto, S.A. was established by Decree-Law Nr. 71/93, of March the 10<sup>th</sup>, which defined the first legal regimen for a Light Rail System in the Porto Metropolitan Area (AMP). It stipulated that the future system would be given in concession to a Public Company with State Shareholders. Metro do Porto, SA, - initially named "Metro da Área Metropolitana do Porto, SA" – was established on August the 6<sup>th</sup> 1993, with the objective of operating a Light Rail System in the AMP.

The Decree-Law Nr. 394-A/98, of December the 15<sup>th</sup>, revoking the Decree-Law Nr. 71/93, of March the 10<sup>th</sup>, appointed the Metro do Porto, S.A. company to be the concessionaire for a period of 50 years, besides regulating the Concession Bases (annex I), establishing rules for the shareholders (annex II – Shareholders Para-social Agreement for Metro do Porto, S.A.) and defining the Company's new Articles of Association (annex III). The concession's legal system was revised by Act 161/99, of September the 14<sup>th</sup>, which approved the Concession Bases, and by Decree-Law n° 261/2001, of September the 16<sup>th</sup>. Recently it was further revised by Decree/Law nr. 249/02, of November the 19<sup>th</sup>, in order to allow the Company to use operating leases.

To fulfil its statutory object, the Company was to conduct studies, design, plan, project and build the required infra-structures, as well as to purchase equipment and rolling stock. These tasks have so far represented the Company's main activities. Light Rail System commercial operation started in 2003 with the Blue Line. Since then, commercial operation has been growing in a significant way. The opening of Trindade – Estádio do Dragão stretch in 2004, the Senhora da Hora – Pedras Rubras (on the Póvoa Line) stretch and Fonte do Cuco – Fórum da Maia (on the Trofa Line) stretch, and the Gaia Line, in 2005, and the Pedras Rubras – Póvoa de Varzim, University Campus –São João Hospital, Fórum da Maia – ISMAI, and Os Verdes – Francisco Sá Carneiro Airport stretches this year, have originated a consistent monthly increase in demand.

In the terms of Decree-Law Nr. 394-A/98 – Basis XIII – the financing for the company's investment and operation is provided by the Government through its Budget, European funds and loan guarantees.

In the terms of Basis XV of the Decree-Law 394-A/98, the system operation's financial balance will be ensured by the State through the allocation of a financial compensation to the Company for providing a public service, which will be the object of a service contract to be signed between the State and the concessionaire.

At the end of 2005 the Company has the following participations:

TIP – Transportes Intermodais do Porto, ACE	33,33%
Metro do Porto, Consultoria Unipessoal, Lda.	100,00%
Nortrem, ACE	0,009%
Transpublicidade, SA	40,00%

The following notes follow the numbering defined in the National Plan of Accounts. All the issues contained there which are not applicable to the Company, or whose content is not relevant for fully understanding the financial statements, are not included. If IAS recommendations are more complete and important to clarify the company financial statements, each note's content is treated according to this normative. The final points, 49 to 58, were introduced to provide greater clarity in the financial statements presented.

## 2 comparative values

During the financial year, the stretches Pedras Rubras – Póvoa de Varzim (Red Line), University Campus –São João Hospital (Yellow Line), Fórum da Maia – ISMAI (Green Line) and Os Verdes – Francisco Sá Carneiro Airport (Violet Line), started to be operated. They represent an extension of 24 km out of a 59 km total extension of the Light Rail System Network. The commercial operation accounts in 2006 are therefore not comparable with the previous financial year.

## 3 accounting methods

The main criteria and accounting methods used in the determination of the year's results and in the presentation of the financial situation are:

#### 3.1 presentation bases

Metro do Porto's financial statements were based on accounting principles generally accepted in Portugal and according to the historic cost principle. As a supplement International Financial Report Statements (IAS/IFRS) required statements are also provided.

## 3.2 income recognition

#### a) Services rendered

The income generated by the use of light rail transport tickets, "Andante", is booked according to the ticketing system's monthly record of validations. This information is provided by TIP, ACE, which is responsible for the treatment of all the sales network information and the corresponding income sharing calculations, according to criteria defined by the member companies.

The income generated on the utilisation of the parking facilities at the Dragão Stadium subway station, is booked according to the monthly records of the access control system together with information extracted from the Andante intermodal ticketing system. The fares include a Park & Ride solution, which has been designed to combine utilisation of the parking facilities together with the metro transport system.

The income from the maintenance of rail transport vehicles, related to operating lease contracts, is booked in accordance with the rents associated to the leases and in the months when they fall due.

The income generated on Andante utilisation in alternative transports was credited in the respective transport service account, to offset the corresponding costs. As from March 18<sup>th</sup> 2006, the date of inauguration of the Pedras Rubras-Póvoa de Varzim stretch, those services are being rendered exclusively on the as yet unbuilt stretches of the Trofa Line.

#### b) State subsidies

During the financial year, an amount of 2,402,806 Euros received as defined in the Concession Bases as compensation for the social transportation service provided as well as for the loss of income due to the use of social ticket prices was booked in the Operating Subsidies account.

Until the publication each year of the Council of Ministers Resolution defining the compensation amounts allocated to the Companies in the State sector, 1/12<sup>th</sup> of the amount received in the previous year is monthly booked. After the publication of that Resolution the amounts already booked are adjusted and the actual value is thereafter monthly recognised.

#### 3.3 financial risk management

The company's exposure to financial risks is not significant and it includes mainly interest rate risk.

#### I. Exchange rate risk

The exchange rate risk is very limited, due to the fact that the loans are in Euros and purchases in other currencies are not significant.

#### II. Interest rate risk

The loans contracted with the EIB are in Euros, based on the EIB variable and on revisable fixed rate as detailed in note n°29.

The remaining medium and long-term loans attract interest at variable interest rates.

The Company has entered into two interest rate swaps to cover its interest rate risk.

#### III. Credit risk

The Company presents a high credit concentration due to the fact that the tickets sales are realised by TIP- Transportes Intermodais do Porto, ACE. The credit risks of this ACE and its clients can rebound to the Company, although this is expected to occur with a low probability.

#### IV. Liquidity risk

Public funds with origin in the Government and the European Union, long term-loans contracted with the EIB and structured leasing operations are the main components of the company's financing model.

#### 3.4 tangible fixed assets

Tangible fixed assets are accounted for at their acquisition or construction costs, net of accumulated depreciation and imparity losses. During the period of construction financial charges are capitalized. Financial leasing contracts in which the Company substantially assumes all the risks and advantages related to the leased assets are classified as financial leasing.

Financial leasing contracts are booked at their start date as assets or liabilities at the lower of the asset's fair value and the present value of future leasing rents. Depreciation of the assets purchased under financial leasing contracts is made according to the method defined by the company for tangible fixed assets.

Rents are constituted by the financial cost and the depreciation of the capital. Financial costs are allocated to their respective periods over the leasing period at a constant periodical interest rate levied on the remainder investment of the lessor.

The costs of maintenance and repairing that do not increase the useful life of fixed assets are recognized as cost in each financial year.

The depreciation of the values of acquisition and construction is calculated according to the linear method with duodecimal imputation (by the method of constant quotas). The applied annual rates reflect the shorter of two periods: the concession period (50 years) and the asset's economic useful life and are summarized as follows:

- Buildings and other construction:

Buildings: 30 yearsUnderpasses: 50 yearsTunnels: 50 yearsTrack: 25 years

- Basic equipment: 20 years

Fixed assets in progress comprise all supplies for the construction of the Light Railway infrastructures, specialized services, third party's services for project development, and internal works capitalized by the company.

#### 3.5 intangible fixed assets

Intangible fixed assets are accounted for at their acquisition cost, net of accumulated depreciation and imparity losses.

Depreciation of the acquisition values is calculated according to the linear method with duodecimal imputation (by the method of constant quotas). The annual rates reflect the period between the beginning of utilization and the stated period of the concession (50 years).

#### 3.6 financial assets

Investments in Group and Associated Companies are accounted for through the Asset Equivalence Method. The shares in Companies on whose activity no significant influence is exerted are accounted for at the lower of cost of acquisition and Residual Value.

Shares in complementary groupings of companies are integrated in the company accounts using the Proportional Consolidation Method.

#### 3.7 asset impairments

The assets of the company are analysed as at the date of each Balance Sheet, so as to evaluate indications of eventual imparity losses. As at December 31st of 2006 no imparity situations exist.

#### 3.8 provisions

Provisions are set up whenever the Company has a present (legal or implicit) obligation resulting from an event in the past and it is probable that a reduction in resources incorporating economic benefits, that can reasonably be estimated, will be demanded to eliminate the obligation. The analysis of the contingent losses is done on the date of each Balance Sheet.

As at December 31<sup>st</sup> 2006, the existence of contingent liabilities which may represent future losses was considered, and a total provision amount of 10.8 million Euros, was set up.

#### 3.9 specialization

The accounting of costs and income is based on the specialisation principle, according to which they are recognised as accrued, independently of their payment or receipt.

#### 3.10 corporate tax

Corporate Tax is calculated on the basis of the taxable income and allows for deffered tax.

Deffered taxes are calculated on the basis of the Balance Sheet responsibility method, on the temporary differences between the accounting values of the assets and liabilities and the respective tax base.

Active deffered taxes are only recognized when a reasonable certainty exists that future profits will be generated against which they could be used.

#### 3.11 operational leases

The contracts of leasing relatively by which the company does not assume substantially all the risks and inherent advantages of the ownership of the good are classified as operational leasings.

Rental costs associated with the operational leasing contracts are recognized as costs at the end of each financial year.

## 3.12 fixed assets financing

Non reimburseable resources attributed to the company to finance fixed assets used in the Light Rail System, stipulated in the Decree-law n°394-A/98 and in its posterior revisions, were accounted for as Deffered Income up to 2003. In 2003 these resources were reclassified to integrate the Company's permanent capital, having been accounted for as "Concessor instalments" as this was considered more correct.

Funds with origin in the Government budget attributed by the PIDDAC, to support the investment in the Infante Bridge, were accounted as deferred incomes and are being used for the reintegration of the investment.



The Company is subject to corporate tax plus local tax. There is also separate taxation arising from the costs with the motor vehicles and the representation expenses.

In accordance with current law, tax losses are carried forward for a period of six years and can be deducted from tax profits made in the relevant period.

Outstanding deferred tax credits for tax losses were not recorded, for prudence reasons.

The available tax losses for future use are as follows

(Units: Euros)

Year of the loss	Value	Usable until
2001	870,512	2007
2002	991,013	2008
2003	26,210,687	2009
2004	36,339,197	2010
2005	69,702,375	2011
2006	119,107,405	2012
	253,221,189	

## 7 average staff

The Company's average staff during the financial year was 123 (137 for 2005), being 118 at the end of the year, 16 of which were employees transferred from CP and REFER.

	2006	2005
Total staff	118	137
Excluding CP/REFER	102	121
Average total staff	123	137

# 8 movements under installation costs and research & development costs

Account Set-up costs reports the values of the studies, projects and project management costs, corresponding to the investments in 2006 in the lines in operation (Blue, Red, Green, Yellow and Violet Lines). The migration of these costs from Fixed Assets in Progress to Fixed Assets was made on the basis of the budgeted weight of these intangible assets relative to the direct investment in the system.

## 10 movements in fixed assets

#### gross assets

(Units: Euros)

Items	Initial balance	Increases	Decreases	Transfers	Final balance
Intangible fixed assets:					
Set-up costs	49,461,606	58,442	0	25,052,157	74,572,204
Fixed assets in progress	147,571,863	27,228,023	0	-87,799,523	87,000,363
Total	197,033,469	27,286,465	0	-62,747,367	161,572,567
Tangible fixed assets:					
Land and natural resources	49,701,892	11,380		60,259,831	109,973,103
Buildings	836,727,455	-1,155,047	228,600	292,958,937	1,128,302,745
Basic equipment	95,468,222	2,823,396		82,518,163	180,809,781
Transport equipment	885,576	321,071	172,778	0	1,033,869
Tools and utensils	257,659	0	0	0	257,659
Office equipment	1,963,864	289,056	1,404	0	2,251,516
Other tangible fixed assets	6,063,305	0	0	0	6,063,305
Fixed Assets in progress	287,805,972	272,359,983	649,482	-372,989,564	186,526,908
Advances for tangible fixed assets	7,486,015	1,788,329	5,333,580	0	3,940,764
Total	1,286,359,960	276,438,168	6,385,844	62,747,367	1,619,159,650
Securities and holdings					
Holdings in group's companies	2,303	0	53	0	2,250
Holdings in associated companies	176,983	36,280	0	0	213,263
Other companies	0	34	34	0	0
Total	179,286	36,314	88	0	215,513

#### depreciation and provisions

(Units: Euros)

Items	Initial balance	Addition	Revising	Final balance
Intangible fixed assets:				
Set-up costs	2,424,036	1,629,986	0	4,054,022
Total	2,424,036	1,629,986	0	4,054,022
Tangible fixed assets:				
Buildings	39,200,287	32,238,781	0	71,439,068
Basic equipment	5,629,933	6,289,257	0	11,919,190
Transport equipment	472,029	206,940	172,778	506,191
Tools and utensils	167,520	47,387	0	214,907
Office equipment	1,566,567	401,083	497	1,967,153
Total	47,036,337	39,183,447	173,275	86,046,509

The direct investments amounts related to the stretches in commercial operation, namely the Pedras Rubras – Póvoa de Varzim (Red Line), University Campus – São João Hospital (Yellow Line), Fórum da Maia – ISMAI (Green Line) and Os Verdes – Francisco Sá Carneiro Airport (Violet Line) were booked as Fixed Assets under Land and Natural Resources, Buildings and Other Constructions and Basic Equipment. Similarly to 2005, the financial costs, inspection costs and other indirect costs of the corresponding works were also transferred to this account. As a result in 2006 the investment relating to the stretches of the Blue, Red, Green, Yellow, and Violet Lines which are completed and in operation has been transferred to fixed assets.

(11) capitalisation of financial costs incurred in the period

An amount of 3,553,117 Euros was capitalized in the Fixed Assets in Progress account, consisting of 1,977,761 Euros in financial charges from long-term loans by the EIB and 1,575,357 Euros in interest from bridge loans (taxes included on booth values).

tangible fixed assets and on course of acquisition/construction

All fixed assets are allocated to the Company's business activities and available for operation. No fixed assets are held in foreign countries.

According to Decree-Law n°. 394-A/98, all assets integrating the implementation of Metro do Porto, S.A. and allocated to its System, shall revert to the State at the end of the concessionary term, which is for a term of 50 years. All assets financed by the Ceding Entity in conformance to the requirements of Paragraph IV of Condition XXVII are considered as being ascribed to the interests of the Ceding Entity.

During the financial year, interest income derived on securities investments was capitalised. Therefore, the value of interest costs capitalised during the financial year was reduced by 44,282 Euros on this account, and consequently, a closing cumulative balance of 3,508,835 Euros in interest expense was recorded as at 31 December 2006.

The value of capitalised financial costs and respective taxation thereon is as follows:

Prior years 44,074,520 Euros Current year 3,508,835 Euros

15) assets being utilised on a financial lease basis

Assets utilised by the Company on a financial lease basis are light vehicles and IT equipment, 910,860 Euros and 148,344 Euros, respectively.

company address and head offices of group and associated companies, and other holdings

		Sh	areholder's	Net income	Value of
Company name	Headquarters	%	capital	(2006)	shareholdings
			(2006)		in 31.12.2006
Metro Consultoria, Lda	Av. Fernão Magalhães, 1862, 7º Porto	100,00%	1,847	-53	2,250
Transpublicidade, SA	Av. Fernão Magalhães, 1862, 13º Porto	40,00%	377,934	90,698	213,263
Nortrem, ACE	R. Gen. Firmino Miguel, nº 3 Lisboa	0,01%	a)	a)	0
TIP, ACE	Av. Fernão Magalhães, 1862, 9º Porto	33,33%	b)	b)	0

a) Losses for the year annulled the value of this holding  $% \left( 1\right) =\left( 1\right) \left( 1\right) \left($ 

b) The accounts of this ACE are consolidated under a proportional consolidation method  $% \left( 1\right) =\left( 1\right) \left( 1\right) \left$ 

- overdue debts to the State and other public entities
  There are no overdue debts in the item "State & Other Public Entities".
- There are no overdue debits in the item. State & other rubite Littlines
- liabilities to third parties with a maturity of over five years

  Company liabilities of a maturity of over 5 years are as follows:

#### a) European Investment Bank

None of the E.I.B.'s facilities were utilised during the year.

(Units: Furns)

Loans	Loan amount	Outstanding balance
EIB I		
Tranche A	99,759,579	99,759,579
Tranche B	100,000,000	100,000,000
Tranche C	100,000,000	100,000,000
Tranche D	243,930,128	243,930,128
EIB II		
Tranche A	120,000,000	120,000,000
Tranche B	80,000,000	80,000,000
Total	743,689,708	743,689,708

EIB loans are denominated in Euro, at a variable EIB rate (which is consistently lower than the Euribor rate applicable for an identical period) and at fixed interest rates subject to reset.

EIB loans are secured against a Sovereign Guarantee from the Portuguese Republic for periods of 20 and 17 years counting as from the date of those guarantees, respectively, as applicable to the EIB I and EIB II loans.

In 2003, a decision was taken to opt for a fixed-rate subject to reset basis in respect of tranches B and C of the loans. The interest rate on Tranche A was fixed until 15 de March 2009 and Tranche C was fixed until 15 September 2009.

Also in 2003, a decision was taken to opt for a fixed-rate subject to reset basis up to March the 15th 2010 in respect of a portion of Tranche D, in the amount of 100 million Euros.

During the financial year, an interest rate swap was entered into with respect to the total of Tranche D of the EIB loan, in an amount of 243.9 million Euros. The swap fixed the interest rate on that tranche until maturity, thereby enhancing the fixed EIB rate subject to reset that had been contracted in 2003 over an amount of 100.0 million Euros of that tranche, up to March 2010.

The repayment schedule on the EIB loans which are classified as medium and long-term loans is as follows:

#### EIB I Loan

- Tranche A: repayable in 10 consecutive annual instalments starting in 2009
- Tranche B and C: repayable in 10 consecutive annual instalments starting in 2012
- Tranche D: repayable in 10 consecutive annual instalments starting in 2013

#### EIB II Loan

- Tranche A: repayable in 13 consecutive annual instalments starting in 2012
- Tranche B: repayable in 13 consecutive annual instalments starting in 2012

#### b) Nortrem, ACE operational leases

Rentals due with respect to the operational lease contracts on 72 Light Rail vehicles were paid during the financial year, and the debt outstanding as at financial year-end was as follows:

(Units: Euros)

Contract	Opening value	Balance outstanding
LEP 2002	97,222,222	84,482,695
LEP 2003	121,527,778	111,852,893
LEP 2004	31,250,000	30,115,317
Total	250,000,000	226,450,905

#### c) Other loans

A 5 years bullet loan for a period of 5 years, renewable for a further 2 years, in an amount of 200 million Euros, was contracted during the financial year.



The most relevant financial undertakings assumed by the Company respect to performance on construction contracts and operation of the Light Rail System, as well on the rendering of Inspection services, and reflect the following distribution, as at year-end:

(Units: Euros)

Entity	Contract value	Realised value	%
Normetro – Base Contract	845,997,409	764,118,168	90%
Normetro – Additional	231,991,030	215,463,613	93%
CFS	35,012,237	14,543,423	42%

## guarantees issued

Bank guarantees were issued in order to guarantee the payment of compensation payable by the Company for expropriated land and buildings destined for construction of the Light Rail network. At the end of the financial year, such contingent liabilities amounted to 10,702,505 Euros in the form of bank guarantees issued, with respect to 211 expropriation processes.



Provisions reflect the following distribution:

(Units: Euros)

	Initial balance	Increase	Decrease	Final balance
Other provisions	10,765,525	0	0	10,765,525
Total	10,765,525	0	0	10,765,525

The item "Other provisions" covers amounts considered as probable losses arising, and estimates from legal consultants were obtained for the effect. The provision accrues to Fixed assets .

**35** realised share capital

Share capital has been fully subscribed and realised.

number of shares and share nominal value

The capital of the Company is represented by 1,000,000 statutory shares with a nominal value of 5 Euros each.

37 share capital composition

As at 31 December 2006, the share capital of the Company was distributed as follows:

Shareholders	2006	2005
Porto Metropolitan Area	59.9993%	59.9993%
STCP	25%	25%
Portuguese State	10%	10%
CP – Caminhos de Ferro Portugueses	5%	5%
Gondomar, Maia, Matosinhos, Porto,		
Póvoa de Varzim, Vila do Conde and	0.0007%	0.0007%
Vila Nova de Gaia Town Councils		

## 40 movements in shareholder funds

(Units: Euros)

	Opening balance	Increases	Decreases	Closing balance
Capital	5,000,000	0	0	5,000,000
Called-up Share Capital	179,033	0	0	179,033
Income (loss) from prior years	-67,581,091	-71,335,191	0	-138,916,283
Income / (loss) for the year	-71,335,191	-122,155,435	-71,335,191	-122,155,435
Sub-Total	-133,737,249	-193,490,626	-71,335,191	-255,892,684
Concedent Instalments	402,883,442	60,677,918	0	463,561,360
Total	269,146,193	-132,812,708	-71,335,191	207,668,676

During 2006 the company received 60,677,918 Euros, from the State Budget and European Funds, reported in the Concedent Instalments account

## (41) cost of goods sold

(Units: Euros)

Movements	Value
Opening stockbalance	161,839
Purchases	310,883
Stock adjustments	0
Closing stock balance	272,077
Costs in the financial year	200,645

Movements in this item arise on proportional consolidation of the ACE TIP and reflect transactions occurring in "stocks" during the financial year, with respect to the Andante travel card (physical support).

## remuneration attributed to the members of statutory bodies

Remuneration attributed to the Company's Statutory Bodies in 2006, was as follows:

Board of Directors 657,954 Euros Single Auditor 19,344 Euros

## 45 net financial income (loss)

(Units: Euros)

		Financial year 2006	Financial year 2005
	Expenses and losses		
681	Interest borne	40,246,103	24,580,198
682	Losses on group and associated companies	88	963
688	Other financial expenses and losses	2,088,182	1,950,769
	Financial income (loss)	-41,457,015	-25,695,716
	Total	877,358	836,213
	Income and earnings		
781	Interest earned	193,039	136,320
782	Earnings on group and associated companies	36,279	9,132
784	Earnings on equity holdings	0	61,277
788	Reversals and other financial earnings	648,040	629,485
	Total	877,358	836,213

Figures include 3,508,835 Euros of interest capitalised (9,006,878 Euros in 2005) recorded under Work for own account.

## net extraordinary income (loss)

(Units: Euros)

		Financial year 2006	Financial year 2005
	Expenses and losses		
691	Donations	54,525	62,813
694	Losses on fixed assets	0	25,028
695	Fines and penalties	1,335	1,106
697	Prior year adjustments	0	2,086
698	Other expenses and losses	1,402	11,476
	Extraordinary income (loss)	759,442	635,750
	Total	816,704	738,260
	Income and earnings		
794	Income on fixed assets	17,578	4,713
797	Prior year adjustments	0	61,089
798	Other lincome and earnings	799,126	672,458
	Total	816,704	738,260

In essence, the balance of the item "Other income and earnings" corresponds to the recognised annual value of subsidies received from the State for construction of the Infante D. Henrique Bridge, with a contra in deferred income, and it equals the amortisation of the respective investment.

# the company is a beneficiary of the following bank guarantees issued by its suppliers:

Normetro – Agrupamento do Metropolitano do Porto, ACE, to which the contract for project planning and construction of the Light Rail System was awarded has issued contractual guarantees in favour of Metro do Porto, in lieu of a performance guarantee on accurate and prompt compliance to contractual obligations, and in the form of bank guarantees with a total cumulative balance of 142,045,483 Euros.

CFS – Consugal, Ferconsult and Sener, a consortium to which the contract for the rendering of inspection and management services on the construction of the Light Rail System of Porto was awarded, has issued contractual guarantees in favour of Metro do Porto, in lieu of a performance guarantee on accurate and prompt compliance to contractual obligations, and in the form of bank guarantees with a total cumulative balance of 7,169,164 Euros.

Other suppliers of fixed assets to Metro do Porto have issued contractual guarantees in favour of Metro do Porto, in lieu of performance guarantees on accurate and prompt compliance to contractual obligations, and in the form of bank guarantees with a total cumulative balance of 35,851,812 Euros.

## 49 state and other public entities

Amounts outstanding due by the State are broken down as follows:

(Units: Euros)

	Financial year 2006	Financial year 2005
Value Added Tax (VAT) refunds	41,032,098	51,517,476
Tax and Company income tax refunds – IRC	205,565	122,526
Tax and Personal income tax refunds – IRS	42,907	7,681
Refunds on social security contributions	5,201	5,201
Total	41,285,772	51,652,884

## 61 deferred expenses

Deferred expenses are broken down as follows:

(Units: Euros)

	Financial year 2006	Financial year 2005
Operational leasing of vehicles – 1st contract	101,663,677	107,184,786
Operational leasing of vehicles – 2 <sup>nd</sup> contract	76,444,410	80,295,410
Operational leasing of vehicles – 3 <sup>rd</sup> contract	56,919,233	59,807,484
Operational leasing of vehicles – 4th contract	37,570,907	39,367,276
Other deferred expenses	61,957	41,590
Total	272,660,184	286,696,547

The company sold and then leased back Light Rail System vehicles. In 2002 the first operation was realized, involving 28 vehicles. In 2003, a new operation was realized in two parts of 20 and 15

vehicles. In 2004 a new operation concerning 9 vehicles was realized. The operational leasing was contracted for 20 years, rents being partly invoiced at the beginning of the contract. The total amount charged for is accounted for as Deferred Expenses with a contra in Other Creditors. The rentals are recognised as expenses for the respective period.



Bank loans are repayable as follows:

(Units: Euros)

	Financial year 2006	Financial year 2005
Short-term loans	265,372,082	284,988,430
Medium and long-term loans	1,123,689,708	743,689,708
Total	1,389,061,789	1,028,678,138

Medium and long-term liabilities consist of loans from the European Investment Banks and another bank loan, as per conditions disclosed under note 29.

## 53 other creditors

The most important balances are the following:

Per Balance sheet item:

(Units: Euros)

	Financial year 2006	Financial year 2005
Other medium and long-term creditors	217,556,186	227,258,709
Short-term fixed asset suppliers	57,529,095	115,113,435
Other short-term creditors	14,643,073	12,454,010
Total	289,728,354	354,826,154

#### Per entity:

(Units: Euros)

	Financial year 2006	Financial year 2005
NORTREM – Aluguer Material Ferroviário, ACE	226,450,905	236,497,427
Normetro, ACE	17,995,053	56,528,060
Bombardier Transportation Portugal, SA	15,006,587	0
ACA Construções – Alberto Couto Alves, SA	4,040,372	3,357,512
Vossloh Electrical Systems	3,615,678	0
Other creditors	22,619,759	58,443,155
Total	289,728,354	354,826,154

Amounts due to Nortrem, ACE respect to rentals outstanding on three operational lease contracts, and such rentals are payable on 40 six-monthly instalments. Rentals due for 2007 were reported under short-term creditors.

## **54** accrued expenses

(Units: Euros)

	Financial year 2006	Financial year 2005
Remuneration due	723,227	688,959
Interest payable on swaps	12,904,143	8,193,823
Other	12,287 730	11,902,473
Total	25,915,101	20,785,255

In essence, the item Other accrued expenses reports to expenses incurred with the operation of the Metro System which have not yet been invoiced for (10.8 million Euros) and to compensations due for losses arising on construction of Light Rail infrastructure (0.8 million Euros).

## 65 deferred income

(Units: Euros)

	Financial year 2006	Financial year 2005
Investment subsidies	31,323,022	31,949,564
Maintenance of light rail vehicles	48,536,885	52,265,315
Interest rebates	4,597,961	4,990,668
NPV US CBL	5,421,097	5,676,430
Total	89,878,965	94,881,977

The Investment Subsidies are mainly related with funding received for the construction of Infante D. Henrique Bridge (31,274,537 Euros).

## 56 services rendered

The Services rendered item is broken down as follows:

(Units: Euros)

	Financial year 2006	Financial year 2005
Passenger transport services	21,271,975	10,349,728
Maintenance of light rail vehicles	3,728,431	3,608,796
Others	853,632	476,588
Total	25,854,038	14,435,112



Operational lease contracts – LEP (Portuguese Structured Leasing) were entered into with respect to 72 Light Rail vehicles during the financial years 2002, 2003 and 2004. Anticipated invoicing for their respective rentals, not yet being accounted for as expenses, is stated on balance sheet, under deferred expenses, in an amount of 272,598,226 Euros.

In 2003, an interest rate swap was entered into with Banco Comercial Português, for a term of 20 years, with respect to the operational lease contract which had been entered into in 2002.

58 contingent liabilities

Instances where the Company is involved in litigation, as at 31 December 2006, are broken down as follows:

(Units: Euros)

Court actions moved by:	Total value of the contingency
Clients	(a)
Tax collection services	(a)
Employees	(b)
Shop owners	(a)
Third parties	108,142 (c)
Expropriations	7,456,168 (d)

- (a) Nil.
- (b) Court actions moved by employees seconded from CP and Refer, claiming maintenance of privileges acquired under their prior employment contracts.
- (c) Instances of civil action moved by shop owners for compensation on damages caused by metro construction work and fines applied by court decision.
- (d) Processes involving expropriations of land an buildings conducted by the Company under legal arbitrage, involving the definition of the amount of compensation payable.

In the event of potential future contingencies that might be adverse to the Company, it is considered that such contingencies do not involve Company assets causing the emergence of such contingencies, since such facts are related to construction work, which, if such materialise, shall be accounted for as increased investment costs. Therefore, such events are not deemed to represent sufficient cause for the creation of provisions against them.





#### LEGAL CERTIFICATION OF THE ACCOUNTS

#### Introduction

1. We have examined the financial statements of "METRO DO PORTO, S.A." which comprise the Balance Sheet as at December 31<sup>st</sup> 2006 (which reports total assets of 2,018,687,573 Euros and total shareholder funds of 207,668,676 Euros, including a net loss for the year of 122,155,435 Euros) and of the Income Statement by nature and by source, and the Cash flow Statement for the year to that date, and respective Appendices.

#### Responsibilities

- 2. The Board of Directors is responsible for reliably and adequately representing the Company's financial position and operational results and cash flows, as reported in its financial statements, as well as for adopting sound accounting policies and criteria and maintaining an adequate system of internal controls.
- 3. It is our responsibility to express a professional and independent opinion on those financial statements based on our assessment thereof.

#### Scope

- 4. Our assessment followed the Technical Standards and Reviewing/Auditing Guidelines of the Chartered Accountants & Auditors Association of Portugal, which require that such a review/audit be planned and carried out with the objective of obtaining an acceptable degree of confidence that the aforementioned reports do not contain material distortions of relevance. To that effect, the review entailed:
- checking, by sampling, the supporting documentation in respect of the amounts and disclosures reported in the financial statements and a review of the estimations, based on judgments and criteria defined by the Board of Directors, which were used for the compilation thereof;
- an appraisal of the adequacy of the adopted accounting policies and disclosure thereof, taking the applicable circumstances into account;
- verification of the applicability of the principle of continuity; and
- an assessment on whether the presentation of the financial statements is overall adequate.
- 5. Our review included as well verification that the financial information contained in its management report agreed to the Company's financial statements.

6. We consider that the review that we carried out makes it possible to express our opinion on an acceptable basis.

#### **Opinion**

7. In our opinion, the aforementioned financial statements represent, in an appropriate and truthful manner and for all relevant material purposes, the financial position of "METRO DO PORTO, S.A.", as at December 31<sup>st</sup> 2006, and its operational results and cash flows for the financial year ended as at that date, and are in conformance with generally accepted accounting practices in Portugal.

#### Highlights

- 8. Without prejudice to the remarks under the previous paragraph, we highlight the following issues:
- 8.1 Up to its financial year ended December 31<sup>st</sup> 2002, the Company had been recognising subsidies received as non-recoverable grants under Decree-Law no. 394-A/98 and subsequent amendments to fund fixed assets allocated to its Light Rail System as Deferred Income. As from 2003, the Company changed its accounting policy with respect to that item, and started crediting such funding as "Concedent Instalments", as per notes 3.12 and 40 attached to its financial statements.
- 8.2 In 2003, the Company entered into an interest rate swap for the purpose of covering interest rate risk arising on an operational lease contract that had been entered into in 2002, as per notes 3.3 and 57 attached to its financial statements. In addition, it entered into another interest rate swap in 2006 associated to a loan from the EIB, as per notes 3.3 and 29 attached to its financial statements.
- 8.3 Without jeopardising the principle of continuity of its operations, and taking into account numerous aspects, of which first and foremost is the guarantee of State funding, we cannot fail to evidence existing uncertainty with respect to the financing model to be adopted, both with respect to the implementation of the Metro's infrastructure, as well as to operating losses being generated on having to provide passenger transport services on a public service basis.

Delay on defining such issues may cause damage to the image of the Company's financial standing.

Porto, February 12th 2007

António Magalhães e Carlos Santos, SROC Represented by: Carlos Alberto Freitas dos Santos, (Chartered accountant no. 177)



report and opinion of the auditors

#### **AUDIT REPORT**

To the Shareholders,

In our capacity as Auditors, we present herewith our report on our auditing activities and give our opinion on the financial statements prepared by the Board of Directors of "METRO DO PORTO, S.A." with respect to its financial year ended December 31st 2006, thus conforming to the foregoing under Sub-paragraph g) of Paragraph 1 of Articles 420 of the Companies Act and Article 25 of the Company's Statutes.

We highlight that the First Phase of the implementation of the Light Rail System was completed, which includes a network with an extension of 58.9 km featuring 69 metro stations under commercial operation, to which commuters, in general, have massively adhered to, as the most relevant aspects of the Company's activities during 2006.

Throughout the year, we have attended various meetings of the Board of Directors and became acquainted with the most pertinent issues being faced by the Company's management.

When discharging our duties, we have been received the full cooperation of the Board as well as the Company's divisions at all times with respect to all information requested, for which we thank you.

During the financial year, we have checked and verified transactions and balances which we deemed adequate and opportune. The Company's year-end financial statements deserved our particular attention.

We have ascertained the Company's conformance to its Statutes and applicable legal requirements and regulations and have no comments thereon.

We believe that it is necessary that the Government takes a rapid decision on the definition of the Company's funding model, in order to prevent deterioration in the image of the Company's financial standing, which should tend to become more adverse given the prospect of the company incurring further operational losses in the future.

In conclusion, we are of the opinion and recommend that the Annual General Assembly:

- 1. Approve the Management Report and the Company's financial statements for the financial year ended December 31st 2006;
- 2. Approve the proposed net income distribution as contained in the aforementioned Management Report;

Porto, February 13th 2007





To the Shareholders of **Metro do Porto, S.A.** 

#### **AUDIT REPORT**

#### Introduction

1. We have examined the financial statements of METRO DO PORTO, S.A. which comprise the Balance Sheet as at December 31<sup>st</sup> 2006 (which reports total assets of 2,018,688 thousand Euros and total shareholder funds of 207,669 thousand Euros, including a net loss for the year of 122,155 thousand Euros) and of the Income Statement by nature and by source, and the Cash Flow Statement for the year to that date, and respective Appendices.

#### Responsibilities

- 2. The Board of Directors is responsible for reliably and adequately representing the Company's financial position and operational results and cash flows, as reported in its financial statements, as well as for adopting sound accounting policies and criteria and maintaining an adequate system of internal controls.
- 3. It is our responsibility to express a professional and independent opinion on those financial statements based on our assessment thereof.

#### Scope

- 4. Our assessment followed the Technical Standards and Reviewing/Auditing Guidelines of the Chartered Accountants & Auditors Association of Portugal and international accounting standards issued by the IFAC, which require that such a review/audit be planned and carried out with the objective of obtaining an acceptable degree of confidence that the aforementioned reports do not contain material distortions of relevance. To that effect, the review entailed: (i) checking, by sampling, the supporting documentation in respect of the amounts and disclosures reported in the financial statements and a review of the estimations, based on judgments and criteria defined by the Board of Directors, which were used for the compilation thereof; (ii) an appraisal of the adequacy of the adopted accounting policies and disclosure thereof, taking the applicable circumstances into account; (iii) verification of the applicability of the principle of continuity; and (iv) an assessment on whether the presentation of the financial statements is overall adequate.
- 5. Our review included as well verification that the financial information contained in its management report agreed to the Company's financial statements.

6. We consider that the review that we carried out makes it possible to express our opinion on an acceptable basis.

#### Reservations

7. The Company recognises subsidies and support received from the State and the European Union relating to assets as "Concedent Instalments" (as per Paragraph 4 of Conditions XXVII), integrated in its Shareholder Funds. In our opinion, these subsidies should be stated as Deferred Income and recognised as income as a function of the depreciation of the subsidised assets. The balance of the Concedent Instalments account was 463.571 million Euros, as at December 31st 2006 (402.883 million Euros, as at December 31st 2005) and we were unable to quantify its effect on deferred income (liabilities) and on operational results;

#### **Opinion**

8. In our opinion, and barring the effect of the issue raised under paragraph 7, above, the aforementioned financial statements represent the financial position of Metro do Porto, S.A., as at December 31<sup>st</sup> 2006, and its operational results and cash flows for the financial year ended as at that date, in an appropriate and truthful manner and for all relevant material purposes, and are in conformance with generally accepted accounting practices in Portugal.

#### Highlights

9. Without prejudice to the remarks under the previous paragraph, we highlight the fact that, as referred under the Introduction to the Notes attached to the Balance Sheet and Income Statement, the financing of the Company's investments and activities is supported by the State, and therefore, continuity of its operations is conditioned to the timely obtaining of such means.

Porto, February 1st 2007

PricewaterhouseCoopers & Associados, SROC, Lda. Represented by: Herminio António Paulos Afonso, R.O.C.

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