BES'06

ANNUAL REPORT

Volume I

BANCO ESPIRITO SANTO

Photography occupies an outstanding position in the history of contemporary art, representing today a major form of artistic expression.

Photography offers a vast and rich universe of languages and resources that question and transform the traditional concepts of plastic expression to afford new insights, new visions and new ways of feeling.

By assuming an increasingly important role as Patron of Photography in Portugal, BES Group has given a key contribution to the development and assertion of this art form. This strategy reveals the commitment to the future and the option for modernity that distinguish the BES brand and the Group's corporate culture.

The illustrations included in this year's Annual Report depict some of the pieces of the BES art collection which the Bank has been building since 2004 with recent works from renowned international and Portuguese contemporary artists.

Some of the illustrations also show images of this year's advertising campaigns.

GRUPO BANCO ESPIRITO SANTO

BES art Colecção Banco Espírito Santo

BES'06

ANNUAL REPORT

BESart Collection • Hannah Collins
"True Stories (Lisbon 3)", 2006 • C-Print • 175 x 235 cm • Edition: 1/3 • Courtesy the Artist

BANCO
ESPIRITO
SANTO

BES'06

ANNUAL REPORT

VOL. I

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03' Corporate Governance Report

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This document is a translation of the 2006 Annual Report submitted to the AGM of 29 Mar 07.

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BESart Collection • **Candida Höfer**
“Biblioteca do Palácio Nacional de Mafra III”, 2006 • C-Print • 152x171 cm

01’
MANAGEMENT REPORT

OVERVIEW AND DETAILS.
DISCIPLINE: FIRM YET FLEXIBLE.
BES’06

1.0 Joint Message from the Chairman of the Board of Directors and the Chairman of the Executive Committee

Dear Shareholders,

2006 confirmed the expectations of a recovery in the Portuguese economy based on the improvement of external demand. Exports benefited from greater dynamism in the Euro Area as well as the Portuguese companies' closer involvement in strong-growth economic areas such as the Asian countries and north-Africa (Morocco), and in particular Angola and Brazil. The integration of the Portuguese and Spanish economies also had a very positive impact on foreign trade and investment flows.

Internally, demand remained constrained by the high price of energy goods and moderate disposable income growth. Nevertheless, an improvement of the main household and business confidence indices was visible along the year, permitting to anticipate a new acceleration of economic activity in 2007.

For the BES Group, 2006 was marked by important achievements, namely the reinforcement of its multi-specialist model and the deepening of client acquisition initiatives that took into account the new demographic realities and a stronger presence abroad.

The performance and the results achieved in 2006 were driven by the strategy that was consolidated over time based on values that are shared by the whole Group and all its employees. The dynamism of BES Group is the result of a growth path that stresses operating performance and the value creation for its Shareholders.

In this context, the capital increase (approved by the General Meeting on April 17th) concluded in May, which yielded total proceeds of euro 1.38 billion, was decisive, as it will permit to pursue an ambitious plan to reinforce the Group's domestic and international positioning in the medium term. The Board of Directors has established and disclosed in due time a set of strategic objectives to be reached until 2009: (i) to reinforce the competitive positioning in Portugal in order to raise the average market share to 20%, (ii) to increase net income by an average 20% per year, with increasing contribution of international operations to 35% in 2009 (iii) to achieve average return on equity of 15%, (iv) to improve efficiency by reducing the cost to income to a level below 50% in 2009.

The acquisition of 50% of BES Vida should contribute to reinforce the Group's domestic positioning, allowing it to benefit from one of the highest growth rates in the financial area, and to gain from the convergence of banking and insurance products while simultaneously taking advantage of Crédit Agricole's large experience in this area.

Over the last years the BES Group has consolidated a differentiated commercial approach for each segment of individuals and corporate Clients. With the integration of BIC, the Group has currently a retail network of 630 branches, complemented by 28 Private Banking Centres and 27 Corporate Centres.

In various business areas the Group has developed specific distinctive expertise competencies that can be selectively exported to economies with high growth potential. These include affluent, private banking and asset management, corporate banking and investment banking. In light of this, the expansion and activity abroad has been selectively oriented to markets with relevant economic and cultural affinities with Portugal (Spain, Brazil and Angola) and also to countries where growth prospects are likely to generate business opportunities, and where the main centres of Portuguese emigration are located (the United Kingdom, US and France).

The international activity's contribution to net income is the outcome of the internacional expansion. In fact, Banking Income from the Group's foreign operations grew by an expressive 28%, while banking income reached euro 93,2 million, or 22% of the consolidated net profit.

The performance of Banco Espirito Santo de Investimento in 2006 was reflected in the net income, which reached euro 60,0 million, representing a growth of 20% comparing to 2005. The activity was very favourable in the main business areas, with reference to the significant increase of the transactions, especially in the international markets. The leadership in brokerage in the Portuguese market was consolidated, and in Spain this business area was reinforced with the evolution to 5th position in the ranking of Madrid Stock Exchange (from 10th). BES Investimento was also considered "Best Investment Bank – Real Estate Investment Banking" by Euromoney magazine and "Transportation Deal of the Year 2006" by Project Finance International.

A methodical implementation of the strategy yielded particularly good results in 2006, translating into a commercial growth, with credit and funding registering well-balanced increases of respectively 14.4% and 13.9%, and new Client acquisitions reaching 150,000 individual Clients (of which 27,250 channelled through the network of Assurfinance agents) and 700 corporate Clients.

Loans to individual clients focused on the higher value, lower risk segments, with a direct impact in the reduction of the portfolio's risk profile. Mortgage loans increased by 8.3%, with the affluent clients segment (BES 360) accounting for 47% of the year's production. Other loans to individuals grew 28.1%, as a result of a few initiatives associated to consumer credit, credit cards and savings products (BES Plans).

On the other hand, Corporate loans increased by 16.7%, backed by the recovery of the Portuguese economy, namely in exports, The Group's competitive position in the middle market segment was significantly reinforced, with loans to medium-sized companies rising by 22%.

On the other hand, on-balance sheet funds increased by 14.8%, while off-balance sheet funds were up by 12.4%, as a result of a wide range of life bancassurance products (namely Pension Plans), investment funds and portfolio management.

The activity resulted in a growth of 10.9% of the banking income, while operating costs were contained at 3.5%. In this context, further efficiency gains were obtained – the cost to income decreased from 56% in 2005 to 52% in 2006. In this respect, the rationalisation and integration of services within BES Group, namely the information systems and integration of BIC and Crediflash were particularly important.

The systematic fine-tuning of risk management methodologies, processes and systems, a strict loan granting policy, and the optimisation of credit recovery led to a significant improvement of asset quality levels. The ratio of overdue loans over 90 days to total loans declined to 1.1%, the respective provisioning coverage rising to 218%, which permitted to reduce the provisioning charge as a percentage of the total loan portfolio from 69 b.p. in 2005 to 51 b.p. in 2006.

Consolidated net income thus totalled euro 420.7 million in 2006, representing a year-on-year increase of 50%. Excluding the effect of the extraordinary provision charged in 2005 for BIC's integration, consolidated net profit would still rise by 30%.

Return on equity (ROE) reached 14.7%, being negatively influenced by the substantial increase in equity as a result of the capital increase. On the other hand, return on assets (ROA) shows a marked improvement, from 0.61% in 2005 to 0.81% in 2006.

The solvency ratios were significantly reinforced with the capital increase: the Core Tier I ratio rose to 7% (4.7% in 2005) while the Tier I ratio increased to 8.4% (6.2% in 2005). The main equity exposures in the available for sale portfolio had a gross potential gain of euro 656.3 million, the holding in Banco Bradesco alone having a potential gain of euro 496.1 million. For regulatory purposes, only 45% of these potential gains is considered as eligible Tier II capital.

At the end of 2006 BES' stock market capitalisation had reached euro 6.8 billion, with BES shares increasing by 27.6% in the year. Since the listing of the new shares resulting from the capital increase (June 1st, 2006) until the end of the year, BES' shares gained 24.7%.

Finally, in the name of the Board of Directors, we wish to convey our deep sorrow for the death of the Chairman of the General Meeting, Mr. Carlos Olavo. He had presided over the Bank's meetings of shareholders since 1996, conducting the works with fairness and independence, for which he won the respect and admiration of the Corporate Bodies and of the Shareholders of Banco Espírito Santo. We thus jointly express a vote of deeply felt recognition for the competence and brilliance which he always put in the performance of his functions.

With a spirit and vision focused on the future, and an intrinsic capacity for renewal, BES Group will pursue its value creation path – a path that is only made possible by the trust of Shareholders and Clients and the inexhaustible professionalism and loyalty of the Employees.

We end by expressing the Board of Director's recognition to the governmental and supervision authorities for the cooperation and trust granted to the Banco Espírito Santo Group.

Ricardo Espírito Santo Silva Salgado
Chairman of the Executive Committee

António Luís Roquette Ricciardi
Chairman of the Board of Directors

2.0 BES Group

2.1 Corporate Bodies

Given BES' status as a public traded company, its corporate bodies are elected at the General Shareholders' Meeting and are located in the Bank's head-office. Their composition for the 2004-2007 four-year mandate is as follows:

Board of Directors

António Luís Roquette Ricciardi (Chairman)
Ricardo Espírito Santo Silva Salgado (Vice-Chairman)
Jean Gaston Pierre Marie Victor Laurent (Vice-Chairman)
Mário Mosqueira do Amaral
José Manuel Pinheiro Espírito Santo Silva
António José Baptista do Souto
Jorge Alberto Carvalho Martins
Aníbal da Costa Reis de Oliveira
José Manuel Ferreira Neto
Manuel de Magalhães Villas-Boas
Manuel Fernando Moniz Galvão Espírito Santo Silva
José Maria Espírito Santo Silva Ricciardi
Jean-Luc Louis Marie Guinoiseau
Rui Manuel Duarte Sousa da Silveira
Joaquim Aníbal Brito Freixial de Goes
Pedro José de Sousa Fernandes Homem
Patrick Gérard Daniel Coudène
Michel Victor François Vilatte(*)
Mário Martins Adegas
Luís António Burnay Pinto de Carvalho Daun e Lorena
Lázaro de Mello Brandão
Ricardo Abecassis Espírito Santo Silva
Bernard Henri Georges De Witt
José Manuel Ruivo da Pena
Jean Frédéric de Leusse
Amílcar Carlos Ferreira de Morais Pires
Bernard Delas
Miguel António Igrejas Horta e Costa
Nuno Maria Monteiro Godinho de Matos
Alberto Alves de Oliveira Pinto
João Eduardo Moura da Silva Freixa

(*) Renounced to his mandate as member of the Board of Directors on February 7th, 2007.

The Board of Directors delegates the day-to-day management of the Bank to an **Executive Committee** composed of the following members of the Board of Directors:

Ricardo Espírito Santo Silva Salgado (Chairman)
Mário Mosqueira do Amaral
José Manuel Pinheiro Espírito Santo Silva
José Manuel Ferreira Neto
António José Baptista do Souto
Jorge Alberto Carvalho Martins
José Maria Espírito Santo Silva Ricciardi
Jean-Luc Louis Marie Guinoiseau
Rui Manuel Duarte Sousa da Silveira
Joaquim Aníbal Brito Freixial de Goes
Pedro José de Sousa Fernandes Homem
Amílcar Carlos Ferreira de Morais Pires
João Eduardo Moura da Silva Freixa

General Meeting

Paulo de Pitta e Cunha (Chairman)
Fernão de Carvalho Fernandes Thomaz (Vice-Chairman)
Nuno Miguel Matos Silva Pires Pombo (Secretary)

Audit Committee

Mário Martins Adegas (Chairman)
José Manuel Ruivo da Pena
Luis António Burnay Pinto de Carvalho Daun e Lorena

Certified Auditor (ROC)

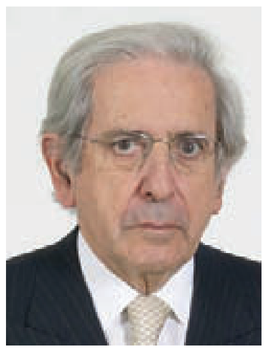
KPMG Associados, SROC, S.A., represented by Inês Maria Bastos Viegas Clare Neves Girão de Almeida

Company Secretary

Eugénio Fernando Quintais Lopes

Executive Committee

Ricardo Espírito Santo Salgado
(Chairman)



Mário Mosqueira do Amaral

José Manuel Pinheiro Espírito Santo Silva

José Manuel Ferreira Neto

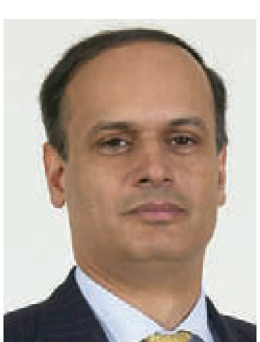
António José Baptista do Souto

Jorge Alberto Carvalho Martins

José Maria Espírito Santo Silva Ricciardi

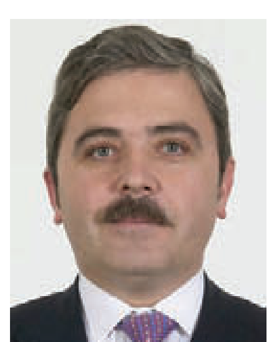
Jean-Luc Louis Marie Guinoiseau

Rui Manuel Duarte Sousa da Silveira



Joaquim Anibal Brito Freixial de Goes

Pedro José de Sousa Fernandes Homem



Amílcar Carlos Ferreira de Morais Pires

João Eduardo Moura da Silva Freixa

2.2 Profile of BES Group

2.2.1 Key Indicators

Activity Indicators

Key Indicators	2004	2005	2006
BALANCE (euro million)			
Total Assets [1]	61,603	71,687	84,628
Net Assets	43,052	50,222	59,139
Loans to Customers (gross)	28,487	31,662	35,752
Total Customer Funds	38,754	43,558	49,632
Regulatory Capital	4,622	5,398	7,063
PROFITABILITY(%)			
Return on Assets (ROA)	0.37	0.61	0.81
Return on Equity (ROE)	6.4	13.5	14.7
SOLVENCY (%)			
Bank of Portugal Ratio			
- Total	12.1	12.3	13.1
- TIER I	6.7	6.2	8.4
BIS Ratio			
- Total	13.9	12.7	13.2
- TIER I	7.7	6.5	8.4
Asset Quality (%)			
Overdue Loans >90 days/ Gross Loans	1.6	1.3	1.1
Coverage of Overdue Loans > 90 days	165.3	196.6	218.2
PRODUTIVITY/EFFICIENCY			
Operating Costs/Total Assets (%)	1.44	1.20	1.05
Assets per Employee (euro thousand)	8 441	9 444	10 855
Cost to Income (%)	62.0	56.0	52.3
RATING			
Long Term			
STANDARD AND POOR'S [2]	A -	A -	A -
MOODY'S	A 1	A 1	A 1
FITCHRatings	A+	A+	A+
Short Term			
STANDARD AND POOR'S [2]	A 2	A 2	A 2
MOODY'S	P 1	P 1	P 1
FITCHRatings	F1	F1	F1

(1) Net Assets + Asset Management + Other off-balance sheet liabilities + Securitised credit.
(2) In March 28th, 2007, S&P upgraded BES ratings to A (long term) and A 1 (short term)
*2004 figures under IFRS.

Results and Profitability

	Symbol	2004	2005	2006
AVERAGE BALANCE (euro million)				
Interest Earning Assets	$\overline{\text{IEA}}$	39,240	41,139	45,377
Capital and Reserves	$\overline{\text{KP}}$	1,890	1,844	2,642
Net Assets	$\overline{\text{NA}}$	41,425	45,924	51,696
INCOME STATEMENT (euro million)				
Net Interest Income	NII	697.0	740.6	829.5
+ Fees and Comissions	FC	549.6	555.1	610.5
= Commercial Banking Income	CBI	1,246.6	1,295.7	1,440.0
+ Capital Markets and Other Results	CMR	184.4	242.0	264.8
= Banking Income	BI	1,431.0	1,537.7	1,704.8
- Operating Costs	OC	887.5	861.2	891.3
- Net Provisions	PROV	322.3	320.6	241.9
= Profit Before Tax and Minority Interests	PBT	221.2	355.9	571.6
- Income Tax	IT	46.7	65.8	135.4
- Minority Interests	MI	22.9	9.6	15.5
= Net Income	NII	151.6	280.5	420.7
Profitability (%)				
Net Interest Margin	NII/ $\overline{\text{IEA}}$	1.78	1.80	1.83
+ Return on Fees and Commissions	FC/$\overline{\text{IEA}}$	1.40	1.35	1.35
+ Capital Market Results and Other	CMR/$\overline{\text{IEA}}$	0.47	0.59	0.58
= Business Margin	BI/$\overline{\text{IEA}}$	3.65	3.74	3.76
- Weighting of Operating Costs	OC/$\overline{\text{IEA}}$	2.26	2.09	1.96
- Weighting Provisions	PROV/$\overline{\text{IEA}}$	0.82	0.78	0.53
- Minority Interestes and Other Costs	(MI+IT+XR)/$\overline{\text{IEA}}$	0.18	0.18	0.33
= Return on Financial Assets	NP/$\overline{\text{IEA}}$	0.39	0.68	0.93
x Weighting on Interest Earning Assets	$\overline{\text{IEA}}$/$\overline{\text{NA}}$	0.95	0.90	0.88
= Return on Assets (ROA)	NP/$\overline{\text{NA}}$	0.37	0.61	0.81
x Placements Multiplier	$\overline{\text{NA}}$/$\overline{\text{KP}}$	17.38	22.16	18.01
= Return on Equity (ROE)	NP/$\overline{\text{KP}}$	6.36	13.54	14.66

Bank of Portugal Reference Indicators

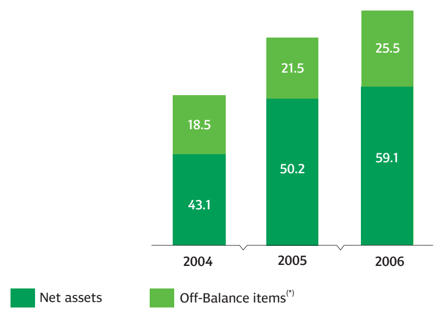
The table below lists the reference indicators established by Bank of Portugal Instruction no. 16/2004, for both December 2006 and 2005.

Indicators	2005	2006
SOLVENCY		
Regulatory Capital / Risk Weighted Assets	12.3%	13.1%
Tier I / Risk Weighted Assets	6.2%	8.4%
ASSET QUALITY		
Overdue and Doubtful Loans [a]/ Total Loans to Customers	1.8%	1.4%
Overdue and Doubtful Loans Net of Provisions[b]/Loans to Customers Net of Provisions[b]	-0.9%	-1.1%
PROFITABILITY		
Income before Taxes and Minorities / Average Equity[c]	13.2%	15.1%
Banking Income(d)/Average Net Assets	3.3%	3.3%
Income before Taxes and Minorities / Average Net Assets	0.8%	1.1%
EFFICIENCY		
General Costs(d) + Depreciation/Banking Income[d]	56.0%	52.3%
Staff Costs / Banking Income [d]	29.5%	28.1%

(a) According to BoP Circular Letter no. 99/03/2003.
(b) Credit net of impairment.
(c) Includes Average Minority Interests.
(d) According to BoP Instruction no. 16/2004.

Total Assets

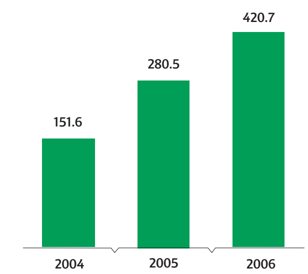
euro billion



(*) Assets and liabilities off-balance sheet items.

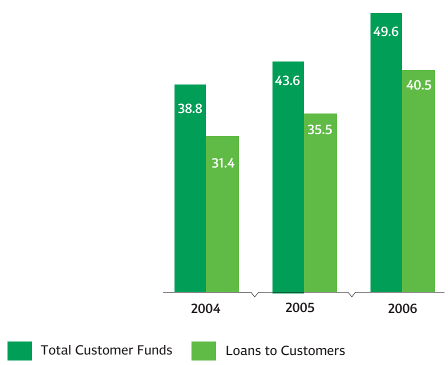
Net Income

euro million



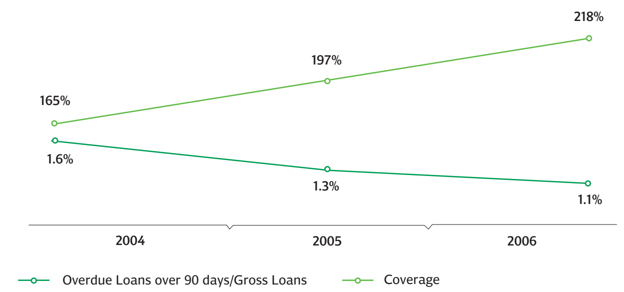
Business with Clients(*)

euro billion



(*) Off-balance sheet assets and liabilities.

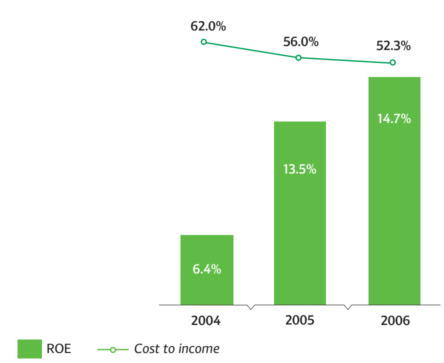
Asset Quality



Own Funds

euro billion

Profitability and Efficiency



2.2.2 Geographical Presence and Distribution Network

The BES Group pursues a strategy of organic growth in the domestic market complemented by an international presence focused on markets with cultural and/or economic affinities with Portugal, as well as markets showing high potential in specific areas where the Group holds particular skills.

In the development of its international activities, the Group exports its expertise and skills in Private Banking, Corporate Banking and Investment Banking, specifically in the area of project finance, taking advantage of the existing affinities with the Spanish market as well as with Portuguese speaking countries, in particular Angola and Brazil.

In Portugal BES operates through a retail network of 630 branches, complemented by 28 Private Banking Centres and 27 Corporate Centres.

ES Private 28

Corporate Centers 27

BES' international operations are developed through 25 platforms:

7 Subsidiaries and Associated Companies: BES (Spain)(1) , BES Angola, BES Oriente (Macao), BES Investimento do Brasil (Brazil), BES Vénétie (France), ES Bank (USA) and ES plc (Ireland)

5 International Branches: New York, London, Cape Verde, Nassau and Cayman Islands

1 Off-shore Branch: Madeira

12 Representative Offices: Toronto, Newark (3), Caracas, Rio de Janeiro, São Paulo, Lausanne, Cologne, Milan, Johannesburg and Shanghai.

(1) On 15 January 2007 the Bank of Spain authorised the transformation of BES, SA (Spain) into a BES branch.

2.2.3 Human Resources

Human resources are the key element behind the high level of efficiency and productivity attained by the Group. Hence the human resources policy relies on the promotion of intellectual capital as a brand differentiation factor.

The management model emphasises development and motivation, enhancing the employees' skills through their permanent qualification, ensured by training plans specifically addressed to each segment, and also group-wide training plans.

2006 was characterised by the need to stabilise BES' structure following BIC's merger, and integration of several activities that were being carried out by subsidiaries and shared services companies. Therefore the recruitment of younger and better qualified professionals was a priority on the admissions policy, while maintaining higher education as a key factor (currently 44% of the Group's employees have university degrees).

In 2006 BES Group's staff was composed of 43% female and 57% male. The average age of the workforce was 37.6, the percentage of the employees under 50 having fallen from 23% in 2000 to 13.3% at the end of 2006.

BES Group's Employees: Breakdown by Country

BES Group's Employees	2005	2006
Portugal	7,536	7,707
Spain	459	471
Brazil	113	129
USA	133	121
Angola	177	265
Others	106	111
Total	**8,524**	**8,804**

2.3 BES' Share Price Performance

On December 31st, 2006 the share capital of Banco Espírito Santo was euro 2,5 billion, represented by 500 million ordinary shares with the nominal value of euro 5 each. In May 2006 BES increased its share capital from euro 1,5 billion to euro 2,5 billion through the issue of 200 million new shares.

The stock market performance of BES shares was influenced by the capital increase that took place in the first half of the year. Hence the necessary adjustments were made for comparability purposes with the previous year.

n 2006 the Portuguese equity market mirrored the upward trend of the main European markets. The PSI 20 gained 29.9%, surpassing the previous year's performance (13.4%), with volatility increasing from 8.3% in 2005 to 9.2% in 2006.

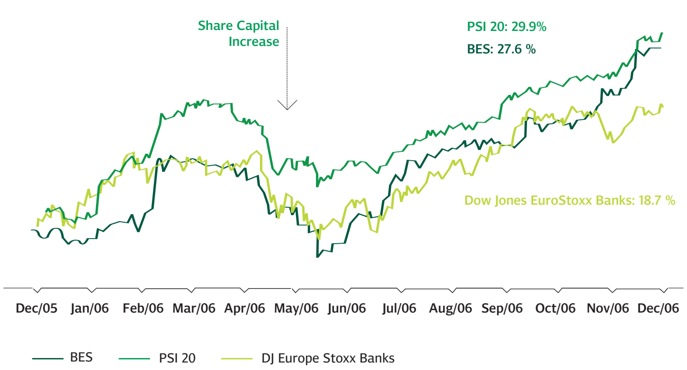
BES shares rose 27.6%, largely surpassing their increase in 2005 (+2.3%), with a volatility of 36.3%, from a minimum of euro 10,21 to a maximum of euro 13,92 (stock price adjusted for the capital increase).

Main Stock Market Indicators

Indicators		Dec-05 (a)	Dec-06 Not Adjusted (b)	Dec-06 Adjusted (c)	Change (c/a)
Stock Exchange Data					
01. No.Shares Outstanding	(thousand)	300,000	500,000	387,500[5]	29.2%
02. Weighted Average of New Outstanding Shares	(thousand)	300,000	417,222[4]	387,500[5]	29.2%
03. Last Price	(euro)	10.67[3]	13.62	13.62	27.6%
04. Market Cap	(euro million)	4,080	6,810	6,810	66.9%
Consolidated Financial Data					
05. Equity Attributable to Shareholders [1]	(euro million)	2,924	4,736	4,736	62.0%
06. Equity Attributable to Ordinary shares [2]	(euro million)	2,324	4,136	4,136	78.0%
07. Net Income	(euro million)	280.5	420.7	420.7	50.0%
08. Net Income Attributable to Ordinary Shareholders	(euro million)	247.0	387.2	387.2	56.8%
09. Gross Dividend of Ordinary Shares	(euro million)	120.0	200.0[6]	200.0	66.7%
10. Pay Out Ratio of Ordinary Shares	(%) (09/07)	42.8	47.5	47.5	4.7p.p.
Per Share Data					
11. Book Value	(euro) (06/01)	7.75	8.27	10.67	37.8%
12. Net Income	(euro) (08/01)	0.82	0.77	1.00	21.4%
13. Gross Dividend	(euro) (09/01)	0.400	0.400	0.516	29.0%
Price as Multiple of					
14. Book Value	PBV (03/11)	1.76[7]	1.65	1.28	-
15. Net Income	PER (03/12)	16.52[7]	17.59	13.63	-
Price Return On					
16. Net Income	(%) (10/02)	6.05[7]	5.69	7.34	-
17. Dividend (Dividend Yield)	(%) (11/02)	2.94[7]	2.94	3.79	-

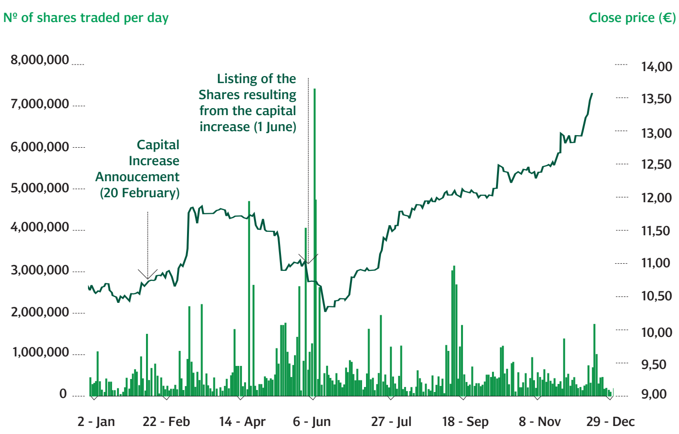
(1) Capital + Preference Shares + Share Premiums - Own Shares + Other Reserves and Retained Earnings + Revaluation Reserves + Results.
(2) Excludes Preference Shares.
(3) Price adjusted for the capital increase (Source: Bloomberg); price on 31 Dec. 05: euro 13,60.
(4) Average number of ordinary shares, weighted for time of permanence after capital increase.
(5) Adjusted for time of permanence and excluding shares attributed by incorporation of reserves: 300 million shares + 7/12x 150 million shares.
(6) Proposal to be submitted to the General Meeting of March 2007 of a dividend per share of euro 0,40, payable on all existing shares at the end of the year.
(7) Based on last price in 2005: euro 13,60.

BES´ share price performance in 2006



Since the listing of the new shares resulting from the capital increase (June 1st, 2006), BES' shares gained 24.7%, which compares with rises in the PSI 20 and DJ Eurostoxx Banks of respectively 19.2% and 13.6%. This performance was to a large extent influenced by the increased free float, which significantly boosted the liquidity of the BES share and enlarged the base of institutional investors in BES share capital. The awareness of BES shares was significantly reinforced in the international markets through a substantial increase in the number of contacts namely through to one-on--one meetings with institutional investors (mostly international) and the Bank's participation in conferences organised by various investment banks.

BES Shares Liquidity



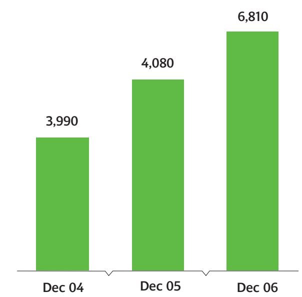
Annual trading volume of BES shares was euro 1,922 million (euro 731 million in 2005), while capital turnover (the ratio of annual trading volume to stock market capitalisation at the end of the year) was 28.2% (17.9% in 2005). The BES share was the third most traded stock in the Euronext Lisbon and the second among financial institutions. The average number of shares traded in 2006 was 650 thousand, corresponding to an average daily trading volume of euro 7,5 million, which compares with 273 thousand shares and euro 2,8 million in 2005. From the listing of the new shares until the end of the year, 646 thousand shares were traded on average per day, corresponding to a daily trading volume of euro 7,6 million.

The Bank's adjusted price earnings ratio (PER) was 13,63 at the end of 2006, while the price book value (PBV) was 1.28.

As of December 31st, 2006 BES' market capitalisation (euro 6,810 million) was the second largest among the Portuguese financial institutions listed on the Euronext Lisbon, and the fourth largest on the PSI 20. The Bank's weight in the market capitalisation of the PSI general index was 8.6% (Dec. 05: 7.2%).

Evolution of BES Market Capitalisation

euro million



Indices

BES shares are listed on the Euronext Lisbon Stock Exchange and are part of several indices (see table for the most significant).

Index	Weight in 2005	Weight in 2006
Euronext Lisbon PSI Financials	26.210%	29.060%
PSI-20	8.330%	9.410%
PSI Geral	7.150%	8.588%
Dow Jones Euro STOXX Mid (Price)	0.490%	0.728%
Dow Jones EURO STOXX Banks Supersector (Price)	0.310%	0.403%
Bloomberg Europe Banks	0.219%	0.363%
Dow Jones STOXX Mid 200 (Price) – EUR	0.260%	0.349%
WT International Midcap Dividend	0.305%	0.338%
S&P Euro Financials GICS Sector	0.250%	0.316%
Euronext 100	0.230%	0.314%
S&P Europe 350 Banks Industry Group	0.220%	0.285%
Bloomberg Europe 500 Banks & Financial Services	0.270%	0.257%
Dow Jones EUROPE STOXX Banks (Price)	0.160%	0.216%
WT International Financial Sector	0.188%	0.200%
Bloomberg European Financial	0.200%	0.193%
BBG World Banks	0.119%	0.192%
S&P Europe 350 Financials - GICS Sector Level	0.131%	0.168%
WT Diefa High-Yielding Dividend Fund Value(*)	0.098%	0.117%
S&P Europe Economic Sectors GICS Sector Level	0.080%	0.109%
Dow Jones EURO STOXX (Price)	0.070%	0.094%
WT Europe Dividend	0.078%	0.087%
S&P Euro Plus	0.063%	0.083%
Bloomberg Europe	0.050%	0.069%
WT Diefa	0.060%	0.068%
Global 1200 Financial Sector	0.046%	0.065%
Bloomberg European (500 Industry Sectors)	0.060%	0.059%
Bloomberg Europe (500 Economic Sectors)	0.060%	0.059%
Dow Jones STOXX 600 (Price)	0.030%	0.048%

Source: Bloomberg
(*) Since the date of creation of index: june 2006.

BES Group also has 600,000 non-voting preference shares with a nominal value of euro 1,000 each issued by its subsidiary BES Finance, Ltd and listed on the Luxembourg Stock Exchange.

Shareholders

The Bank's shareholder structure changed as a result of the capital increase. The main shareholders as of December 31st, 2006 were as follows:

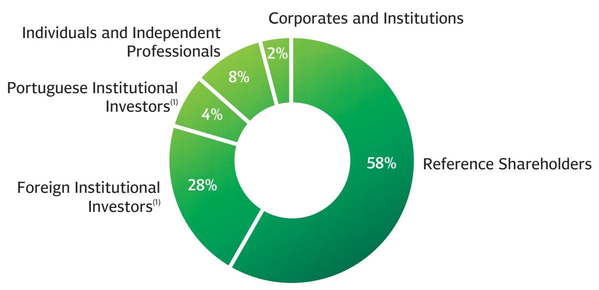
Shareholder	% Share Capital	
	Dec 05	Dec 06
BESPAR — Sociedade Gestora de Participações Sociais, S.A.	4.98	40.00
Crédit Agricole, S.A.	8.81	10.81
Companhia de Seguros Tranquilidade - Vida, S.A.	6.46	0.00
Bradport, SGPS, S.A.(*)	3.05	3.05
Hermes Pensions Management Ltd.	0.00	2.13
Grupo Portugal Telecom	4.02	4.02
Previsão - Sociedade Gestora de Fundos de Pensões, S.A.	2.62	2.62
Portugal Telecom, S.G.P.S., S.A.	1.40	1.40

(*) Portuguese company owned by Banco Bradesco, S.A..

BES' pool of investors was considerably expanded as a result of the capital increase, the free float rising from 36% in 2005 to 42% in 2006.

At year-end 2006 the Bank's shareholder structure was the following:

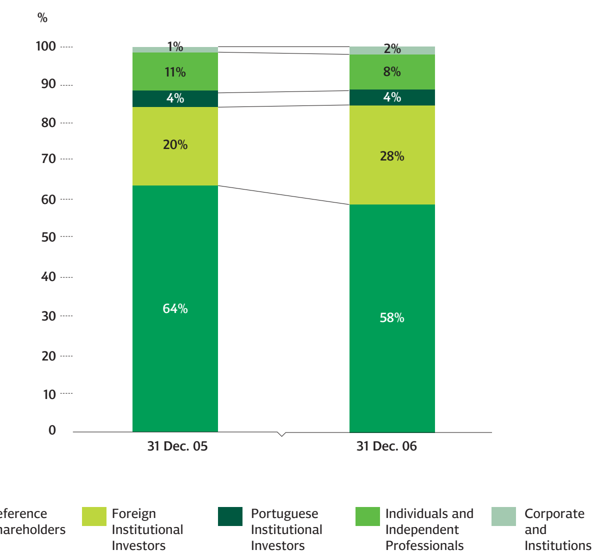
Shareholder Structure as at December 31st, 2006
(% of share capital)



(1) Includes stakes held by asset management companies (eg mutual funds, pension funds, discretionary management), custodian banks, brokers, etc.

At the end of 2006 institutional investors accounted for 32% of the Bank's share capital, which compares with 24% in 2005. The increase in the weight of foreign institutional investors was particularly significant - from 20% to 28%, largely reflecting the increase in the BES shares' free float and stock market liquidity.

Evolution of Shareholder Structure (% of share capital)



Dividends

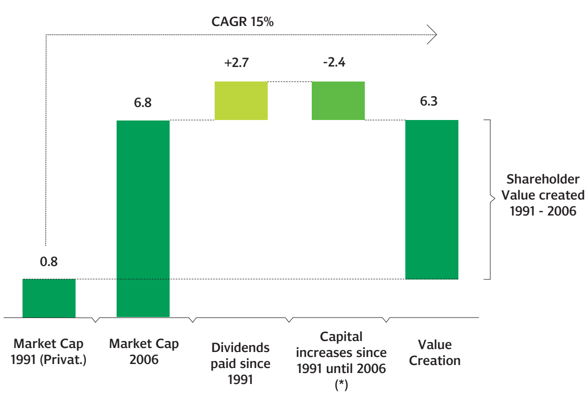
The Bank's objective is to pay dividends to its shareholders to the amount of at least 50% of its individual net income. However, this objective depends on financial conditions and results, as well as other factors deemed relevant by the Board of Directors.

In this context, and as described in the proposal for the distribution of the 2006 net income, BES' Board of Directors will submit at the General Shareholders' Meeting a proposal to pay a gross dividend per share of euro 0.4, which, if adjusted for the effect of the capital increase, corresponds to a 29% increase versus the total amount distributed in 2005. On a comparable basis, i.e., adjusted for the average number of shares in 2006, the dividend yield rose from 2.94% to 3.79% while the consolidated payout ratio increased to 47.5%, from 42.8% in 2005.

Shareholder Value Creation

BES' main priority is to create value for the shareholders. Since the Bank's privatisation in 1991, its organic growth strategy has resulted in value creation in the amount of euro 6.3 billion, which corresponds to a CAGR of 15%. This is based on adjusting the 2006 market cap to reflect the present value of the dividends and the capital increases carried out since 1991, comparing with the market cap in 1991.

Shareholder Value Creation since Privatisation



Notes:
a. Considers only cash entries.
b. Present value of capital increases and dividends using total return rate up to December 31.
c. Stock market captitalisation in 2006 based on closing price at year-end 2006 (euro 13.62).

Own Shares

In accordance with article 66 of the Companies Code, BES states that transactions involving the Bank's own shares in 2006 related exclusively to transactions carried out within the scope of its Share Based Incentive System (SIBA).

BES Shares	Number	Unit Value (euro)	Total (euro)
Balance as at 31st, 2005	**0**	-	-
Transactions during the year			
Purchases	2,215,244	14.95	33,117,898
Sales	2,215,244	14.95	33,117,898
Balance as at Dec 31st, 2005	**0**	-	-

(*) Includes open market and OTC transactions.

On December 31st, 2006, BES held euro 63,732,000 accounted in "Treasury Stock", corresponding to 5,667,612 shares traded within the scope of the Share Based Incentive System, which is duly explained in the Notes to the Financial Statements.

2.4 Milestones and Main Events in 2006

2.4.1 Milestones

1869

Banco Espírito Santo's origins date back to 1869, the year José Maria do Espírito Santo e Silva opened his exchange business ("Caza de Cambio").

1884

José Maria do Espírito Santo e Silva sets up several banking houses: Beirão, Silva Pinto & Cª. (1884-1887), Silva, Beirão, Pinto & Cª. (1897-1911), J. M. Espírito Santo Silva (1911-1915), J. M. Espírito Santo Silva & Cª. (1915).

1916

Following the death of its founder, the firm was replaced by Espírito Santo Silva & Cª., set up by his heirs and former partners under the management of his eldest son, José Ribeiro do Espírito Santo e Silva.

1920

The Banking house is made into a public company under the name of Banco Espírito Santo (BES). BES inaugurates its first branch at Torres Vedras.

1932

Ricardo Espírito Santo Silva is appointed Chairman of the Bank's Board of Directors.

1937

BES merges with Banco Comercial de Lisboa, creating Banco Espírito Santo e Comercial de Lisboa (BESCL). With 33 branches spread all over the country, BESCL has the broadest geographical coverage by private sector banks.

1946

To expand its operations into the Azores, BES purchases the largest savings bank in these islands.

1955

On the death of Ricardo Espírito Santo, BESCL's Secretary General, Manuel Espírito Santo Silva succeeded as Chairman of the Board of Directors.

1966

Launch of pioneering products, namely personal loans and traveller's cheques. BESCL acquires the Blandy Brothers banking house, operating in Funchal (Madeira).

1973

In a joint venture with the First National City Bank of New York BESCL sets up Banco Inter-Unido in Luanda, Angola.

1975

The Portuguese credit institutions and insurance companies are nationalised.

1976

Creation of the Espírito Santo Group, under the leadership of Manuel Ricardo Pinheiro Espírito Santo Silva.

1986

In the same year that Portugal joined the EEC, the Espírito Santo Group sets up Banco Internacional de Crédito in Lisbon, in a joint venture with Caisse Nationale du Crédit Agricole

1991

The reprivatisation of BESCL begins, and the Espírito Santo Group, in partnership with Caisse Nationale du Crédit Agricole, regains control of the Bank. In the same year, Crediflash (credit cards) was incorporated and the broker ESER was acquired.

1992

BES enters the Spanish market following the acquisition of Banco Industrial del Mediterráneo, later transformed into Banco Espírito Santo (Spain).
Creation of ESAF – Espírito Santo Activos Financeiros, the Group's holding company for the asset management business.

1995

Incorporation of Banco Espírito Santo do Oriente, in Macao.

1999

On July 6th, BESCL changes its name to Banco Espírito Santo by public deed.

2001

Incorporation of Banco Espírito Santo de Angola and Banco BEST – Banco Electrónico de Serviço Total.

2002

Start-up of Banco Espírito Santo dos Açores, owned by Banco Espírito Santo as majority shareholder and by Caixa Económica da Misericórdia de Ponta Delgada and Bensaúde Participações, SGPS.

2003

Integration of ES Dealer (brokerage) into Banco Espírito Santo de Investimento. BES acquires a stake in Locarent (rent-a-car), a joint venture created by BES, CGD and Serfingest.

2004

Conclusion of the merger by incorporation of Euroges, Besleasing Mobiliária and Besleasing Imobiliária into a new company called Besleasing e Factoring, IFIC, S.A.

2005

In September BES announces the merger by integration of Banco Internacional de Crédito (BIC), which was concluded by public deed on December 31st, 2005.

2.4.2 Main Events in 2006

January

28th Banco Espírito Santo launches a new corporate identity, changing the image in all its communication supports.

February

2nd BES Group reports 2005 consolidated results.
Net income reached euro 280.5 million, a year-on-year increase of 85% on a comparable basis (IFRS) and corresponding to a return on equity (ROE) of 13.5%.
20th Banco Espírito Santo announces that it will submit to the General Shareholders' Meeting of April 17th a proposal to increase the share capital from euro 1.5 billion to euro 2.5 billion.
21st BES' Board of Directors announces that it has designated, by cooptation, Nuno Maria Monteiro Godinho de Matos and Alberto de Oliveira Pinto to fill two (non-executive) vacancies in the Board of Directors.
24th BES' Board of Directors announces strategic objectives for 2006-2009 period.

March

21st and 22nd BES participates in the European Banks Conference, in London, organised by Morgan Stanley.
24th BES informs the market that it has presented a preliminary non-binding offer for the acquisition of Banco Urquijo in Spain.

April

17th BES' General Meeting of Shareholders approves the management report, the individual and consolidated accounts for 2005 and the respective net income application. The Shareholders also approved a proposal to increase the share capital from euro 1.5 billion to euro 2.5 billion.
18th Launch of the "from Mathematics to Financial Literacy" programme, a school communication project designed to stimulate and encourage the teaching and learning of mathematics and address the existing deficiencies in this area.
24th BES Group reports first quarter 2006 results. Consolidated income reached euro 105.1 million, corresponding to a ROE of 20.5%.

May

3rd Payment of dividends of 2005 results. The gross dividend of euro 0.4 per share corresponds to a payout ratio of 42.8% on a consolidated basis and 63.1% on an individual basis.
12th BES informs the market on the binding offer for the acquisition of Banco Urquijo, in Spain.
16th BES announces results of the bookbuilding process related to its share capital increase.
20th As sponsor of the National Team competing in the 2006 World Football Cup, BES launches a campaign under the motto "The Most Beautiful Flag in the World", entering the Guinness Book of Records for achieving the largest human flag ever assembled in the world, with the original and unique feature of being entirely formed by women – 18,788 all in all.
30th Conclusion of the merger by incorporation of Crediflash into BES.

June

1st The new shares resulting from the capital increase are listed on the Euronext Lisbon Stock Exchange.
27th BES completes the acquisition of 50% of Companhia de Seguros Tranquilidade-Vida and the sale of 15% of Espírito Santo Seguros, where it maintained a stake of 25%. Both companies changed their names, respectively to BES Vida, Companhia de Seguros and BES, Companhia de Seguros.

July

7th Banco Espírito Santo opens a branch in Cidade da Praia, Cape Verde.
18th BES announces the merger of BES (Spain) and its transformation into a branch of Banco Espírito Santo. This transaction was authorised by the Bank of Spain on January 15th, 2007.
25th BES releases its first half 2006 results. The BES Group posts net consolidated income of euro 200.7 million, corresponding to a year-on-year increase of 34.7% and to a ROE of 17.6%.

September

12th BES informs the market that Hermes Pensions Management has purchased 10 million BES shares, corresponding to 2% of its share capital.
25th BES Group concludes its eighth securitization transaction in the international market - Lusitano Mortgages No. 5 – for a total amount of euro 1.4 billion.
20th and 21st BES participates in the European Financials Conference, in London, organised by Keefe, Bruyette & Woods.

October

24th BES Group releases third quarter 2006 results. Consolidated net income for the first nine months of 2006 was euro 304.7 million, corresponding to a year-on-year increase of 46.5% and to a ROE of 15.2%.

November

9th BES Group concludes its first securitisation transaction on credits granted to Portuguese SMEs - Lusitano SME No. 1 -, in the overall amount of euro 863 million. This was the ninth securitisation transaction performed by BES Group in the international market.

December

18th An Extraordinary General Meeting is held. BES' Shareholders designated the members of the Board of the General Meeting, ratified the filling, by cooptation, of a vacancy in the Board of Directors, deliberated on a proposal to change the Company's bylaws to the effect of entrusting joint supervision of the company to the Audit Committee and the Certified Auditor, and elected the members of these two bodies.
31st BES Group reaches net income of euro 420.7 million in 2005, corresponding to a year-on-year increase of 50% and a ROE of 14.7%.

3.0 Strategy and Business Model

For Banco Espírito Santo Group the main pillar for development and strategic differentiation lies in the excellence of service and permanent focus on the needs of each client, acting as a universal financial group serving all individual, corporate and institutional customer segments, offering a full range of financial products and services that meet their needs through distinctive approaches and value propositions that have a common three-fold focus: to better know the customer's needs, to develop the offer in accordance with the needs identified, and to find the best solutions.

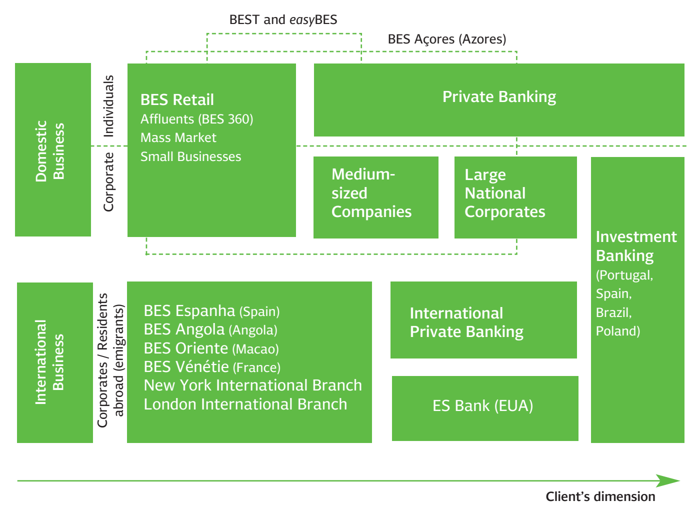
The capital increase carried out in 2006 had, as key objectives to allow for the reinforcement of the competitive positioning in Portugal – namely through the acquisition of 50% of BES Vida, which meant acquiring a direct participation in the bancassurance business-, and to sustain an international expansion focused on the triangle formed by Spain, Angola and Brazil.

The Board of Directors has outlined a medium-term plan that establishes the following objectives for the 2006-2009 period:

- Average Return on Equity of 15% during the period;
- Net profit CAGR of 20%, based on:
  - Sustained domestic activity growth in order to reach an average market share of 20%;
  - Increased contribution of international operations to consolidated net profit reaching 35% in 2009;
- Cost to Income (total operating costs / banking income) below 50% in 2009.

These objectives assume on the one hand the gradual but sustained recovery of the Portuguese economy, and on the other the growth of customer credit and funds in the Portuguese market.

BES Group's Multi-specialist Market Approach



BES its share Group doubled its average market share since the privatisation, from 8.5% in 1992 to 19% in 2006, based on the fine-tuning of its multi-specialist model, supported by a strategy of organic growth.

Market share per product and average market share

(E) Estimate

These results stem naturally from a very dynamic performance in the individual and corporate clients segments, and the effort made to reach the following objectives:

- reinforcement of client acquisition levels;
- continued focus on the higher-value customers and segments by creating or repositioning the product and services offer;

• increasing the customer share-of-wallet at the Bank, especially through cross selling.

In Retail, a more specialised commercial approach led to the creation of the BES 360 service (targeted at the affluent segment) and to a renewed approach to small businesses and independent professionals, emphasising growth in strategic sectors of activity. More recently, and after consolidating its approach to the higher value segments, a value proposition was also developed for the other individual customer segments, based on the standardisation of products and services and taking into account the customer's life cycle.

The strategy outlined for the Corporate Banking segment is consistent with the evolution of the business world's reality in recent years. BES has a central structure that supports the commercial network for the corporate segments, stimulating the commercial activity of the national and international economic agents that maintain financial relations with BES.

Corporate Banking strong performance was backed by the upturn of the economy, namely in exports, and by the Bank's strong foothold in this segment and consistent support to the Portuguese firms internationalisation. In 2006 the Global Finance magazine considered BES the "Best Trade Finance Bank" in Portugal, a prize that distinguishes the best banks in 57 countries in Trade Finance. The Bank's market share is 28%.

Faced with the increasing globalisation of financial markets and the need to obtain economies of scale and operating efficiency gains, the Group expanded on the international front into fast-growth countries that have affinities with Portugal (Spain, Brazil and Angola). The strategy is to serve local customers in target segments but also customers doing business on a trans-national scale.

This growing expansion beyond the Group's domestic frontiers – fuelling high growth levels that complement a fully exploited potential of the domestic customer base -, a strong focus on excellence, the constant fine-tuning of the services provided and operating efficiency in the activities developed are critical for reinforcing BES Group's strategic autonomy in the medium and long term.

A highly diversified customer base, allied with the complementary role of the international business, have over time proved essential to the generation of revenues, translating into a sustained growth pattern of results.

3.1 Retail Banking

Backed by a number of actions carried out during the year, retail banking posted a strong commercial performance in 2006 in the small businesses and individual client segments.

Through the initiatives taken to attract new clients and control erosion in the customer base, BES Group attracted 150,000 new individual clients (year-on-year increase of 25%) during the year, which, together with client retention, resulted in an increase of 58% in net client acquisition. Between 2005 and 2006 BES gained more than 190,000 new clients overall, which has allowed the bank to rejuvenate the client base, especially by a strong contribution from clients that are less than 30 years old.

Complementing this client acquisition effort, the consolidation of the specialised commercial approaches to address the financial needs of each segment, adopt since 2004, also allowed to increase the number of loyal clients in 2006.

Assurfinance: the T-World becomes mature

In 2006 the Assurfinance programme once again gave a strong contribution to the performance of the Retail segment at Banco Espírito Santo Group.

This programme is based on a partnership between BES and Companhia de Seguros Tranquilidade, and involves a total of 1,200 agents. In 2006 BES acquired 27,250 new clients through this initiative and placed more than 25,000 credit cards (T-cards). The Assurfinance programme also contributed with 15% of the year's total mortgage production at BES (vs. 14% in 2005).

These results stem from the cross selling and cross segment initiatives developed in 2006: (i) T Card promotion (payment on credit permitted) for Auto Insurance holders; (ii) increased focus on selective client acquisition and bonding, particularly in the BES 360 segment.

The Bank's client acquisition capacity was also further reinforced by the introduction of a new concept of cooperative distribution, applied in the "Agents' Branches", of which there were already 17 by the end of the year.

BES 360 - a reference in financial advisory services

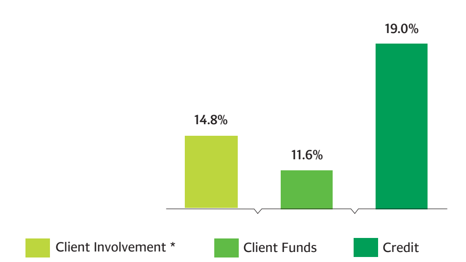
The BES 360 service for the affluent client segment is based on a customer-centric approach. Each customer benefits from the permanent support of a specialised dedicated Account Manager, and an exclusive offer of products and solutions tailored to meet the segment's needs, featuring high quality standards and guaranteed service levels.

Setting up the BES 360 service implied a large infrastructure investment at various levels. The team of Account Managers was reorganised and given an intense and thorough training programme. These Account Managers are supported in their daily work by a group of highly skilled consultants in the areas of financial planning and investments. The offer was fine-tuned and extended, and became extremely attractive. Finally, specific areas were set aside in each branch for the exclusive use of BES 360 customers.

In addition, BES 360 offers a unique and innovative financial planning tool, the "360 Map". Using this map, the customers can trace their entire financial life and map out the best way to achieve their financial objectives. The result is a recommendation concerning the investments that best suit their profile. This is a pioneering service in the Portuguese market, which, while offering considerable advantages to the customer, further reinforces BES Group's already strong competencies in the area of financial advisory services. The expressive growth posted by discretionary portfolio management largely reflects the implementation of this service.

Since the launch of the BES 360 service, the results obtained have been extremely positive. In 2006 the loyal customers' base surpassed 95,000, a year-on-year increase of 9%, with the respective financial involvement rising by 15%. BES 360 customers were responsible for 47% of BES Group's mortgage credit production in 2006.

Growth of BES 360 Segment (Affluent Clients)



(*) Client Involvement: credit and funds.

Small Businesses - confirmation of a winning strategy

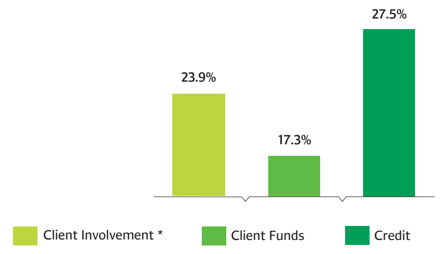
In line with last year, the Small Businesses segment had a vigorous commercial performance in 2006, reflecting a stronger competitive positioning in this important market segment: the financial involvement of clients (credit and funds) rose by 23.9%

This performance, which was decisive for consolidating BES' position as the prime bank for small businesses, was based on three main growth drivers:

• 19% increase in client acquisition, supported by the commercial activity developed by the team of Small Businesses client prospectors;
• selective market share increase in segments with high potential (such as Notaries - 52%, Pharmacies - 30%, Tourism, Health and Franchising), and low associated credit risk;
• the expansion of cross-selling, namely the increase in the number of "BES Negócios Tesouraria" accounts (an integrated solution designed to meet the daily needs of Small Businesses) - two out of every three new clients acquired in 2006 opened this account – and the 14% increase in Pension Plans sales, leveraging on the growing awareness for the need to plan for retirement.

As a consequence of the commercial strategy consolidation, and the development of differentiated value propositions for the higher potential sectors, the Small Businesses segment reached 31,000 loyal clients (+11% vs. 2005).

Growth of Small Businesses Segment



(*) Client Involvement: credit and funds.

Mass Market Segment – Greater Focus on the Client, enhanced commercial proactivity

Following its full repositioning, the strategy for the Mass Market segment was consolidated in 2006, with results that further reinforced BES's leading share in this market segment.

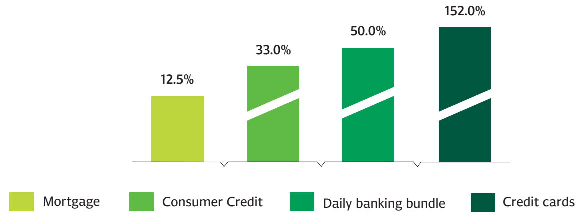
These results were underpinned by a commercial approach focused on three key aspects:

• Offers were redesigned for each sub-segment, taking into account the customer's life cycle and launching innovative products – namely the BES 100% account (campaign "10-0"), offering a wide range of free daily banking bundle (with salary transfer or purchase of a Pension Plan);

• Launch of client acquisition initiatives, including reinforcing the Assurfinance programme as well as the cross-segment programme (which targets the employees of companies that are BES customers);

• Full revision of branches' working tools with the purpose of making them simpler, more flexible and integrated to ensure true customer focus, seamless commercial production, and enhanced proactivity at the frontline.

Growth of the Mass Market Segment (Production)



In 2006 the number of new clients rose by 25%, the quality policies implemented led to a reduction in the erosion rate to 2.7% and more than 1 million products were sold (corresponding to an increase of over 10% in commercial productivity per employee).

Backed by the consolidation of segmented approaches, Retail Banking grew across the board:

• Customer funds posted a significant increase, namely retirement and education savings plans portfolio that grew 22% - with a market share of 24%, the Bank reinforced its leadership in this strategically important product; and in the discretionary asset management business (especially in the BES 360 segment);

• The increase in customer loans was supported by high levels of mortgage credit production (+8% vs. 2005, with over 47% of the production in the BES 360 segment) and by a 28% increase in Other loans to individuals, which was driven by growth in consumer credit and credit cards.

The success of cross-selling initiatives is evident in the significant increase in the product ownership rate, particularly in product bundles that contribute to foster client loyalty: credit cards placed increased by 72%, retirement plans by 20% and life insurance products by 10%. As a result of cross selling efforts, the number of retail clients with the basic product package increased by 13%.

3.2 *Private Banking*

Leveraging on the Group's intrinsic competencies and competitive advantages, the advisory services and customer monitoring were reinforced throughout 2006, consolidating high levels of customer service and customer loyalty, as mirrored in the results obtained:

• High client acquisition levels achieved by the 28 Private Banking Centres;

• Investments good performance as a result of several factors, namely the reinforcement of discretionary management. Investment and trading portfolios under management were monitored by specialised teams, and depending on the asset allocation profile, registered growth rates of 5% to 15%. In a year when the average return on money market funds was 3.4%, the opportunities seized in the derivatives market, with a particular focus on equity securities (securities and diversified indices) as underlying assets, yielded significant gains in financial advisory transactions;

• The reinforcement of customer relationship, developing the non-financial offer and increasing client acquisition through cross-segment initiatives, based on a common identity and image, and a programme of cultural and leisure events;

• Improving customer service levels, namely through the inauguration of new premises at Guimarães, Setúbal and Porto, the latter in the newly restored "Maristas" building - a reference in the city of Porto where the Bank stressed its vocation as a sponsor of culture;

For International Private Banking, 2006 was the first full year of full activity serving Portuguese communities abroad. Two main axes have been privileged:

• markets where BES Group holds competitive advantages while at the same time show greater potential, namely South Africa, Angola, Brazil, Spain, France and Venezuela; individual performances naturally varied in each market, but overall the results obtained translate the success of the strategy implemented;

• the improvement of the services provided, particularly the financial offer and the commercial approach, while implementing new management processes supported by information systems plan development and compliance systems.

The commercial approach was supported by a team of expert Private Bankers highly dedicated to their clients, and fully covering the national territory and present in the main international markets, allowing the achievement of a strong growth pace, with the clients' financial involvement (credit and funds) rising by 9.6%.

3.3 Corporate Banking and Institutional Clients

Corporate Banking and Institutional clients are divided into four sub-segments so as to better address their specific needs: Middle-market (medium-sized companies with turnover of between euro 2,5 million and euro 50 million), Large Corporations (national companies with turnover of over euro 50 million), International Corporate (multinational companies present in Portugal) and Municipalities and Institutional customers.

Middle Market

In a climate of growing competition, the medium-sized companies segment once again posted a strong performance in 2006 in terms of profitability, quality and risk. The consistency of this performance is the outcome of the strategy implemented since the creation of an autonomous structure dedicated this segment. This strategy has six key elements:

1. Human Resources management: the medium sized-companies are supported by a fully dedicated commercial network consisting of 27 Corporate Centres spread all over the country and a team of highly specialised account managers who benefit from a plan of continuous training and development.

2. Focus on quality: service quality levels are improved using customer satisfaction surveys. These surveys have revealed consistent improvement in satisfaction levels, which reached 86% in 2006, in line with the level of excellence required. In 2006 BESnet Negócios – the internet banking service for corporate clients – designed a Quality Management System certified by the Portuguese Association for Certification (APCER) in accordance with the NP EN ISSO 9001:2000 international standard.

3. Credit risk management: speed in decision-taking and consistency in the credit policy are values recognised by the customers. The Bank uses high quality tools to assess risk and optimise risk/return, which have permitted to improve the credit-decision process, leading to a faster and more efficient response, and to improved risk levels and risk adjusted return.

4. Development of products and services: the offer of products and services designed to achieve customer satisfaction and loyalty continued to deserve particular attention:

• **A la card** – the first meal voucher in the shape of a credit card to be launched in Portugal, used to process employees' meal allowances; and the Card Account, which, among other purposes, is used in programmes to foster loyalty among corporate customers and in expense management. These products together already account for 22,000 cards, twice the number of traditional credit cards in the corporate segment.

• **Specialised credit –** leasing production and the factoring portfolio reached euro 1 billion each. Besleasing e Factoring not only grew in line with the market, but reinforced its position by advancing its market share in both products by 1 percentage point, to 18.7% in leasing and 22.2% in factoring, thus consolidating its second position in the Portuguese ranking for both segments.

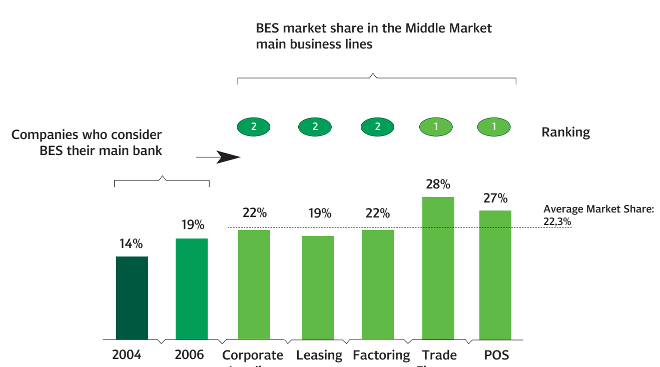
• **Renting** (vehicle hire and fleet management), a business developed by Locarent, which placed over 1,200 vehicles in the corporate segment.

• **The Financial Advisory Service and Derivative products**, have brought to medium-sized companies investment banking services and hedging products that were, traditionally, only accessible to large companies. The segment continued to post very positive results, having doubled revenues in this area.

• **Human Resources Solutions:** sales of **life and capitalisation insurance products** performed well, with production rising by 123% and 39%, respectively.

• **The cross-selling of non-life insurance products** with Companhia de Seguros Tranquilidade provides a very good complement to the banking offer. Revenues increased by 57%, fuelled by the BES Companies Programme.

• Focus on **trade finance** and support for the international arm of medium-sized companies. Organisation of business missions, namely to Morocco and Angola, presenting to a group of Portuguese entrepreneurs the trade and investment opportunities existing in these countries.



Source: DataE (Marktest)

5. Client Acquisition and Loyalty: establishing and maintaining a database of roughly 4,000 identified potential customers with a good risk profile has proved to be a priceless customer-acquisition tool, leading to the acquisition of 700 new active customers in 2006. Innovating start-ups deserved special attention and a commercial network was specifically developed for incubators, universities and innovation centres. The existing tools for improving knowledge about customers and their needs continued to help reinforce loyalty levels, namely through cross-selling. The number of loyal clients increased by 16%.

6. Knowing our customers: defining the optimum portfolio size, Corporate Managers focused on sales and the enhancement of sales support instruments – such as the Corporate Account Planning System (CAPS), which provides propensity indicators and allows individual action plans to be defined - boosted the capacity of the sales force for fast and efficient diagnosis.

Corporate Banking: an Iberian approach

In this era of globalisation of markets, the notion of an Iberian market has gained momentum, and Spain increasingly reinforced its role as Portugal's main trade partner in goods and services. Hence the concept of extending the domestic market to the whole Iberian space has become a reality.

BES is the only listed Portuguese private bank having an Iberian approach based on a physical presence on the ground. Aware of the opportunities that arise from this commercial complicity at Iberian level, the Bank established as one of the strategic objectives for 2006-2009 to be the first Portuguese bank to provide a global and integrated service to the Portuguese companies present in Spain and to the Spanish companies with commercial links with Portugal.

As part of a set of initiatives to be launched in Spain, and leveraging on its successful approach to corporate banking in Portugal, BES decided to develop and implement a new model of corporate banking in Spain. Among other steps, and in line with the approach to the Middle Market segment in Portugal, this model involved, in a first stage, opening 8 specialised Corporate Centres in Spain, respectively in Madrid (2), Barcelona, Valencia, Seville, Vigo, Bilbao and Valladolid, and working in close cooperation with the area of investment banking. The seven communities in which these cities are located account for approximately 80% of the trade flow between Portugal and Spain.

Large National Corporates

In the Large Corporates segment, there was an increase in the financial involvement (credit and funds) of selected economic conglomerates responsible for major projects of national interest, namely in the sectors of renewable energy, road infrastructure, and water and sanitation, while maintaining adequate profitability and risk control criteria.

BES Group also supports the international expansion of Portuguese companies, either directly, or by promoting its international network with customers developing projects abroad.

This business area continued to focus on the coordination of the offer of products and services with other business areas, specifically investment banking, leasing, factoring and insurance, while increasing cross-segment initiatives with the retail banking area, to promote the expansion of this segment's customer base.

Subsidiaries and Branches of Multinational Companies

Multinational companies with branches and subsidiaries in Portugal find in BES a commercial team that is specialised by countries of origin and which, in close articulation with BES Group's international network, can provide a global range of products and services. BES thus positions as the main local bank for multinational companies with subsidiaries in Portugal.

BES Group has played a prominent role in supporting multinational companies in various sectors of activity that use their subsidiaries in Portugal as a strategic platform to enter the Community of Portuguese Speaking Countries (CPLP), particularly Angola. The Group's know-how, local presence, cultural affinities, and attractive financing conditions are competitive advantages perceived by these companies, contributing to highlight Portugal and the Group as major players in these countries' growth strategies.

The trend has persisted amongst multinational companies to increasingly centralise their cash management and reduce their financial involvement, while contracting more services (renting/leasing/factoring) at the domestic market level. At the same time, BES has made its offer for this segment more sophisticated, namely through innovative electronic payment means that reinforce customer loyalty.

Municipalities and Institutional customers

BES's area dedicated to the Municipalities and Institutional clients develops specific banking services solutions that are designed to match the administrative modernisation of public institutes and other public bodies such as social solidarity institutions, and to promote investment and entrepreneurship.

At the same time, and bearing in mind the existing restrictions on loans to local government entities, BES Group has also promoted innovative financial solutions for investment projects developed by civil society associations, municipalities or companies in which these municipalities participate.

In this respect, it should be pointed out that the FAME programme (microproject development fund) launched by BES in 2002 was in 2006 included by the Government in IAPMEI's Finicia Programme (Axis III of the Portuguese Technological Plan). BES is the financing bank in 18 out of 23 protocols signed under this programme, a number that clearly shows its leadership in this area.

Support to investment and economic development

In so far as the support to investment is one of the mainstays of Banco Espírito Santo's relationship with corporate clients, it is important to stress the Bank's leading role in Investment Support Programmes, and in particular its support to Tourism through a system of banking protocols with the Portuguese Tourism Institute (IPT), where approximately one third of the promoters chose BES as their banking partner, which corresponds to 37% of the eligible investment supported by the IPT.

The activity developed within the scope of the Community Support Framework (QCA III 2000 – 2006) reinforced BES's competencies in the area of support to investment. The new National Strategic Reference Framework (QREN 2007/2013), for its importance to Portugal's economic development, will be assumed by Banco Espírito Santo as a new challenge deserving full attention.

In November BES Group performed its first securitisation transaction on credits granted to Portuguese Small and Medium-sized Enterprises (SMEs), in the overall amount of euro 863 million. The success of the placement – demand was twice as large as the offer - reflects the market's recognition of the credit portfolio's quality and will allow the Bank to continue to promote the development of the national economy, and in particular that of SMEs.

BES National Innovation Contest

In line with its goal of being a reference in the promotion and encouragement of entrepreneurship and innovation in Portugal, BES has launched the 2nd edition of the BES National Innovation Contest, involving a broad group of partners featuring prominently in Portuguese scientific, academic and business circles. The purpose is to reward and divulge research, development and innovation projects in application areas linked to the endogenous resources of the country viewing the improvement of products, processes or services.

3.4 Investment Banking

Investment banking offers BES Group's clients a wide range of specialised products and services, including advisory services in mergers and acquisitions, access to transactions in the capital markets (equities and debt), brokerage and portfolio management services, leveraged finance, project finance and private equity.

Investment banking business strategy is based on two main pillars: (i) maintain a leading position in the Portuguese market and (ii) selective expansion of international activities compatible with a sustained growth path of results.

In Portugal, the aim is to continue boosting turnover through the continuous fine-tuning of a customer focused approach, the reinforcement of cross-selling and cross-border initiatives, the distribution network strengthening and the financial products and services offer expansion.

The top positions reached in many of the Portuguese market the league tables are worth mention. In 2006 and for the fourth consecutive year BES Investimento has led brokerage in Portugal (according to Euronext Lisbon), has been market leader by number of merger and acquisition deals, and was distinguished by the Project Finance Internacional magazine with the prize "The Renewable Deal of the Year in Portugal " for the structuring of a euro 985.5 million financing to Enersis.

At the same time, a firm and well substantiated decision was taken to expand the investment banking activity abroad. At a first stage to Brazil and Spain, and in a second stage to the United Kingdom, namely project finance activity, leveraging on the skills developed during the infrastructure investments in boom in Portugal. A team has been set up specifically for this purpose in London. In this business area BES Investimento achieved the sixth position in Europe, and was the Iberian leader in infrastructure projects in 2006. Finally, a third stage involved exploiting opportunities to grow in new markets, namely Poland and Angola. Hence in October 2005 BES Investimento established a joint venture with Concordia Sp, a financial consultancy firm based in Warsaw, to provide investment banking services in Poland (the largest market in Eastern Europe), namely in project finance and mergers and acquisitions.

Investment banking activities are thus deployed in three continents, with an active presence in Spain, Brazil, Angola, the United Kingdom and Poland. The investment banking business is set to grow based on selective international expansion and consolidation of positions abroad, while seeking to maintain the leadership in Portugal, always with the objective of meeting clients' needs and providing a high quality investment banking service.

3.5 Asset Management

BES Group's asset management business is essentially developed by ESAF – Espírito Santo Activos Financeiros, which operates in Portugal, Spain, Luxembourg, and more recently in Brazil.

At the end of 2006 the total volume of assets under management (off-balance sheet customer funds and contracted collateralized debt obligations (CDOs) reached euro 20,7 billion, corresponding to a year-on-year increase of 17.4%. These results were driven by the growth strategy developed some years ago based on the launch of innovative products and expansion of the offer, aligned with market conditions.

Mutual Funds

Total assets under management reached euro 5.54 billion in December 2006. The strategic match of the Clients' needs and product offer led to the launch of new funds in 2006, namely ES Estratégia Activa II, ES Brasil and ES Alpha 3-FEI, which jointly accounted for more than euro 104 million at year-end. In order to make the offer of funds more attractive, selling conditions were revised, including the elimination of subscription fees for all funds (except for Espírito Santo Estratégia Activa fund). At the same time the offer was streamlined through the merger of the BIC Tesouraria fund into the ES Monetário Fund and the merger of the ES Portfolio I and ES Portfolio funds into the ES Opção Conservadora – Fund of Funds.

International Mutual Funds

In Luxembourg, BES Group has four funds under management targeting customers with a wide range of risk profiles. At the end of 2006 total assets under management were euro 1,204 million, representing a year-on-year increase of 13%.

The ABS Opportunity Fund, a newly created fund, achieved assets under management in excess of euro 63 million at the end of 2006. The ES Fund, which has 10 compartments, surpassed euro 579 million in December 2006, which is 14% more than in December 2005. The ES Active Allocation Fund, targeting individual clients and institutions, was highly successful, with volume growing by 37% to over euro 71 million on 31st December 2006. The Caravela Fund SICAV, made up of 5 compartments, saw assets under management grow to more than euro 521 million, up by 15% on 2005, the new compartment launched in 2006 – the Caravela Compass - reaching over euro 50 million at year-end. The SICAV European Responsible Consumer Fund, whose investments take into account ethical, environmental and social concerns, surpassed euro 32 million at year-end. This fund is sold in Portugal, Spain, Italy and Luxembourg.

Real Estate Funds

In Real Estate Funds, the Gespatrimónio Rendimento Fund maintained its absolute leadership in terms of market share, with volume under management exceeding euro 1,292 million at the end of 2006.

In 2006 the asset management activity was extended to business areas of particular interest to potential investors, broadening the offer through the launch of 18 new closed-end real estate funds. Leveraging on the successful launch in 2005 of the Espírito Santo Reconversão Urbana Fund, a new fund was launched this year targeting the same segments – the Espírito Santo Reconversão Urbana II. These closed-end funds are designed for customers who wish to invest in real estate for a pre-determined period of time.

Pension Funds

In Pension Funds, assets under management surpassed euro 2,6 billion, a year-on-year increase of 11.5% that was driven by new collective subscriptions to open-end pension funds.

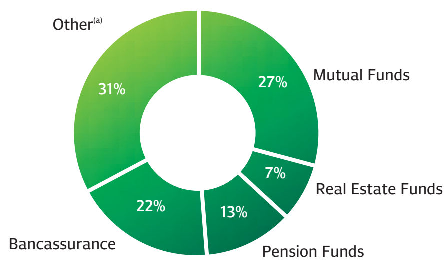
Discretionary Management / Bancassurance

New mandates were obtained this year, in both the individual and the institutional client segments. Supported by the technical skills developed in CDO management, new advisory management contracts were obtained for two portfolios worth an overall amount of roughly euro 2,1 billion, by the end of the year.

Portfolio Management

BES Group has always been eager to embrace technological innovation of financial services, thus meeting its clients' increasingly demanding needs. This stance led to the creation of a third-party portfolio management service for the affluent client segment, where each client benefits from an exclusive offer of products and solutions designed to satisfy their requirements, and a sophisticated financial planning service. Clients that subscribe to this service take full advantage of a simple and integrated service based on principles of value creation, diversification and growth, in line with a pre-established investment profile and timeframe. The portfolio management service always seeks the best solutions to invest clients' money, taking into account market conditions and the target return corresponding to the client's chosen profile. Portfolios are composed of securities, financial, money market and fx instruments, term deposits, certificates of deposit, derivatives (which may be used for purposes other than for hedging risk), treasury bills, savings plans, life insurance capitalisation products, unit linked insurance products, or any other, including absolute return funds – hedge funds – providing they can be legally traded.

Asset Management: product distribution



(a) Includes portfolio management, individual clients discretionary management and CDOs.

3.6 International Activity

The international activity is developed in markets with cultural and economic affinities with Portugal, and its expansion is essentially oriented to the triangle formed by Spain, Angola and Brazil. The Group's international presence is mainly focused on specific areas where it holds competitive advantages, exploiting markets and/or business areas with high growth potential, leveraging on the experience obtained (and in some areas the leading position) in the domestic market.

Spain

The year 2006 marks the launch of a new focus in the Spanish market and the implementation of a growth strategy backed by a more efficient and competitive positioning with the objective of fostering the business in Private Banking, Affluent Banking and Corporate Banking segments – with an Iberian-wide perspective. In this context, the Bank of Spain authorised, on the 15th of January of 2007, the transformation of BES (Spain) into a branch of Banco Espirito Santo.

In Private and Affluent Banking, the clients are offered a global and personalised service that seeks to meet individual needs and provide the most efficient, safe and profitable solutions, currently supported by a network of 25 branches.

In Corporate Banking, an Iberian approach to the market was developed in 2006 that combines the experience accumulated in Spain over the last years with a strong position in the Portuguese market and broad domestic coverage. Hence BES Group is in a privileged position to support companies that operate in the two economies. During the year, 8 Corporate Centres were opened, respectively in Madrid (2), Barcelona, Vigo, Seville, Valencia, Bilbao and Valladolid, which are also supported by the current branch network to ensure greater proximity to the Clients. At the same time, the reinforcement of links with the investment banking operation allows to offer corporate clients a global commercial/investment banking service.

In investment banking, the first steps towards the creation of an Iberian platform were taken in 2000, with the acquisition of the brokerage house Benito y Monjardin. The Group has since then reinforced its positioning in the Spanish market, particularly in brokerage (5th position in the Madrid Stock Exchange Ranking in 2006), equity derivatives, leveraged finance and mergers and acquisitions.

In asset management, the global volume under management in Spain grew by 13.3% versus 2005, to more than euro 2,158 million, underpinned by strong increases in investment funds (+11%) and discretionary management (+19%).

France

The Group's activity in France is carried out by BES Vénétie, where Banco Espírito Santo holds a 40% stake. In 2006 BES Vénétie considerably expanded its business of real estate financing operations, while maintaining its already traditional activity in corporate banking, and financial engineering (with a focus on the arrangement or participation in leverage finance operations and the provision of financial services to the Portuguese resident community in France). While increasing its commercial activities, BES Vénétie also reinforced its funding base, essentially its medium term component.

United Kingdom

In the United Kingdom the Group's activity is focused in wholesale banking, alongside investment banking, particularly project finance.

In international transactions the Group's credibility and know how allow it to act as participant, arranger and underwriter of syndicated credit operations, leveraged finance operations and commodities structured trade finance.

The internationalisation of project finance was leveraged by the expertise obtained during the expansion process of infrastructure investments in Portugal. With a London-based specialised team set up in 2001, the Group is recognised as a major player at European level, with a large stock of experience in the financing of infrastructure investment, particularly in the transport sector.

The programme of Certificates of Deposits, which are placed with corporate and institutional clients, represents a value proposition that has consistently contributed to assert the Group's positioning in attracting resources. The London branch also provides products and services to

Portuguese companies in the UK as well as to the community of Portuguese residents. Finally, it also offers mortgage loans for residential tourism in Portugal, essentially to British and Irish individual customers.

United States of America

From Miami, Florida, the Group develops international private banking activities in Latin America, where its main customers are the communities of residents of Portuguese origin. To support its activity in this business segment, the Group has a broker-dealer house that offers a broad range of investment products in the North-American financial markets. In the domestic market, lending activity is focused on two main areas: real estate credit, both residential and commercial, and more recently, trade finance operations within the scope of Export Credit Agency programmes, namely the U.S. Eximbank.

Based in the New York branch, BES Group operates in the North-American and Latin American markets, with a special focus on the US and Brazil. It main business activities are corporate banking for large and medium-sized companies - particularly medium and long-term syndicated credit operations -, trade finance, and more recently, project finance operations, while it also actively participates in the North-American capital markets, and plays an important role in raising liquidity through its Certificates of Deposit and commercial paper programmes.

Brazil

In Brazil, the Group develops investment banking activities, playing an active role in the growth of the Brazilian capital market, leading and participating in debt issues and issues of Brazilian shares. In mergers and acquisitions, it also occupies an important position (3rd place by number of deals). As a complement to capital market activities, the Group also began to develop the asset management business in Brazil.

Angola

The Group's strategy for the Angolan market is to provide a global service to individual and corporate clients. To serve its individual clients, mainly in the affluent segments, there is a network of 17 branches located across 6 provinces. The corporate banking business essentially supports Portuguese companies and entrepreneurs that are expanding their activity to Angola and the Group has a specialised team that provides assistance to exports to this country. In addition, there is an investment banking team permanently based in the city of Luanda, among others to seek business opportunities in the area of project finance.

Macao

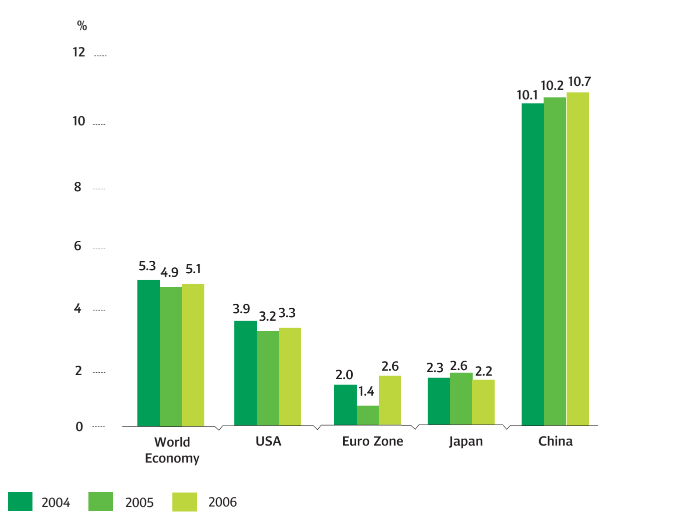
The Group's presence in Macao mainly aims to support its clients' business activity in the region, while seeking to seize business opportunities, leveraged by the expressed intent of the People's Republic of China to consider Macao as a platform for economic cooperation between China and Portuguese speaking countries.

4.0 Economic Environment

4.1 International Economic Situation

In 2006 the world economy registered strong growth, estimated at around 5.1% (4.9% in 2005). The year was characterised by a more even distribution of growth, the emerging economies performing particularly well, posting GDP growth of 7.3%. Within this group Asia was particularly strong, growing by 8.7%.

GDP Growth (in real terms)

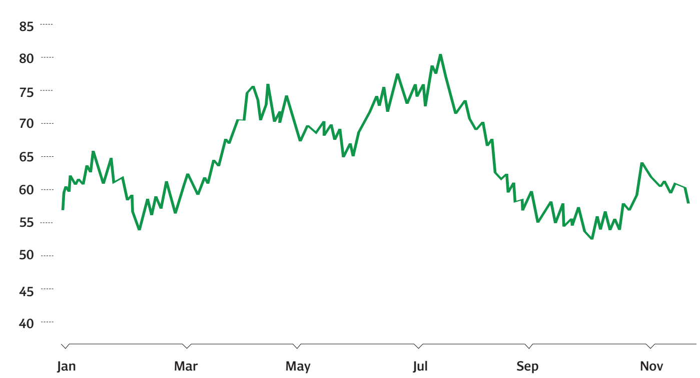


Sources: IMF and European Commission.

The first eight months of the year were characterised by the rise of oil prices, which reached a nominal historical high of USD 78/bbl at the end of August. On average annual terms, the price of oil went up from USD 54.5/bbl to USD 65.4/ bbl, on the persistence of strong demand, restrictions on the increase of supply, and speculative movements mainly linked to geopolitical factors. In the last quarter of 2006 oil prices retreated to around USD 60/bbl.

Strong economic growth and moderate inflation – supported towards the end of the year by a drop in the price of energy goods – contributed to boost global economic sentiment, translating into the good performance of the equity markets. In Europe, the Paris CAC40, the Frankfurt DAX and the Madrid IBEX35 stock market indices rose by 17.53%, 21.98% and 31.79%, respectively. In the United States, the S&P500 and Dow Jones gained respectively 13.62% and 16.29%, while the Nasdaq advanced by 9.52%. These performances were underpinned by the persistence of ample liquidity at a global level, leading to strong M&A activity and low credit spreads.

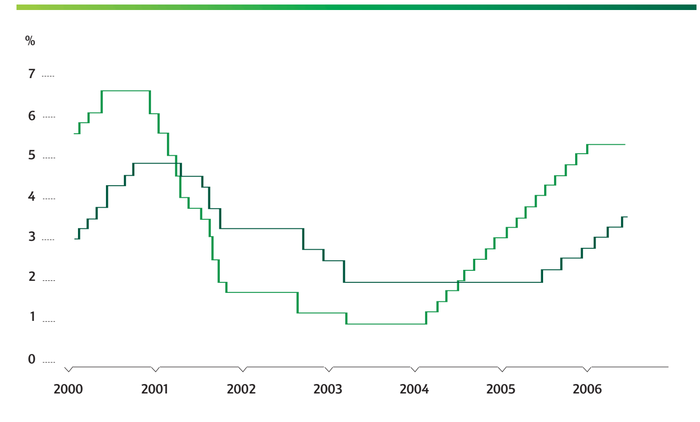
Oil Price (USD/bbl)



Source: Bloomberg.

In the United States, GDP grew by 3.3% in 2006, slightly above the 3.2% increase registered in 2005. In the early part of the year, a lingering wealth effect arising from the increase in house prices, particularly through mortgage equity withdrawals, led to strong private consumption and investment growth. With the economy growing above its potential, the Federal Reserve raised the Fed funds' target rate by 100 basis points in the first half of the year, to 5.25%, breaking there the growth cycle of reference rates initiated in the summer of 2005.

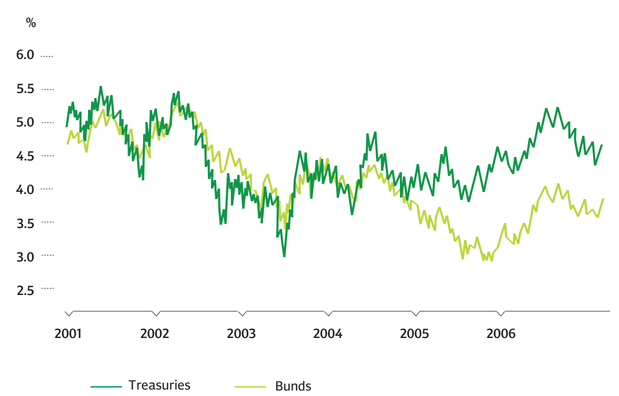
Evolution of the Fed Funds' Target Rate (US) and Refi Rate (Euro Area) (2000-2006)



Source: Bloomberg.

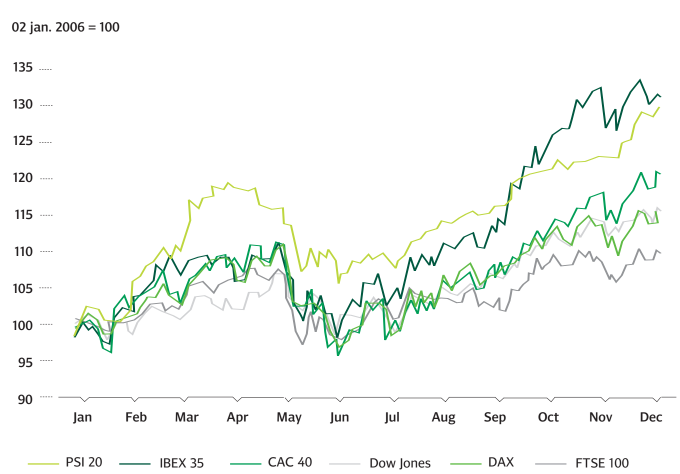
The second half of the year saw a significant cooling of the housing sector, with prices stagnating and residential investment falling by an annual rate of 19% in the period. However, economic activity continued to be supported by household spending, which still grew at a strong real pace of 3.2% in the full year (3.5% in 2005). Private consumption growth was backed by falling energy prices in the last quarter, lower unemployment (4.6% of the labour force, versus 5.1% in 2005) and the persistence of favourable monetary and financial conditions, with the equity markets showing strong gains and market interest rates remaining relatively low. The yield on 10-year US Treasuries rose from 4.4% to 4.7%, thus remaining at a historically low level.

Public Debt Securities Yield
(10-Y Bunds and 10-Y Treasuries) (2001-2006)



Source: Bloomberg.

Stock Market Indices (2006)

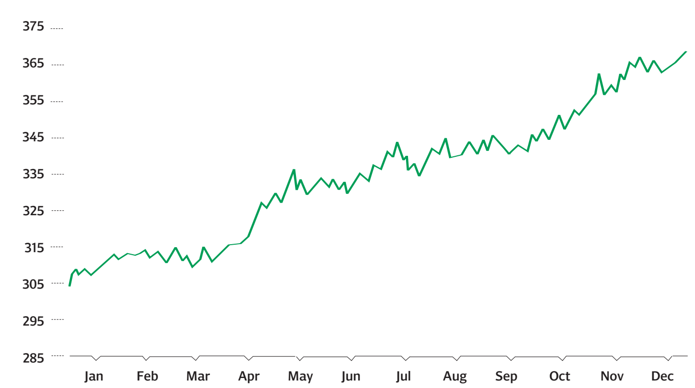


Source: Bloomberg.

Asia reinforced its role as one of the main growth drivers of the world economy. China, in particular, posted annual growth of 10.7% (surpassing by 0.2 of a percentage point its performance in 2005), supported by booming fixed capital formation (real increase of 24%) and exports, the trade surplus having risen by 70% over 2005. The Chinese economy's performance acted as a spur on the other Asian economies, including Japan, where GDP grew by 2.7%, slightly accelerating from last year's growth rate of 2.6%. With GDP growth shored up not only by exports but also by internal demand, the rate of unemployment dropped to around 4% of the working population. In this context, the consumer price index rose by 0.3%, which contrasts with a drop of 0.6% in 2005, leading the Japanese central bank to gradually abandon its quantitative easing policy and raise the reference rate from 0% to 0.25%. The Nikkei index advanced by 6.92%, lagging behind the main international indices.

Strong growth in China and Emerging Asia also contributed to maintain pressure on demand for non-energy raw materials, in particular industrial metals: the average price of aluminium, copper and zinc registered annual increases of respectively 35%, 80% and 137%.

Commodities Price Index (2006)

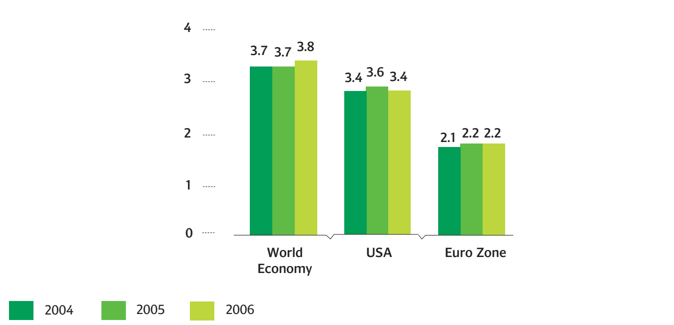


Source: Commodity Research Bureau.

In the Euro Area, the year was marked by a significant recovery in confidence indices, particularly at the corporate level, reflecting the acceleration of economic activity. GDP growth rose from 1.4% to 2.6%, mainly on the good behaviour of external demand, for which Emerging Asia and the Middle East were increasingly responsible. Exports from the Euro area grew 8.4% in real terms. Growing external demand and increased business optimism in turn led to an upturn in investment, which grew by 4.5% in 2006, and an improvement in the labour market, with the unemployment rate dropping from 8.5% to 8% in average annual terms. The German economy was aligned to this performance, with GDP posting an annual increase of 2.7%, above expectations. Household spending in the Euro Area showed signs of picking up, although a climate of strong wage moderation still kept growth at a moderate pace (1.8%).

2006 was also characterised in the Euro Area economy by strong liquidity growth (as measured by M3 monetary aggregate), with broad money supply showing a year-on-year increase of 9.8% at year end, the highest in the last 16 years and largely surpassing the European Central Bank's reference rate of 4.5%. As happened in 2005, money supply growth continued to be associated with a strong increase in loans to the private sector, which were up by 10.7%, with a salient 13% rise in loans to non financial corporations. Loans to households lost some speed, but even so mortgage and consumer credit grew by 9.5% and 7.8%, respectively.

Inflation Rate (%) (%)

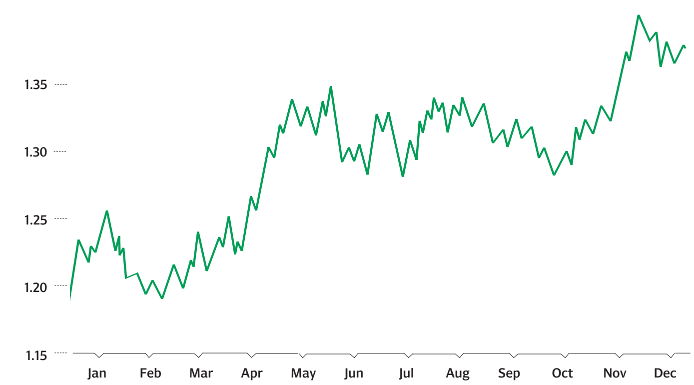


Source: IMF and European Commission.

High economic growth against a background of strong liquidity led the ECB to raise the key refi rate by 125 basis points, to 3.5%. In average annual terms, inflation remained flat at 2.2%. The yield on 10-year public debt securities rose from 3.309% to 3.948%.

A narrowing interest rate differential versus the United States contributed to drive up the euro by 12% against the dollar, to EUR/USD 1.319.

EUR/US$ Exchange Rates (2006)



Source: Bloomberg.

4.2 Economic Situation in Brazil

With interest rates still relatively low, high liquidity growth and strong demand in the markets for commodities, the international economic scenario remained favourable for the Brazilian economy, where GDP rose from 2.9% to 3.7%. Exports maintained a strong upward trend for the fifth year in a run, causing the trade surplus to grow from USD 44.8 billion to USD 46 billion.

Faced with a decline in the inflation rate (as measured by the Broad Consumer Price Index) from 5.7% to 3.1% and firmly anchored medium and long term inflation expectations, the Central Bank cut the key rates by an accumulated total of 475 basis points, to 13.25%. In turn, better monetary conditions fuelled internal demand, leading to estimated annual increases in private consumption, from 3.1% to 3.8%, and investment, from 1.6% to 6.3%. The unemployment rate remained relatively stable, at 8.4% of the working population (8.3% in 2005).

Thanks to the Central Bank's repeated interventions in the foreign exchange market, the real showed great stability in the second half of the year. In full 2006, the Brazilian currency gained around 8% against the US dollar, reaching USD/BRL 2.17, while dropping by close to 1.5% against the euro, to EUR/BRL 2.81.

2006 was also marked by presidential elections in October, which gave Lula da Silva a second term as President of Brazil. On line with the real, the main sovereign risk measures remained stable, even during the pre-election period. In the second half of the year the EMBI+ Brazil index (spread against US treasuries) rose slightly above 200 basis points.

At the level of the public accounts, the Brazilian economic situation also remained favourable: the primary budget surplus target of 4.25% of GDP was surpassed, the government running a primary surplus of 4.34% of GDP.

4.3 Economic Situation in Angola

In 2006 the Angolan economy maintained the brisk growth pace that characterised its recent past, with GDP estimated to have grown by around 14.5% (20.6% in 2005). Strong economic activity was supported by the positive behaviour of prices of natural resources, which weigh heavily on Angolan exports (namely oil and diamonds), stable macroeconomic variables, namely inflation, and investment in basic infrastructures. The oil sector's output is thought to have risen by 15% in 2006, after growing by 26% in 2005.

The "strong kwanza" policy, i.e., the authorities' intervention in the foreign exchange market to support the currency and put downward pressure on import prices, was pursued in 2006, leading to a new drop in inflation, which fell from 23% to 13%. At the same time, the declining trend of interest rates continued throughout the year. The Central Bank's rediscount rate dropped from 18% to 14%, while the yield on Central Bank 3-month bills fell from 11% to 6%.

4.4 Economic Situation in Spain

Once again, the Spanish economy stood out from the overall European performance, with GDP growing by 3.9%, after rising by 3.5% in 2005. Internal demand, though losing some speed when compared to a year earlier, still exhibited very healthy growth, slightly below 5%. Private and public consumption were up by respectively 3.7% and 4.4%, while gross fixed capital formation grew by 6.3%. Notwithstanding the increase in short term interest rates in the Euro Area, Spanish real interest rates remained negative or close to zero for the largest part of the year, with average inflation rising by 0.1 of a percentage point, to 3.5%.

The persistence of expansionist monetary conditions once again contributed to the positive performance of the construction and housing sectors, which grew by around 6%. Although clearly slowing down when compared to 2005 (when they had increased by 13%), home prices still rose by nearly 9% in 2006, surpassing the European average. With these conditions, mortgage lending continued to grow at a strong pace – 20% -, which compares with 24% in the previous year. Loans to non financial companies performed in line with the upward trend of investment, rising to 24% from 21% in 2005.

Spanish exports responded well to the economic recovery in the Euro Area, accelerating from 1.5% to 6.3%. Hence, despite the acceleration of imports (from 7% to 8.4%), the negative contribution of net external demand to growth diminished in 2006. Even so, the recovery of exports versus imports was not sufficient to stop a further deterioration of the external accounts, the current account deficit increasing from 7.4% to 8.8% of GDP.

The buoyancy of the economy had a positive impact on the labour market, and the rate of unemployment fell from 9.2% to 8.4% of the labour force. On the other hand, a favourable environment to budget revenue growth allowed for a new improvement in the public accounts, the budget surplus rising from 1.1% to 1.8% of GDP.

4.5 Economic Situation in Portugal

In 2006 the Portuguese economy recovered from its performance in 2005, with GDP growth rising from 0.5% to 1.3%. This upturn in economic activity was mainly underpinned by the strong growth of exports of goods and services, with a real increase of 8.8%, which compares with 1.1% in 2005. In addition to a consistently high growth of GDP in Spain, Portugal also benefited from rebounding economic activity in the whole of the Euro Area, particularly in Germany. At the same time, exports to less traditional destinations experienced sharp increases, namely to Angola (close to 60%, in nominal terms). In this scenario, the contribution of net exports to GDP growth increased from -0.5 to 1 percentage point in 2006.

Portugal – Main Economic Indicators

Real growth rates (%), except when indicated.

	2000	2001	2002	2003	2004	2005	2006 E
GDP	3.9	2.0	0.8	-0.7	1.3	0.5	1.3
Private consumption	3.7	1.3	1.3	-0.1	2.5	2.2	1.1
Public consumption	3.5	3.3	2.6	0.2	2.5	2.3	-0.3
Investment	2.1	1.2	-4.7	-8.3	2.1	-3.8	-1.7
Exports	8.4	1.8	1.4	3.9	4.4	1.1	8.8
Imports	5.3	0.9	-0.7	-0.8	6.6	1.9	4.3
Inflation (CPI)	2.9	4.4	3.6	3.3	2.4	2.3	3.1
Budget balance (% of GDP)	-2.9	-4.3	-2.9	-2.9	-3.3	-6.0	-3.9
Public debt (% of GDP)	53.3	53.6	55.5	56.8	58.2	63.6	64.7
Unemployment (% of labour force)	4.0	4.1	5.1	6.3	6.7	7.6	7.7
Current and capital account balance (% of GDP)	-8.9	-8.5	-6.0	-3.3	-5.7	-8.1	-8.5

Sources: INE, Bank of Portugal, European Commission, OECD, ES Research.

On the other hand, internal demand saw its contribution to GDP growth drop from 1 to 0.3 percentage points. Private consumption further stressed the deceleration trend observed since 2004, rising by a mere 1.1% that compares with 2.2% in 2005. Despite a visible recovery in the Portuguese household confidence index towards the end of the year, private consumption expenditure was contained in 2006 by rising interest rates, the still subdued expansion of the disposable income of households and a restrictive budget policy, namely the increase in some indirect taxes. With disposable income rising below the increase in private consumption, the household savings ratio registered a slight drop, from 9.2% of disposable income in 2005 to an estimated 8.5% in 2006.

Gross fixed capital formation was once again the worst performer amongst all domestic demand components, suffering a real drop of 1.7%, after having fallen by 3.8% in 2005. Although the recovery of external demand shored up confidence levels in services and industry, the vulnerability of domestic demand meant that the business sector remained cautious in what concerned investment decisions. Total fixed capital expenditure was also restricted by budgetary consolidation efforts, leading to falling public investment and the continuing adjustment of families' investment in housing expenditures.

In this context, the average annual rate of unemployment increased from 7.6% to 7.7% of the labour force.

Public consumption declined by 0.3% on the reduction of staff costs and goods and services expenditures. This, combined with the reduction of public investment and strong increase in tax and non tax revenues (slightly below 8%), contributed to curb the public deficit, from 6% to 3.9% of GDP, which is below the Stability and Growth Pact's target for the year.

The subdued growth of internal demand allied to a strong expansion of exports of goods and services did not prevent a deterioration in the combined balance of the current and capital accounts, with the net external financing needs rising from 8.1% to 8.5% of GDP. As regards the balance of payments, the good performance of direct investment in Portugal also deserves a note, reaching EUR 5.8 billion.

Loans to the non financial private sector slightly accelerated in 2006, with annual growth rising from 7.4% to around 8.8%. This performance was underpinned by the more robust growth of consumer and other loans – from 4.5% to slightly above 10% -, in line with the improvement in the confidence level of families and signs of a recovery in private consumption towards the end of the year. In turn, residential mortgage lending maintained the gradual weakening trend of recent years, having risen by 9.9%, which compares with 11.1% in 2005. Loans to the non financial sector accelerated throughout the year, growing by 7.2% (5% in 2005). These loans were mainly intended for debt restructurings, mergers and acquisitions and to finance the current activity of companies.

The average inflation rate rose from 2.3% in 2005 to 3.1% in 2006. This record is biased by a change in the method used for the statistical treatment of some components of the Consumer Price Index (CPI), only affecting the inflation figure for 2006. Without this effect average inflation would have been 2.5%. The 2006 increase in prices is explained by rising prices of energy goods in the first half of the year, and the increase in some indirect taxes (VAT in July 2005 and some consumption taxes in January 2006).

5.0 Financial Management and Capital Markets

Within BES Group's medium and long term strategy, attracting customer funds and granting customer loans are extremely important aspects of the overall activity.

In this perspective, and considering the current market conditions characterized by fierce competition in the banking sector, the ability to access the financial markets, at both domestic and international levels, is a crucial aspect of the Group's financial management. Hence, the Group has over the years developed a sophisticated structure to support the business in the various markets - capital, interbank, derivatives and foreign exchange - in order to benefit from the overall economic trends, and in particular interest rate exposure, while pursuing a prudent liquidity risk management . This ability to act in the financial markets has been used within the scope of BES Group's financial management and also as an enhancement to the services provided to its customers.

On 20 February 2006 BES announced a capital increase from euro 1,5 billion to euro 2,5 billion, which took place in May, with total proceeds of euro 1,38 billion. The structure of this transaction included a rights issue, to be subscribed by shareholders and a mechanism of rights "recycling" intended to increase the free float of the BES share, expanding the base of institutional investors and hence improving stock liquidity. A group of BES reference shareholders reduced their holdings, placing rights corresponding to 6.5% of the bank's share capital at the disposal of a banking syndicate, to be placed in the market as a pot deal. A banking syndicate of five investment banks, acting as Joint Bookrunners, of which four underwriters, was formed to coordinate the placement of rights in the international market.

The price of the new shares was determined within a price range previously approved by the General Shareholders' Meeting, considering a discount to the Theoretical Ex-Rights Price (TERP) of 20%. Despite difficult market conditions at the time of placement, demand for subscription rights surpassed the offer, allowing BES to meet all the market objectives it had established for the transaction.

The Group is actively involved in the international markets (i) issuing hybrid capital instruments, (ii) issuing debt - mainly under the Euro Medium Term Notes programme (EMTN), and (iii) executing asset securitisation transactions. With the aim of diversifying the asset categories used in securitisation transactions, the Group executed in November 2006 its first securitisation of loans granted to small and medium size companies - Lusitano SME No. 1 -, amounting to euro 863 million. In September 2006, BES Group executed its fifth mortgage-backed securitisation transaction - Lusitano Mortgages no. 5. This transaction was extremely successful, as reflected in the 13 bp spread over the Euribor of the AAA rated tranche.

With consistently high daily transaction volumes, BES Group stands as one of the reference entities in the Portuguese public debt market, both as primary dealer and market maker. Its active role as specialised Treasury bond operator (OEVT) was once again recognised by the Public Lending Management Institute (IGCP), which elected BES the leading Portuguese financial institution in the treasury bonds market in 2006.

Through its close involvement in the financial markets, namely the interest rate and foreign exchange markets, the Group has been able to offer to its clients, and in particular corporates, innovative solutions to manage financial risk, in accordance with each client's risk profile. This competitive advantage allied to the prevailing market conditions has led to sustained value creation, for BES Group and for its clients.

Proprietary trading, involving both debt securities and derivatives (interest rates, credit and equity), carried out through an integrated management of market risks, has given a positive contribution to banking income. As favourable factors this year, we note the good performance of the equity markets, in particular the Brazilian and Portuguese equity markets, and the stable environment of credit markets, interest rates and foreign exchange rates in the US and Europe, which contributed to the positive performance of the emerging markets.

The funding policy is an important part of overall liquidity management, and is defined for all types of liabilities, from customer funds to ordinary and preferred shareholder's equity, including the use of various instruments available on the financial markets.

To implement this policy, the Group uses several funding mechanisms, such as Money Market Facilities and commercial paper programmes (Euro Commercial Paper Programme and US Commercial Paper Programme) for short term funding, the Euro Medium Term Notes programme (for senior and subordinated debt issuance), loans and securitisation transactions, for medium and long term funding.

Bes Finance: attracting funds in international markets

As in most of the major international financial groups, BES Group owns a company specialised in raising funds in the international markets. BES Finance is based on the Cayman Islands, and was established in 1997 with ordinary share capital fully subscribed by BES.

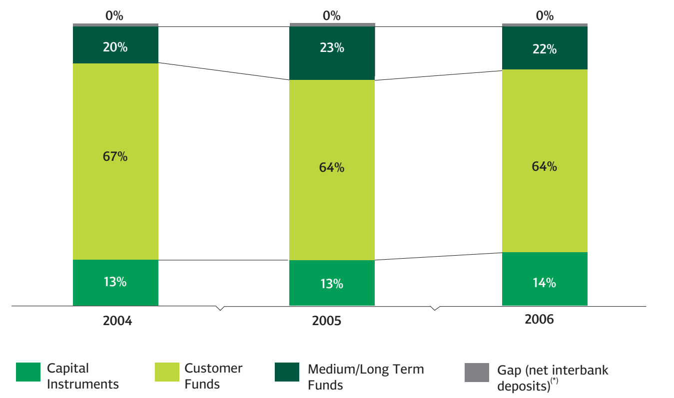
In February 1997 BES Finance set up a Euro Medium Term Notes Programme (EMTN), which is updated every year through the respective Prospectus. The EMTN allows the issuance of senior or subordinated notes up to a nominal aggregate amount of euro 10 billion.

Currently, and in addition to BES Finance, BES and its branches in the Cayman Islands and Madeira can also issue debt under this programme. These bonds, which can be issued in any currency and at any maturity, are listed on the Luxembourg Stock Exchange. Senior bonds issued under the EMTN programme and outstanding as of December 31st 2006 totalled euro 8,035 million. Subordinated bond issues totalled euro 1,738 million at the end of 2006.

Outside the scope of the EMTN programme, BES Finance issued preference shares totalling euro 600 million. These shares, which were placed with European institutional investors, are guaranteed by BES and listed on the Luxembourg Stock Exchange.

On-balance sheet customer funds represented by deposits and capital guaranteed securities continue to represent 64% of the funding sources. The weight of medium and long term funds slightly decreased from 23% to 22% of total funding sources, while the contribution from the Group's own funds increased to 14%, following the capital increase carried out in May 2006. Through the liquidity management policy implemented over the last few years, the treasury gap has been consistently negative, representing a liquidity surplus. The short term liquidity surplus is managed at consolidated level, allowing the Group to closely monitor the risk of an increase in commercial activity, with credit growing at a higher pace than on-balance sheet customer funds.

Funding Structure



(*) Treasury gap: cash and deposits with central banks, loans and advances to credit institutions repayable on demand, loans and advances to banks repayable up to one year less amounts owed to central banks and deposits from banks due up to one year.

Several transactions conducted in the international capital markets contributed to the positive performance in 2006, namely:

- the capital increase, with total proceeds of euro 1,38 billion;
- medium and long term funding obtained, both through new issues of senior debt under the EMTN programme (euro 1,728 million net inflow) and through medium and long term loans granted by international financial institutions;
- the securitisation transaction of residential mortgage loans amounting to euro 1,4 billion executed in September (Lusitano Mortgages No. 5) and the first securitisation transaction of corporate loans, executed in October (Lusitano SME No.1), amounting to euro 863 million.

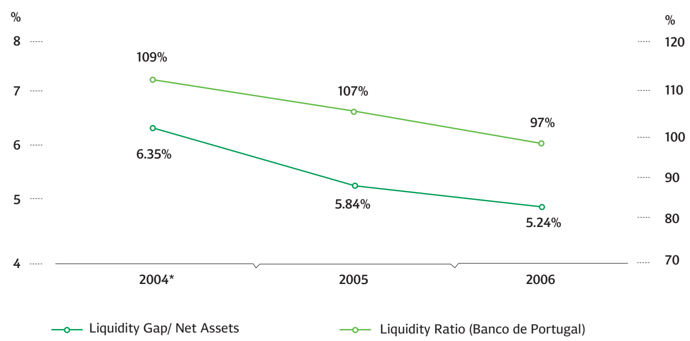
Funding Sources

	2004**	2005	2006
Gap (net interbank deposits)*	(2,736)	(2,932)	(3,096)
Cash and Equivalent with credit institutions	7,000	7,139	9,153
Short term deposits from credit institutions	4,264	4,207	6,057
Medium/long term funds	7,518	9,994	10,842
Euro Medium Term Notes	5,499	7,252	8,980
Medium and long term deposits with credit institutions	2,019	2,742	1,862
Customer Funds on-balance sheet	25,110	27,873	31,995
Capital Instruments	4,622	5,398	7,063
Total	**34,514**	**40,333**	**46,805**

(*) Treasury gap: cash and deposits with central banks, loans and advances to credit institutions repayable on demand, loans and advances to banks repayable up to one year less amounts owed to central banks and deposits from banks due up to one year.
(**) Financial statements data under IFRS.

This prudent liquidity management policy, based on the diversification of funding sources and the extension of the maturity profile, has allowed the Group to maintain short term liquidity surpluses since 2002. At the end of 2006 the short term liquidity surplus represented 5.24% of total net assets.

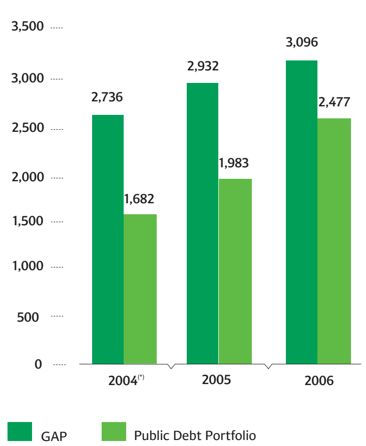
Liquidity Gap (as % of Net Assets)



(*) Financial statements data under IFRS

The portfolio of public debt securities provides an additional source of liquidity, either through rediscounting with the Central Bank or through access to the repos market.

Public Debt Portfolio vs Liquidity Gap (euro million)



(*) Financial statements data under IFRS.

Ratings assigned to Banco Espírito Santo

The ratings assigned to Banco Espírito Santo by the international rating agencies reflect the bank's financial strength, driven by its successful organic growth strategy.

Agency	Long Term	Short Term	Outlook
Standard & Poor's	A-	A2	Stable
Moody's	A1	P-1	Stable
Fitch	A+	F1	Stable

Standard & Poor's: In March 28th, 2007 S&P upgraded BES ratings to A / A 1, stable outlook (from A- / A2, positive outlook). The credit rating upgrade reflects BES stronger capital position following the euro 1,380 million concluded in May 2006, the strengthening of the Bank's franchise in the competitive Portuguese market, as well as the resilience of asset quality ratios, particularly in the SME's and Retail segments. Moreover, the Stable Outlook, emphasises the belief on the Bank's ability to weather eventual future challenges to its medium term growth plan.

Moody's: A1 for long term debt and P1 for short term (stable outlook). The rating reflects the Group's strong and diversified positioning in the domestic market and its financial strength.

FitchRatings: A+ for long term debt and F1 for short term debt (stable outlook). The rating is based on BES Group's strong positioning in the domestic market, its asset quality, low risk profile and adequate solvency and profitability levels.

6.0 Risk Management

6.1 The Risk Function within BES Group

Risk management and control has played a fundamental role in the balanced and sustained growth of the BES Group, contributing to optimise risk/return across the various business lines while simultaneously providing a consistently conservative risk profile in terms of solvency, provisioning and liquidity.

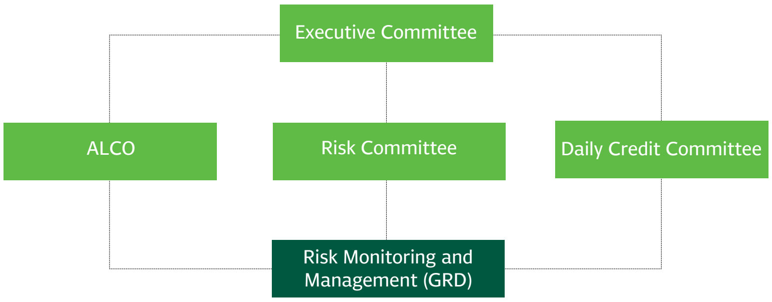
The definition of the objective risk profile is part of the responsibility of BES' Executive Committee. Its responsibility also includes establishing general principles of risk management and control, and ensuring that the BES Group has the necessary competencies and resources for the purpose.

At a more specialised level, BES Group has several committees within its organisation that support the decisions of the Executive Committee. The following bodies play a relevant role in the area of risk management and control:

Risk Committee: holds monthly meetings, attended by the Chairman of the Executive Committee, and is responsible for monitoring the evolution of the Group's integrated risk profile, and for proposing methodologies, policies and procedures to deal with all types of risk; also analyses the performance of risk adjusted return and the evolution of value added by the main segments/Clients;

Daily Financial and Credit Committee: its meetings are attended by members of the Executive Committee and heads of departments; the main credit operations are submitted to and decided by this committee, in accordance with established risk policies, it also monitors the treasury position and the evolution of the financial markets;

ALCO (Assets and Liabilities Committee): holds monthly meetings, which are attended by the members of the Executive Committee, including its Chairman, and is responsible for managing market, interest rate and liquidity risk.



At operating level, the management and monitoring of Risk is centralised at the Global Risk Department (GRD), whose activity reflects the principles underlying the best risk management practices. The GRD must ensure:
• independence relative to the other areas of the Group and credibility with the management and supervisory bodies, shareholders, investors and regulators; the GRD has no decision powers over specific operations;
• the integrated and global management of all types of risk (credit, market, liquidity, interest rate and operational risk, at both domestic and international level) and consistency in direct risk and return comparisons;
• consistent incorporation of risk and capital concepts in the strategy and business decisions of the entire BES Group.

6.2 The New Capital Accord (Basel II)

BES Group fully recognises the challenges and opportunities that arise from application of the New Capital Accord. Matching regulatory vision with the economic perspective implicit in the new regulatory framework proposed by the Basel Committee - whose principles underlie the Group's rationale and practices – creates new opportunities and constitutes a stimulus to the effort made over the last few years in the area of Risk Management.

In 2003, the BES Group set a target to adopt the IRB Foundation approach for Credit Risk and the Standardised Approach for Operational Risk. Since then the Group has invested heavily in the Basel II Project, namely in the development of technical platforms and the reinforcement of human resources competencies.

One of the main priorities of the Basel II Project was to consolidate the development and fine-tuning of internal risk analysis models, in particular risk rating systems. At the same time, major developments in information systems were required, which included centralising information at Group-wide level. Finally, the introduction of risk metrics and criteria in the day-to-day decision-making processes was reinforced. To this end, management practices, policies and procedures had to be adapted in order to ensure that risk assessment was explicitly considered in the decision-making process.

All the methodologies, practices, policies and procedures developed were implemented consistently across BES Group's branches and subsidiaries to standardise risk management through all the business areas of the Group.

BES Group has submitted, on schedule, an application to the Bank of Portugal to apply the Foundation Internal Ratings Based Approach (IRB Foundation Approach) without internal estimates of loss given default (LGD) or probability of default (PD) to calculate regulatory capital requirements for credit risks, and the standardised approach to calculate regulatory capital requirements for operational risks. This application represents the last step in the activities developed within the scope of the Basel II Project, which included developing, implementing and validating risk mitigation models and techniques and management and decision support procedures. The Group is the final stage of developing the information systems applications to calculate capital requirements and Pillar II and III support applications.

The table below shows, for the Group's main companies and broken down by portfolios, the method to calculate regulatory capital requirements for credit risks which the Group has submitted for approval

Classes of Assets / Entities	BES PORTUGAL	SFE MADEIRA	SUCURSAL LONDRES	SUCURSAL NOVA IORQUE	BES AÇORES	BES ESPANHA	BES LEASING E FACTORING	BESI	ESPIRITO SANTO BANK	BES ANGOLA	BANCO BEST	ESPIRITO SANTO PLC	BES ORIENTE
Sovereigns	ST	ST	ST	ST	ST	ST	ST	ST	ST	ST	ST	ST	ST
Banks	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF
Corporate (not including SMEs, SL e Purchased Receivables)	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	ST	ST	IRBF	IRBF	IRBF
SMEs Treated as Corporate Exposures	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	ST	ST	IRBF	ST	ST
Specialized Lending (not including HVCRE) Exposures	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	IRBF	ST	ST	N/A	IRBF	ST
Purchased Receivables	N/A	N/A	N/A	N/A	N/A	N/A	IRBF	N/A	N/A	N/A	N/A	N/A	N/A
SMEs Treated as Retail Exposures	IRBA	N/A	N/A	N/A	IRBA	ST	N/A	N/A	ST	ST	N/A	N/A	N/A
Residential Retail Exposures	IRBA	N/A	ST	ST	IRBA	IRBA	NA	ST	ST	ST	N/A	N/A	N/A
Other Retail	IRBA	IRBA	ST	ST	IRBA	ST	ST	ST	ST	ST	IRBA	ST	ST
Qualifying Revolving Retail Exposures	IRBA	N/A	N/A	N/A	IRBA	ST	N/A	N/A	N/A	N/A	IRBA	N/A	N/A
Equity	PD/LGD	PD/LGD	PD/LGD	PD/LGD	PD/LGD	PD/LGD	PD/LGD	PD/LGD	PD/LGD	SRW	PD/LGD	PD/LGD	PD/LGD
Securitization	IRBF	N/A	N/A	N/A	N/A	N/A	N/A	IRBF	N/A	N/A	N/A	N/A	N/A

ST Standard Approach
IRBF Foundation Internal Ratings Based
IRBA Advanced Internal Ratings Based
PD/LGD PD/LGD Approach
SRW Simple Risk Weight Approach
N/A Non applicable

6.3 Credit Risk

Credit risk is the potential financial loss arising from the failure of an obligor or counterparty to honour its contractual obligation. As the major risk to which the Group is exposed within the scope of its lending activities, credit risk management and control continue to deserve particular attention, being supported by a robust system that permits to identify, assess and quantify risk, and which is permanently being fine-tuned.

6.3.1 Management Practices

In line with a long-standing practice which has always yielded good results, credit portfolio management in BES Group is an ongoing process that requires the interaction between the various teams responsible for the management of risk during the different stages of the credit process. This approach is complemented by the continuous improvement of methodologies and risk assessment and control tools, on the one hand, and decision procedures and circuits, on the other.

a. Internal Risk Rating Systems

Internal rating systems fall into two broad categories according to their specific characteristics of development and use:

• Internal Rating Models for Corporate Credit Portfolios

Corporate Credit portfolios are approached differently, according to customers and/or transaction size and industry sector, using different models specifically adapted to project finance, leveraged finance and real estate.

For the middle-market segment (medium-sized companies) the Group uses statistical rating models, which combine financial information with qualitative data. The disclosure of risk ratings requires a previous validation by a team of risk analysts, who also take into account behavioural factors and express their opinion on the proposed operations.

In the small business segment, ratings are determined not only on the basis of financial and qualitative analysis, but also according to the track record of the company and respective partners.

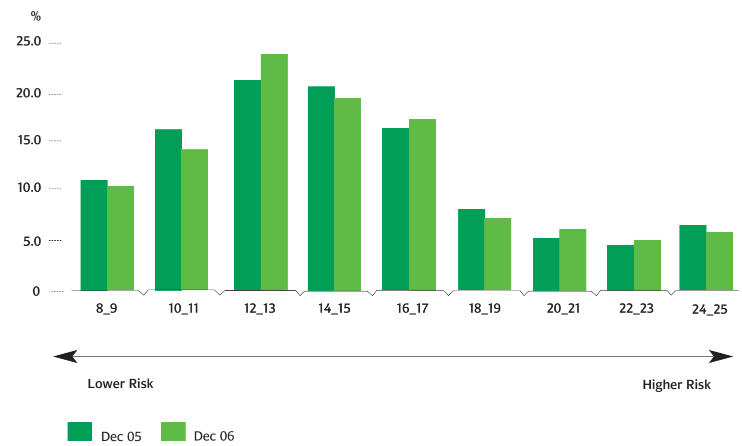
For Large Companies, Institutional Customers, Financial Institutions, Municipalities and Specialised Finance (i.e. project and leveraged finance) credit ratings are assigned by a rating desk. This unit is structured by industry sectors and run by highly specialised credit analysts.

To assign internal risk ratings to these risk segments, classified as Low Default Portfolios, this team uses expert-based systems (templates) that include quantitative and qualitative variables strongly linked to the industry sector in question, with benchmarks aligned to those used by one of the main international rating agencies.

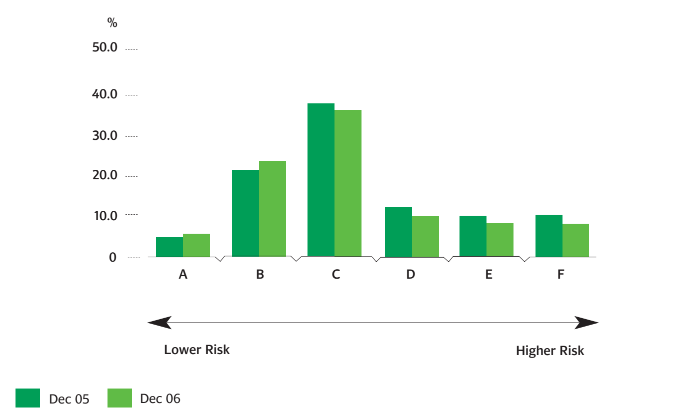
Specific rating models have also been implemented to quantify the risk inherent to the financing of start-ups (companies in business for less than 2 years) and real estate projects and companies. In this last case, the models are applied by a specialised team, using quantitative and technical, as well as qualitative variables.

Credit Portfolio breakdown by risk rating in the Domestic

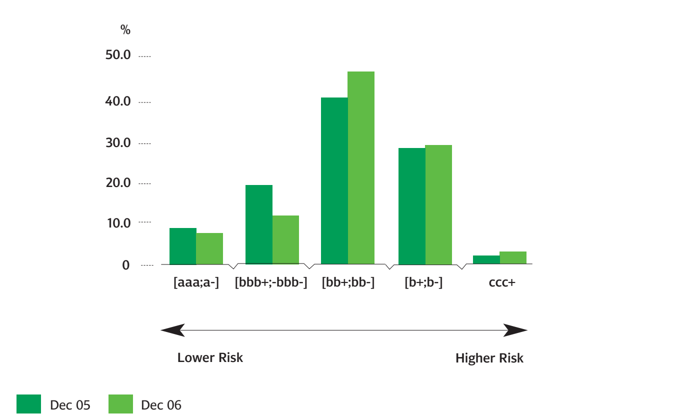
Rating Model for Middle Market



Scoring Model for Small Businesses



Rating Model for Large Corporates



Business

• Internal Scoring Models for Individual Customers' Credit Portfolios

The BES Group uses origination and behavioural scoring models for the main products offered to its individual customers - mortgage loans, consumer loans, credit cards, overdrafts and loan accounts – whose ratings are calibrated to a probability of default within one year. The models' predictive capacity is subject to regular monitoring.

Besides estimating the probability of default, the Group also regularly monitors other parameters required for risk quantification and management, namely Loss Given Default (LGD) and Exposure at Default (EAD).

Throughout 2006, all the rating and scoring models developed in previous years were fully in place. These models now play a key role, not only in the technical analysis of risk, but also in the credit risk approval and monitoring processes. In 2006 BES Group carried out an internal validation exercise of the various rating and scoring models implemented in previous years. The results obtained were overall positive, showing that the models maintain a good capacity to discriminate risk and therefore remain valid to support business decisions. The risk models were re-calibrated and subject to validation by the internal control and audit areas. This validation and re-calibration exercise will be carried out at least once a year, following the best risk management practices and in accordance with the new rules on regulatory capital requirements (Basel II).

b. Loan Granting

Continuing the initiatives taken in previous years and in accordance with the objectives established for 2006, the global project of revising and adapting the credit granting process in the various commercial segments was pursued, aiming to increase integration of internal ratings and risk-adjusted return metrics in the credit decision process.

Hence a project involving the full redesign of the credit process in the Large Companies segment was implemented in 2006, fully based on an economic perspective and with rating classifications being incorporated into the definition of credit powers at the various decision-taking levels (in terms of both exposures and pricing).

Likewise, and totally in line with the risk management practices and methodologies followed in Portugal, a global project was started this year to redesign, by segments, all the credit analysis, decision and monitoring processes currently used by BES (Spain), with implementation scheduled for the first quarter of 2007. This project seeks to address the demanding strategic challenge posed by the Iberia project, which aims to reinforce the Group's position in Spain.

c. Credit Risk Monitoring

The monitoring and control activities aim to quantify and control credit risk, in order to allow early definition and implementation of specific measures to deal with specific situations indicative of a deterioration of risk – with a view to mitigating potential loses - , as well as to outline global strategies for credit portfolio management.

In this perspective, and with the aim of preserving BES Group risk quality and standards, the credit risk monitoring function and its development are still one of the top priorities of the risk management and control system. This function comprises the following processes:

• Detecting warning signals and monitoring customers

In addition to the rating/scoring models, and in close connection with the process of determining, analysing and assessing credit impairment, BES Group has in place a risk monitoring system supported by mechanisms to detect the multiple warning signals suggesting impairment indications.

On the basis of this warning signal system and on the frequency, severity and correlation of these signals the exposure of customers whose risk profile shows symptoms of deterioration is periodically identified, analysed and quantified, and strategic options considered with regard to the bank's commercial relationship with these customers (i.e. "demobilise", "reinforce guarantees", "reduce exposure"). The system also permits to determine the level of active vigilance justified by and best suited to the customer's profile and the real situation of the entity under analysis, and when applicable, the respective credit impairment level, and also the coverage provided by the risk mitigation instruments available for each contract/client.

The powers mentioned above are held by the Committee for Credit Risk Analysis. This committee holds several meetings during the year which are attended by representatives from all the commercial structures. The meetings' conclusions are periodically reported to the Risk Committee and the Executive Committee.

• Control of credit limits

The limits approved by the Executive Committee for the Bank's portfolios are centrally monitored by the Global Risk Department.

• Global analysis of the risk profile of credit portfolios

The risk profile of BES Group's credit portfolios is analysed on a monthly basis by the Risk Committee. In these meetings the Committee monitors and analyses the risk profile of the BES Group and its business units from four main angles: evolution of credit exposure, monitoring of credit losses, capital allocation and consumption and control of risk adjusted return.

d. The recovery process

The entire recovery process is developed based on the concept of "integrated client". Whether in a corporate or retail segment, each client is assigned a "recoverer" that monitors all this client's credits subject to recovery.

In view of its nature and volumes involved, credit to individual clients is in some phases treated in an automatic and industrialised fashion, while a customised approach is used to treat credit to corporate clients.

Throughout the process, the possibilities of reaching an agreement are weighed and legal action taken whenever required to recover the credits and defend the Group's rights. However, there is constant openness to consider solutions permitting a return to a non-default situation and therefore to maintain the client.

6.3.2 Credit Risk Analysis

a. Credit Portfolio

• Loan Portfolio Breakdown

As of December 31st, 2006 BES Group's loan portfolio increased 14.4% year-on-year.

(euro million)

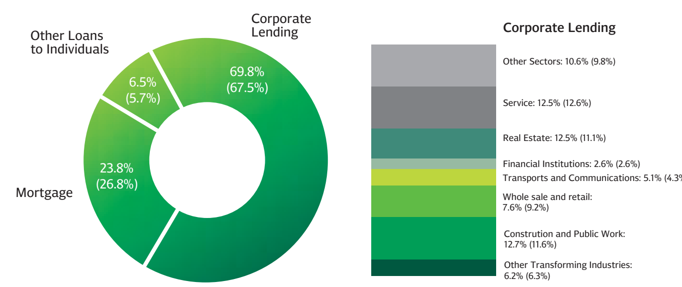
	Dec 05		Dec 06		Change (%)	
	Excluding Securitisation	Including Securitisation	Excluding Securitisation	Including Securitisation	Excluding Securitisation	Including Securitisation
Loans to Customers (gross)	**31,662**	**35,451**	**35,752**	**40,546**	**12.9**	**14.4**
Mortgage	8,481	12,270	8,500	13,294	0.2	8.3
Individuals (other)	1,802	1,802	2,309	2,309	28.1	28.1
Corporates	21,379	21,379	24,943	24,943	16.7	16.7

Securtisation figures = outstanding balance of Securitization operations at year end.

The performance of the loan portfolio reflects, on the one hand, the policy established by the Group for the individual customer segment focused on low risk products, mainly residential mortgages (annual increase of 8.3%), and on the other, an approach to the Corporate segment supported by the Group's vast experience in the sector.

In accordance with its policy of diversifying the corporate loan portfolio, in 2006 the BES Group once again ensured that concentration levels by industry sector remained within prudent limits.

Corporate loans breakdown by Industry sector (balance sheet values)



( ) December 2005

• Quality of the loan portfolio

Despite the substantial growth of the loan portfolio, the risk profile of the bank's lending activity improved significantly in 2006, consolidating the favourable trend of the previous years. The ratio of overdue loans over 90 days to total loans was reduced to 1.11% (1.33% in 2005) while the respective provision coverage rose by 21.6 p.p., to 218.2% (196.6% in 2005).

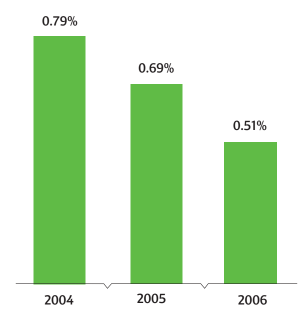
Loan Portfolio – Quality Indicators (euro million)

	Dec 05	Dec 06	Change	
			Absolut	Relative
Loans to Customers (gross)	31,662	35,752	4,090	12.9%
Overdue Loans	488	473	-16	-3.2%
Overdue Loans > 90 days	422	398	-24	-5.6%
Overdue and Doubtful (B.Portugal) [a]	564	495	-69	-12.3%
Credit Provisions	830	869	39	4.8%
Overdue Credit / Loans to Customers (gross)	1.54%	1.32%	-0.22 p.p.	
Overdue Loans > 90 days / Loans to Customers (gross)	1.33%	1.11%	-0.22 p.p.	
Overdue and Doubtful Loans[a]/ Loans to Customers (gross)	1.78%	1.38%	-0.40 p.p.	
Coverage of Overdue Credit	170.0%	184.0%	14.0 p.p.	
Coverage of Overdue Credit > 90 days	196.6%	218.2%	21.6 p.p.	
Coverage of Credit and Doubtful Loans	147.1%	175.6%	28.5 p.p.	

(a) According to Circular- Letter nº 99/03/2003 of the Bank of Portugal.

This positive performance results from a strict credit granting policy, supported by internal rating and scoring systems and by selective and systematic risk mitigation instruments. The good level of credit recoveries in 2006 and the sale of overdue loans (referred in chapter 7.2 of this report) should also be highlighted.

Provisioning cost(*)



(*) Accumulated provision charge in the year / Customer loans.

The steady improvement in the risk profile has also translated into a systematic reduction in BES Group's provisioning effort, which was achieved despite strong growth of the loan portfolio. This double objective (loan portfolio growth and risk reduction) was possible through a selective management of the credit portfolio and increasingly sophisticated decision support instruments.

b. Bond Portfolio (counterparty risk)

At year-end 2005 36.5% of the Group's bond portfolio corresponded to public debt securities. In addition, 65% of this portfolio corresponded to investment grade securities.

Bond portfolio: rating distribution

External Ratings		S&P 2005	S&P 2006	MOODY'S 2005	MOODY'S 2006
AAA	Aaa	16.1%	13.0%	17.0%	13.0%
[AA+;AA-]	[Aa1;Aa3]	22.1%	26.4%	34.9%	28.7%
[A+;A-]	[A1;A3]	30.8%	19.2%	20.8%	16.4%
[BBB+;BBB-]	[Baa1;Baa3]	7.1%	6.2%	5.9%	6.8%
[BB+;BB-]	[Ba1;Ba3]	0.8%	6.5%	0.6%	6.0%
[B+;B-]	[B1;B3]	0.1%	0.4%	0.0%	0.3%
[CCC+;CC]	[Caa1;Ca]	0.0%	0.0%	0.0%	0.0%
SD/D	C	0.0%	0.0%	0.0%	0.0%
N.R.	N.R.	23.0%	28.1%	20.8%	28.6%
TOTAL		100.0%	100.0%	100.0%	100.0%

Derivatives counterparty risk, calculated in accordance with the replacement cost (sum of the transactions' positive replacement values), arises mainly from exposure to entities rated by international rating agencies. The soundness of this portfolio is evidenced by the fact that 67% of current exposure has a rating between AAA/Aaa and A-/A3.

c. Exposure to emerging markets

Emerging market exposure is low, net exposure accounting for 4.2% of consolidated assets. Moreover, of the Group's net exposure of euro 2,481 million, only euro 849 million correspond to foreign currency exposure.

(euro million)

Bank of Portugal		Dec 05		Dec 06				
		Net Exposure				Net Exposure		
Countries	Risk Weight	Total	in foreign currency	Gross Exposure(1)	Garanties and Deductions(2)	Total	in foreign currency	Structure
Latin America		**1,319**	**169**	**1,954**	**184**	**1,770**	**334**	**71%**
Bahamas	10%	17	17	33	30	3	3	0%
Brazil	10%	1,186	36	1,606	73	1,533	97	62%
Mexico	10%	13	13	48	46	2	2	0%
Panama	10%	94	94	232	6	226	226	9%
Venezuela	50%	3	3	15	15	0	0	0%
Other		6	6	20	14	6	6	0%
Eastern Europe		**9**	**9**	**3**	**0**	**3**	**3**	**0%**
Romenia	10%	2	2	0	0	0	0	0%
Russia	10%	4	4	2	0	2	2	0%
Ucrania	25%	3	3	1	0	1	1	0%
Other		0	0	0	0	0	0	0%
Asia-Pacific		**44**	**29**	**65**	**7**	**58**	**49**	**2%**
India	10%	5	5	7	0	7	7	0%
Macao	10%	38	23	43	0	43	34	2%
China	10%	0	0	8	0	8	8	0%
Turkey	25%	0	0	6	6	0	0	0%
Other		1	1	1	1	0	0	0%
Africa		**416**	**198**	**773**	**123**	**650**	**463**	**26%**
South Africa	10%	1	0	36	19	17	17	1%
Angola	25%	376	188	691	64	627	445	25%
Cape Verde	25%	0	0	31	30	1	1	0%
Morroco	10%	37	8	9	5	4	0	0%
Other		2	2	6	5	1	0	0%
TOTAL		**1,788**	**405**	**2,795**	**314**	**2,481**	**849**	**100%**
% Net Assets		**3.6%**	**0.8%**			**4.2%**	**1.4%**	

(1) Gross value net of provisions for country risk; includes off-balance sheet elements : euro 223 million (Dec.06) and euro 88 million (Dec.05).
(2) Includes Trade Finance under one year firmed in Portugal worth euro 61 million.

The following exposure to emerging markets, which is in line with the internationalisation strategy deployed by the Group, is worth highlighting:
• Net exposure to Brazil increased by euro 347 million, of which euro 100 million derived from the valuation of the Group's holding in Banco Bradesco and the remainder related to BES Investimento business growth in this country;
• Exposure to Angola increased by euro 251 million relating to BES Angola's strong business growth in this market.

Both overall and individual exposure is considerably below the maximum limit permitted by the Bank of Portugal, which recommends maximum exposure corresponding to 30% of own funds.

6.4 Market Risk

Market risk is the possible loss resulting from an adverse change in the value of a financial instrument due to fluctuations in interest rates, foreign exchange rates and share prices.

6.4.1 Management Practices

Market risk management is linked to balance sheet management through the Assets and Liabilities Committee (ALCO). This committee is responsible for defining policies for the structuring and composition of the balance sheet, and for controlling exposure to interest rates, foreign exchange and liquidity risk.

The main measure of market risk is the assessment of potential losses under adverse market conditions, for which Value at Risk (VaR) valuation criteria is used. BES Group's VaR model uses the Monte Carlo simulation, based on a confidence level of 99% and an investment period of 10 days. Volatilities and correlations are historical, based on an observation period of one year.

To improve on the VaR assessment, other initiatives have been developed, namely back testing, which consists of comparing the losses foreseen by VaR with actual losses. These exercises allow the model to be fine-tuned and its prediction capacity improved.

As a complement to the VaR model, stress testing is also carried out – allowing the Group to assess the impact of higher potential losses than those considered using the VaR.

6.4.2 Analysis of Market Risk

Consolidated value at risk (VaR) in December 2006 (relating to trading positions in equities and interest rate instruments, as well as FX positions) totalled euro 24,1 million, which compares with euro 34,4 million at year-end 2005. This value (euro 24,1 million) corresponds to circa 0.6% of the Group's consolidated Tier I capital. The maximum VaR of the year reached euro 35,3 million, which represents 0.94% of the consolidated Tier I capital, and the average VaR was euro 25,8 million, or 0.69% of the consolidated Tier I.

Value at Risk 99% at 10 days (euro million)

	Dec 05	Dec 06	Maximum 2006	Average 2006
Equity	3.9	13.6	6.3	6.7
Interest Rate	31.9	5.0	21.9	13.7
FX	7.4	15.1	23.4	16.2
Diversification Effect	-8.9	-9.6	-16.3	-10.8
Total	**34.4**	**24.1**	**35.3**	**25.8**

As a complement to risk measurement, simulated extreme scenarios are also analysed. The analysis of worst case scenarios, based on 20% change in risk factors, and assuming the remote possibility of a perfect correlation between the worst possible scenario for the various categories of risk, determines that the maximum loss in a VaR of euro 24.1 million could, in the most extreme conditions, reach euro 170.6 million or 4.5% of consolidated Tier I Capital.

VaR versus Extreme Scenarios (euro million)

	2005		2006			
	Extreme Scenario	% of Tier I	Value at Risk	% of Tier I	Extreme Scenario	% of Tier I
Equity	15.2	0.6%	13.6	0.4%	54.4	1.5%
Interest Rate	123.8	5.3%	5	0.1%	12.4	0.3%
FX	32.3	1.4%	15.1	0.4%	103.7	2.8%
Total	**171.3**	**7.3%**	**24.1**	**0.6%**	**170.6**	**4.5%**

6.5 Interest Rate Risk

Interest rate risk may be defined as the impact on shareholders' equity or net interest income of an unfavourable change in market interest rates.

6.5.1 Management Practices

Given its importance, interest rate risk is monitored at internal level by the ALCO Committee, namely through the monitoring of net interest income and using repricing tables.

6.5.2 Analysis of interest rate risk

In accordance with Basel II (Pillar 2) recommendations and Bank of Portugal Instruction 19/2005, the Group's exposure to on-balance sheet interest rate risk is calculated on the basis of Bank of International Settlements (BIS) methodology, classifying all Assets, Liabilities and off-balance sheet items, excluding those from trading, using repricing schedules.

The model used is similar to the duration model, using a stress testing scenario corresponding to a parallel shift of 200 bp in the yield curve for all interest rate levels.

Interest rate risk measurement basically consists of determining the effect of the referred change in interest rates on an institution's shareholders' equity and annualised net interest income.

In December 2006 interest rate risk, measured as its impact on BES Group's shareholders' equity, was euro 500 million, which compares with euro 399 million at year-end 2005.

6.6 Liquidity Risk

Liquidity risk derives from the potential incapacity to fund assets while satisfying commitments on due dates and potential difficulties in liquidating positions in the portfolio without incurring in exaggerated losses.

6.6.1 Management Practices

The purpose of liquidity management is to maintain adequate liquidity levels to meet short, medium and long term funding needs. Liquidity management is centralised in the Financial Department (Treasury).

The overall exposure to liquidity risk is assessed through reports that, by identifying negative mismatches, allow for their hedging on a permanent and on-going basis.

6.6.2 Analysis of Liquidity Risk

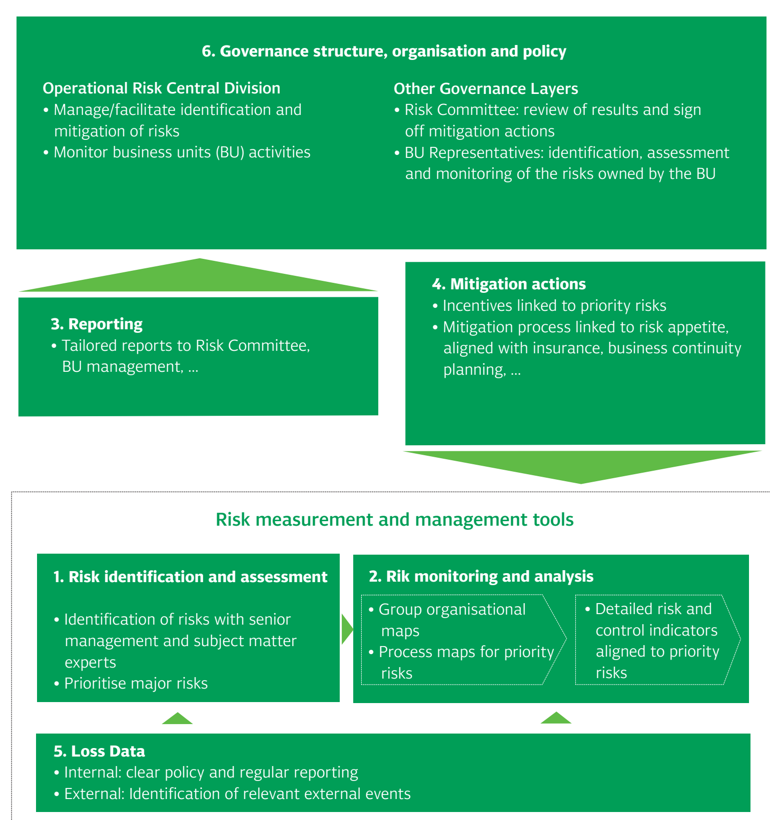
Liquidity risk is analysed from a two-fold perspective, i.e., it considers both the internal perspective and the regulatory perspective. Internally, the existing procedures are considered adequate to monitor, on the one hand, the evolution of liquidity on a daily basis (responsibility of the Treasury area), and the evolution of liquidity in the medium/long term (analysed at meetings of the ALCO). From a regulatory standpoint, the liquidity ratio calculated in accordance with Bank of Portugal rules was 97% at the end of 2006, which compares with 107% at the end of 2005.

6.7 Operational Risk

Operational risk represents the risk of losses or of a negative impact on the relationship with the customers or other stakeholders, resulting from inadequate or negligent application of internal procedures, staff behaviour, information systems or external events. Operational risk also includes business/strategic risk, i.e., the risk of losses thorough fluctuations in volume/business, earnings/prices or costs.

Legal risk is also included in the above definition. Legal risk represents the risk of losses arising from non compliance with regulations in force (due to inadequate document retention, failure to change processes as required by new legislation and/or differences in the interpretation of the law) or resulting from legal action.

To manage operational risk, there are a set or procedures in place that standardise, systematise and regulate the frequency of actions viewing the identification, monitoring, control and mitigation of this risk.



These processes are part of a management model comprising two broad areas: the first concerns the collection and treatment of information, using tools that permit to identify and monitor risk; the second uses the information that has been duly processed for the efficient management of risk, monitoring the more critical situations and implementing the risk management strategy. These two broad areas are coordinated through reporting to senior management and the monitoring of the mitigation measures determined.

These are some of the main aspects of the management model implemented:

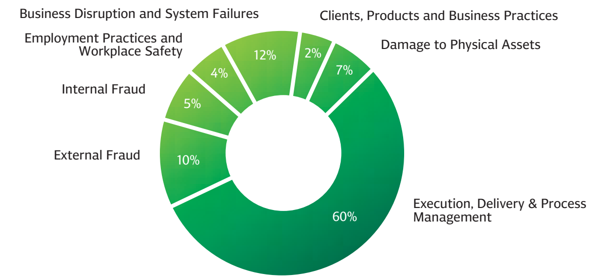
• Identification of risk focused on priority risks (high criticality), definition of scenarios and in-depth analysis of factors liable of affecting the BES Group's risk profile;
• Monitoring identified risks and trends, using perfectly aligned indicators and controls;
• Mitigation actions aligned to priority risks;
• Analysis of loss events data to determine trends; review of near misses and analysis of losses external to the organisation (when available);
• Sound corporate governance models, reporting aligned to main concerns.

This operational risk management model is supported by a structure within the organisation exclusively dedicated to the model's design, monitoring and maintenance, that includes in its composition representatives of relevant subsidiaries. This structure guarantees the application of the established procedures and ensure the day-to-day management of operational risk.

The following areas and functions also play an important part in the implementation of the model:

• the Internal Control System's management, executed by the Compliance Department, for its important role in guaranteeing that the processes are well documented, detecting specific risks and verifying the controls implemented, ascertaining the rigour of control design and identifying required steps for improvement and full effectiveness; there is continuous reporting to and from the operational risk management;
• the Internal Audit, which tests the efficacy of controls, identifies required steps for improvement and assesses their implementation;
• the Security Coordination area, with responsibility for data security, the security of people and property and business continuity.

Breakdown of operational risk events by type of loss (2004, 2005 and 2006)



In 2006 the Operational Risk Management System was for the first time subject to an independent revision process, all the conditions being in place for application of the standardised approach for purposes of calculating the regulatory capital requirements for operational risk.

7.0 Financial Analysis

7.1 Financial Analysis of BES Group

For the Banco Espírito Santo Group, 2006 was marked by strong business growth, with total assets rising by 18.1%, to euro 85 billion. Net income for the year reached euro 420.7 million, a year-on-year increase of 50% and corresponding to a return on equity (ROE) of 14.7%.

7.1.1 Activity

The BES Group reported strong commercial activity in its main business areas in 2006:

• loans to customers (including securitised loans) grew by 14.4;

• total customer funds were up by 13.9%;

• the international business was particularly dynamic, with customer loans increasing by 34% and total customer funds by 26%.

Activity Indicators (euro million)

	Dec 05	Dec 06	Chg %
Total Assets(1)	**71,687**	**84,628**	**18.1**
Net Assets	**50,222**	**59,139**	**17.8**
Loans to Customers (includes securitised)			
Loans to Individuals	14,072	15,603	10.9
- Mortgage	12,270	13,294	8.3
-Other Loans to Individuals	1,802	2,309	28.1
Corporate Lending	21,379	24,943	16.7
Total Loans to Customers	**35,451**	**40,546**	**14.4**
Customer Funds			
+ Deposits(2)	24,283	26,732	10.1
+ Debt Securities placed with Clients(3)	3,590	5,263	46.6
= On Balance-Sheet Customer Funds	**27,873**	**31,995**	**14.8**
+ Off-Balance Sheet Funds	15,685	17,637	12.4
= Total Customer Funds	**43,558**	**49,632**	**13.9**

(1) Net Asset + Asset Management + Other Off-Balance Sheet Liabilities + Securitized Credit.
(2) Includes: "Customer Deposits and Other Loans" and Certificates of Deposits.
(3) Includes funds related to securitisation transactions and bonds at fair value.

As for customer loans, corporate lending grew 16.7%, allowing the Group to reinforce its competitive position in this important business area. This performance was backed by a recovering economy, namely in exports - an area where BES Group has a firm foothold - and by its long-standing support to the internationalisation of the Portuguese companies.

The leasing and factoring business maintained its second place in the domestic market rating in both products, with global production reaching euro 4.6 billion, which represents a year-on-year increase of 14.6%.

In loans to individuals, mortgage loans grew by 8.3%, while other loans to individuals increased 28.1%, as a result of several programmes associated to consumer credit, credit cards and BES 95 Plans (savings products).

During the year the BES Group performed two securitisation transactions: (i) one of residential mortgage loans (the fifth so far) totalling euro 1.4 billion; and (ii) another of loans to small and medium sized enterprises (SMEs) totalling euro 863 million.

In turn, total customer funds grew by 13.9%, with off-balance sheet funds reaching euro 17.6 billion, which corresponds to a year-on-year increase of 12.4%. This growth was underpinned by the wide range of the life bancassurance products offer, investment funds (three new mutual funds and eighteen closed end real estate funds) and portfolio management.

Off-balance sheet funds (euro million)

	Dec 05	Dec 06	Chg %
Mutual Funds	5,392	5,540	2.7
Real Estate Funds	1,463	1,469	0.4
Pension Funds	2,338	2,608	11.5
Bancassurance	4,396	4,647	5.7
Other	2,096	3,373	60.9
Total	**15,685**	**17,637**	**12.4**

The international banking business progressed according to the plan: the expansion of the presence in Angola, the business in Spain, and the already traditional positions in the United Kingdom, France, the United States, Brazil and Macao, resulted in a 34.2% increase in the loan portfolio, to euro 5,497 million, which represents 13.6% of the consolidated loan portfolio. Total customer loans were up by 26.3% to euro 12,477 million.

International Banking Business (euro million)

	Dec 05	Dec 06	Chg %
Net Assets	11,189	15,285	36.6
Loans to Customers (gross)	4,095	5,497	34.2
Total Customer Funds	9,881	12,477	26.3

7.1.2 Liquidity Management and Transformation Ratio

In a context of strong lending growth, liquidity management was supported by concerted action by the main business units. Hence in 2006 the transformation ratio of customer funds (deposits and debt securities) into credit was slightly better than in 2005, decreasing from 111% in December 2005 to 109% in December 2006, which is explained by funding growth higher than credit growth.

Transformation Ratio (euro million)

		Dec 05	Dec 06
LOANS TO CUSTOMERS			
Loans to Customers (gross)		31,662	35,752
Impairment/Specific and General Provisions		830	869
Net Loans	**A**	**30,832**	**34,883**
CUSTOMER FUNDS + DEBT SECURITIES			
Deposits	**B**	**20,753**	**21,994**
Debt Securities placed with Clients		7,120	10,001
Customer Funds	**C**	**27,873**	**31,995**
Euro Medium Term Notes + Commercial Paper		7,282	9,029
Total on Balance-Sheet Funds	**D**	**35,155**	**41,024**
TRANSFORMATION RATIO			
Deposits into Credit	**A/B**	**149%**	**159%**
Customer Funds into Credit	**A/C**	**111%**	**109%**
Total Funds into Credit	**A/D**	**88%**	**85%**

7.1.3 Capitalisation and Capital Adequacy Ratios

Own funds totalled euro 7,063 million at year-end, an increase of euro 1,664 million on the previous year.

a. Own Funds Composition

(euro million)

	Dec 05	Dec 06	Change abs
Capital	2,100	3,100	1,000
Ordinary Shares	1,500	2,500	1,000
Preference Shares	600	600	0
Share Premium	300	669	369
Treasury Stock	-96	-64	32
Revaluation Reserves	366	512	146
Other Reserves and Retained Earnings	-26	98	124
Minority Interests	106	87	-19
Subordinated Debt	2,368	2,240	-128
Net Income	280	421	140
Total	**5,398**	**7,063**	**1,664**

This increase reflects the reinforcement of ordinary shares and share premium as a result of the capital increase concluded in the second quarter of 2006. Retained earnings also increased (income of the year retained for self-financing), as well as the revaluation reserves.

The General Meeting of BES Shareholders, held on April 17th, 2006, approved a capital increase from euro 1.5 billion up to euro 2.5 billion through (i) the issue of 50 million new shares by incorporation of share premiums of euro 250 million; (ii) a rights issue of 150 million new shares for shareholders, at the price of euro 9.20 per share.

Capital Increase Operation (euro million)

	Before capital increase (Dec 05)	Change		Post Capital Increase (Dec-06)	Change
		Gross proceeds	Incorporation of Reserves		
Capital	1,500	750	250	2,500	1,000
Share Premium	300	630	-250	680	380
Total	**1,800**	**1,380**	**0**	**3,180**	**1,380**
Number of shares (milion)	**300**	150	50	**500**	200
Market Cap	**4,080**			**6,810**	2,730

Proceeds from BES capital increase totalled euro 1.38 billion, which represented 34% of the Bank's stock market capitalisation as of December 31st, 2005. BES market capitalisation increased 67% in 2006.

Through public deed of May 30th, 2006, BES share capital is now represented by 500 million shares, with nominal value of euro 5.00 each. This operation was registered with the Commercial Registry of Lisbon, and the listing of the 200 million new shares on the Eurolist by Euronext Lisbon took place on June 1st, 2006.

This was the sixth capital increase since the Bank was reprivatised, and the largest (representing nearly 50% of the proceeds of the previous operations).

Capital Increases since the Reprivatisation (euro million)

Operations		No. of Shares (million)				Placement		
		Capital Increase						
No.	Month/Year	Incorporation of Reserves	Total	Accumulated	NOMINAL CAPITAL	Proceeds	Share Premium	% Share Premium
				40.0	**200**			
1	Aug 92	20.0	26.0	66.0	**330**	59.8	29.9	50
2	Aug 95	13.2	21.4	87.4	**437**	83.7	43.0	51
3	Jun 98	17.5	30.2	117.6	**588**	286.4	223.2	78
4	Jul 00	44.6	82.5	200.0	**1,000**	453.6	264.3	58
5	Feb 02	50.0	100.0	300.0	**1,500**	550.0	300.0	55
6	May 06	50.0	200.0	500.0	**2,500**	1,380.0	630.0	46
						2,814.0	**1,490.4**	**53**

Revaluation reserves of euro 512 million correspond to potential gains in the portfolio of "Assets available for sale", which are recognised at fair value and the changes, including foreign exchange fluctuations are recognised under reserves, net of deferred tax liabilities.

The main equity exposures in the available for sale portfolio reflected an overall potential gain of euro 656.3 million at the end of 2006 (2005: potential gain of euro 472.1 million). Under the terms and conditions established by the Bank of Portugal, 45% only of the amount of these potential gains is considered as eligible Tier II capital.

Main Equity Exposures (euro million)

Available for sale Portfolio	Potencial gains and losses (gross)	
	Dec 05	Dec 06
B. Marocaine Com. Ext.	10.3	2.8
Banco Bradesco	397.7	496.1
Bradespar	35.0	8.3
EDP	0.0	68.0
Portugal Telecom	29.1	66.3
Outros	0.0	14.8
TOTAL	**472.1**	**656.3**

b. Solvency

BES Group's comfortable solvency ratios position the Group for further growth in the medium term and are above minimum levels, either that required by the Bank of Portugal or recommended by the Bank of International Settlements (BIS).

Risk weighted assets and regulatory capital (Bank of Portugal) (euro million)

		Dec 05	Dec 06	Change	
				Abs.	Rel.
Net Consolidated assets	(1)	50,222	59,139	8,917	17.8%
Risk Weighted Assets	(2)	38,046	44,738	6,692	17.6%
Risk Weight	(2)/(1)	76%	76%		
Regulatory capital requirements	(3)	3,044	3,579	535	17.6%
Risk Weighted Assets		2,839	3,332	493	17.4%
Trading Portfolio		205	247	42	20.7%
Existing Regulatory Capital	(4)	4,689	5,839	1,150	24.5%
Tier I		2,372	3,751	1,379	58.1%
Complementary		2,372	2,277	- 95	-4.0%
Deductions		(55)	(189)	- 134	243.6%
Surplus	(4) - (3)	1,645	2,260	615	37.4%
Solvency Ratio Total	**[4/(12,5 x3)]**	**12.3%**	**13.1%**	**0.8p.p.**	
TIER I		**6.2%**	**8.4%**	**2.1p.p.**	
Core TIER I		**4.7%**	**7.0%**	**2.3p.p.**	

The Group's capital ratios were significantly reinforced, reflecting the effects of the capital increase, which increased the Core Tier I capital to 7.0%, from 4.7% in December 2005. In addition, the performance above expectations of pension funds had a positive effect on Tier I capital, contributing to a reduction in actuarial deviations outside the corridor of euro 222 million, which, under Bank of Portugal regulations, are deductible to Tier I.

Bank of Portugal's Notice no. 12/2006, of 26 December, introduced new rules on the regulatory accounting of equity holdings in insurance companies, translating into a euro 102 million deductions to regulatory capital (a 20 basis points reduction in the total solvency ratio).

Under BIS criteria, the total solvency ratio is 13.2% (12.7% in 2005) whereas the Tier I ratio is 8.4%, which compares with the minimum recommended level of 4%.

Solvency ratios: BIS criteria

	Dec 05	Dec 06	Change
Total BIS Ratio	**12.7%**	**13.2%**	**0.5p.p.**
TIER I	6.5%	8.4%	1.9p.p.
Core TIER I	4.9%	7.1%	2.2p.p.

7.1.4 Results

The BES Group reached consolidated net income of euro 420.7 million in 2006, corresponding to a year-on-year increase of 50%.

Income Statement (euro million)

	2005	2006	Change Abs.	Change Rel. (%)
Net Interest Income	**740.6**	**829.5**	**88.9**	**12.0**
+ Fees and Commissions	555.1	610.5	55.4	10.0
+ Capital Market Results	242.0	264.8	22.8	9.5
= Banking Income	**1,537.7**	**1,704.8**	**167.1**	**10.9**
- Operating Costs	861.2	891.3	30.1	3.5
= Gross Results	**676.5**	**813.5**	**137.0**	**20.2**
- Net Provisions	320.6	241.9	-78.7	-24.6
Credit	219.9	181.6	-38.3	-17.4
Securities	30.2	6.9	-23.3	-77.0
Other	70.5	53.4	-17.1	-24.5
= Profit before Tax and Minorities	**355.9**	**571.6**	**215.7**	**60.6**
- Income Tax	65.8	135.4	69.6	105.8
= Profit after Tax	**290.1**	**436.2**	**146.1**	**50.4**
- Minority Interests	9.6	15.5	5.9	60.9
Net Income	**280.5**	**420.7**	**140.2**	**50.0**

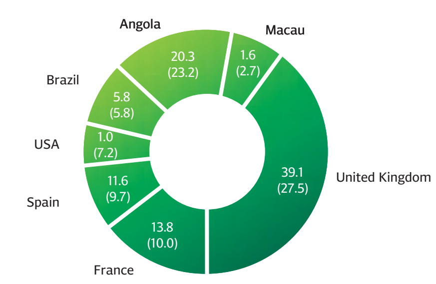
In addition to the positive impacts of the recovery of the Portuguese economy and the improvement of the main confidence indices at corporate and private consumption levels, the following factors contributed to the BES Group's performance in 2006:
- strong growth in all areas of activity, especially in customer lending (+14.4%) and customer funds (+13.9%);
- the good performance of banking income, which grew by 10.9%, underpinned by the increase in net interest income (+12%) and fees and commissions (+10%);
- the international banking business, with banking income rising by 28%, driven by fees and commissions that reached euro 124 million (+57%) and trading, that increased 50%;
- control of operating costs through the implementation of rationalisation measures: costs increased by 3.5%, despite the 12.9% increase in costs related to international activity expansion;
- the reduction in the credit provisioning charge, as a result of a consistent loan policy focused on lower risk segments;
- the reduction in the provisioning charge for other risks compared to 2005, when a provision of euro 57.6 million had been made for the restructuring/integration of Banco Internacional de Crédito.

Income from domestic and international activity (euro million)

	Domestic Activity 2005	Domestic Activity 2006	Domestic Activity Chg (%)	Internacional Activity 2005	Internacional Activity 2006	Internacional Activity Chg (%)
Net Interest Income	633.4	724.5	14.4	107.2	105.0	-2.1
+ Fees and Commissions	476.4	486.6	2.1	78.7	123.9	57.4
= Commercial Banking Income	**1,109.8**	**1,211.1**	**9.1**	**185.9**	**228.9**	**23.1**
+ Capital Market Results and Other	200.0	201.6	0.8	42.0	63.2	50.5
= Banking Income	**1,309.8**	**1,412.7**	**7.9**	**227.9**	**292.1**	**28.2**
- Operating Costs	731.9	745.3	1.8	129.3	146.0	12.9
= Gross Results	**577.9**	**667.4**	**15.5**	**98.6**	**146.1**	**48.2**
- Net Provisions	317.0	219.0	-30.9	3.6	22.9	....
Credit	221.0	162.3	-26.6	-1.1	19.3	....
Securities	30.2	7.2	-76.2	0.0	-0.3	....
Other	65.8	49.5	-24.8	4.7	3.9	-17.0
= Profit before Tax and Minorities	**260.9**	**448.4**	**71.9**	**95.0**	**123.2**	**29.7**
- Tax	63.9	115.8	81.2	1.9	19.6	....
= Profit after Tax	**197.0**	**332.6**	**68.8**	**93.1**	**103.6**	**11.3**
- Minorities	2.6	5.1	96.2	7.0	10.4	48.6
= Net Income	**194.4**	**327.5**	**68.5**	**86.1**	**93.2**	**8.3**

The international activity contribution to the 2006 consolidated net income (22.2%) increased to euro 93.2 million (from euro 86.1 million in 2005), with euro 39.1 million in the UK, euro 20.3 million in Angola, euro 13.8 million in France, euro 11.6 million in Spain and euro 5.8 million in Brazil.

International activity contribution to consolidated net income (euro million)



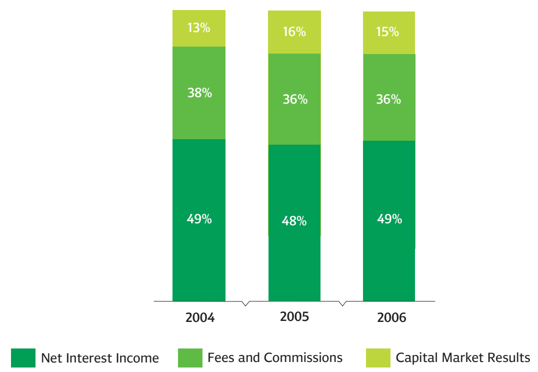
( ) 2005

a. Banking Income

Banking income grew by 10.9%, fuelled by the good performance not only of Banco Espírito Santo but of the Group's operating units in general, in particular BES Investimento, BES (Spain), BES Angola, ESAF (asset management) and Besleasing e Factoring.

Banking income maintained its traditional balanced structure, with net interest income slightly increasing its weight within revenue-generating sources versus a decline in capital markets and other. The relative weight of fees and commissions remained unchanged.

Evolution of Banking Income Breakdown



b. Net Interest Income and Net Interest Margin

Net interest income reached euro 829.5 million in 2006, corresponding to a 12% year-on-year increase. This increase was driven by the commercial policies implemented, which had a positive impact on the following:

- activity growth, especially in customer loans and customer funds, with a positive euro 63 million volume effect, which accounts for ca. 70% of the total increase in net interest income;
- improvement in the net interest margin by 3 basis points, as a result of adjustment of the asset and liability management to the new upward trend in interest rates, despite strong competition in the domestic market;
- the capital increase, which had a positive impact on net interest income;
- the abrupt drop in interest rates in Angola, which had a negative impact on net interest income from the international activity and on its contribution to consolidated results.

Net Interest Income (euro million)

	2005	2006	Change
Revenues	**1,852**	**2,301**	**449**
Customer Loans	1,312	1,673	361
Other Placements	540	628	88
Costs	**1,111**	**1,471**	**360**
Customer Funds	765	1,036	271
Other Funds	346	435	89
Net Interest Income	**741**	**830**	**89**

Interest revenues exceeded the previous year's total by euro 449 million, with customer loans increasing the most. Interest costs increased by euro 360 million, of which euro 271 million were costs related to customer funds.

The following table shows the revenues and costs of interest-earning assets and interest-bearing liabilities and compares them to respective average interest rates.

Net Interest Income and Net Interest Margin (euro million)

	2005			2006		
	Average Volume	Rate (%)	Revenue /Cost	Average Volume	Rate (%)	Revenue /Cost
Placements	**41,811**	**4.46**	**1,852**	**45,377**	**5.07**	**2,301**
Customer Loans	30,122	4.36	1,312	33,354	5.01	1,673
Other Placements	11,017	4.90	540	12,023	5.22	628
ALM	672	-	-	-	-	-
Borrowed Funds	**41,811**	**2.66**	**1,111**	**45,377**	**3.24**	**1,471**
Customer Funds	32,634	2.35	765	34,673	2.99	1,036
Other Funds	9,177	3.77	346	9,917	4.38	435
ALM	-	-	-	787	-	-
Result/Global Margin	**-**	**1.80**	**741**		**1.83**	**830**

(1) Include certificates of deposits and debt securities placed with clients.

Through the implementation of measures aiming at a better adjustment to the upward cycle of interest rates, the net interest margin improved by 3 basis points, rising from 1.80% in 2005 to 1.83% in 2006. Hence the margin's improvement resulted from a higher pace of re-pricing financial assets than occurred with borrowed funds.

The increase in net interest income can also be explained by the effect of prices and volume and the joint price/volume effect, as shown in the following table.

Price versus Volume Effect (euro million)

	Volume Effect	Price Effect	Volume/Price Effect	Change
Interest Earning Assets	158	269	22	449
Interest Bearing Liabilities	95	245	20	360
Net Interest Income	**63**	**24**	**2**	**89**

The increase in volume (euro 63 million) backed the performance of net interest income, while the price effect explained an increase of euro 24 million.

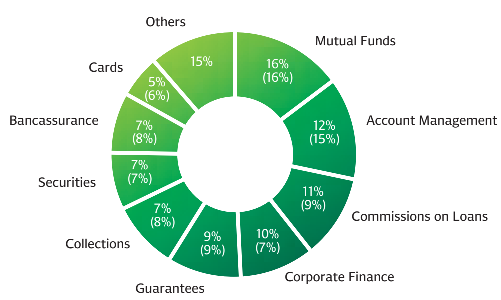
Net interest margin monitoring and balance sheet management are the responsibility of the Assets and Liabilities Committee (ALCO). Some of the most important measures defined by the ALCO concern (i) the monitoring of on-balance sheet customer funds and interest rates on a diversified range of products (insurance, mutual funds and on balance sheet products) and (ii) the adjustment of the balance sheet to reflect interest rate, liquidity and exchange rate risks and the forecast trend in the yield curve.

c. Fees and commissions

Fees and commissions totalled euro 610.5 million in 2006, a year-on-year increase of 10%. This improvement was mainly due to services provided at the international level, which grew over 57% year-on-year, especially in the Corporate and Project Finance areas, with UK and Spain achieving high growth in the investment banking business.

Analysing breakdown per product, the highest growth in commissions was achieved in credit linked commissions, which improved significantly (above 30%), documentary credits (+22%) and investment funds (+9%). All these more than compensated the reduction in commissions on account and card management, due to strong competition in these areas.

Breakdown of Fees and Commissions



( ) last year

During the year BES Group continued to pursue the goals defined for its commercial strategy: investment in service quality, improving the commercial offers specifically designed for each client segment and promoting proactive cross-selling through the commercial network.

Along these lines, the Group's focus on a multi-channel relationship with its customer base, whether individuals or companies, is of particular relevance. In 2006 the role of the direct channels in the day-to-day life of the clients was particularly reinforced. The number of internet banking users among individual clients – BESnet – reached 813,000 in December, which corresponds to a year-on-year increase of 7.9%. The number of transactions performed through BESnet grew by 58.4% year-on-year, raising the ratio of off-branch transactions to total transactions from 43.4% in 2005 to 52.5% in 2006. This growth trend was also very strong in BESnet Negócios – the internet banking service for corporate clients – which reached 53,000 users in December, a year-on-year increase of 23.5%. The number of logins and transactions rose by respectively 27.4% and 35.9%.

d. Capital Markets Results and Other

Capital markets and other results totalled euro 264.8 million, a year-on-year increase of 9.5%.

Capital Markets Results and Other (euro million)

	2005	2006	Change abs.
Interest Rate & Fx	**121.8**	**89.4**	**-32.4**
Equity	**108.8**	**169.2**	**60.4**
Trading	69.9	127.6	57.7
Income from Securities	38.9	41.6	2.7
Other Results	**11.4**	**6.2**	**-5.2**
Total	**242.0**	**264.8**	**22.8**

The positive equity capital markets results reflect the positioning based on the expectation of positive performance of the world equity indices in general and more specifically of the Brazilian and Portuguese markets. Maintaining this positioning during the year of 2006, along with efficient risk management, allowed to achieve positive overall results.

In the foreign exchange, interest rate and credit markets, lower volatility in Europe and the US highlighted the performance of the emerging markets where the Group has been taking positions, permitting to obtain positive results.

The capital market results and other include euro 3.7 million generated by BES-Vida in the second half of the year, after the euro 2.5 million amortisation of the value in-force resulting from the acquisition of 50% of BES-Vida by BES.

e. Operating costs

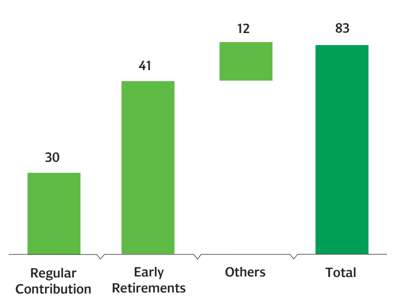
Operating costs totalled euro 891.3 million, rising year-on-year by 3.5%. This increase essentially reflects the expansion of the international area's business, with costs rising by 12.9%.

Operating Costs (euro million)

	2005	2006	Chg (%)
Staff Costs	453.7	478.2	5.4
Salaries	359.8	383.6	6.6
Post Retirement Benefits	93.9	94.6	0.7
Other Admin. Costs	327.2	344.1	5.2
Depreciation and Amortisation	80.3	69.0	-14.1
Operating Costs	**861.2**	**891.3**	**3.5**
Domestic	731.9	745.3	1.8
International	129.3	146.0	12.9

Staff costs were up by 5.4%, mainly driven by the international area where the increase in the number of staff led to a 15% increase in staff costs. As for costs related to post retirement benefits (pension, health care and seniority payment), there were no relevant actuarial differences, while the pension fund assets achieved a significant profitability (12%), creating positive actuarial differences. As a consequence, the accumulated actuarial differences on the balance sheet, using the corridor method, decreased by euro 222 million, which will have a positive impact on their amortisation in the future. Contributions to the Pension Funds totalled euro 83 million.

Contributions to the Pension Funds (euro million)



Actuarial differences on the balance sheet with amortisation in the future (euro million)

	2005	2006
Initial Balance	**513**	**672**
Changes of the year	159	- 203
Final Balance	**672**	**469**
of which:		
Inside the corridor	194	213
Outside the corridor	478	256

Total post retirement liabilities are fully covered, either through the value of pension fund assets, or through the balance sheet.

Coverage of post-retirement liabilities (euro million)

	Dec 05	Dec 06
Liabilities for post-retirement benefits	**1,944**	**2,001**
Coverage	**1,943**	**2,138**
Value of plan assets at the end of the period	1,816	2,029
Value on balance sheet	127	109
Coverage	**100%**	**107%**
Impact of the change in actuarial assumptions on the liabilities	213	0

Other administrative costs benefited from the consistent implementation of streamlining measures, in particular the merger of BIC and Crediflash into BES. However, other factors contributed to the increase in this cost line: the corporate identity change, which took place in the first quarter of 2006, advertisement expenses associated to sponsorship of the Portuguese national football team in the World Cup 2006 and promotional campaigns of mortgages, credit cards and service accounts. All these resulted in an overall increase of 5.2%.

Depreciation and amortisation decreased by 14.1%, reflecting the restructuring process effects, namely in the information systems area.

f. Productivity and Efficiency

The Group's productivity and efficiency ratios continued to improve: operating costs as a percent of average net assets decreased from 1.88% in 2005 to 1.72% in 2006 while total assets per employee grew by 14.9%.

Productivity and Efficiency Indicators

	2005	2006	Change
Cost to Income (including markets)	56.0%	52.3%	-3.7p.p.
Cost to Income (excluding markets)	66.5%	61.9%	-4.6p.p.
Operating Costs/Average Net Assets	1.88%	1.72%	-0.16p.p.
Total Assets* per Employee (thousand euros)	9 444	10 855	14.9%

(*) Net Asset + Asset Management + Other off-balance Sheet Liabilities + Securitised Loans.

The cost to income also improved significantly, dropping from 56.0% to 52.3%; excluding capital market results, the efficiency improvement is even more expressive, reaching 4.6 percentage points reduction in the cost to income.

g. Provisioning

As in previous years, and in line with current national and international macroeconomic conditions, the Group continued to adopt a prudent policy of risk coverage via provisions.

Credit provisions were thus reinforced by euro 181.6 million, while provisions for securities were increased by euro 6.9 million. An extraordinary provision of euro 10.8 million was charged for the costs of the integration/merger of Crediflash into Banco Espírito Santo (BES), while in 2005 an extraordinary provision of euro 57.6 million had been charged for costs arising from the merger of Banco Internacional de Crédito (BIC) into BES.

Provision Charges (euro million)

	2005	2006
For Loans to Customers	219.9	181.6
For Securities	30.2	6.9
For other Risks and Charges*	70.5	53.4
TOTAL	**320.6**	**241.9**

(*) includes provisions for credit institutions, assets held to maturity, assets with repurchase agreement, tangible and intangible assets, tax contingencies and garantees and other assets.

The credit provisioning policy, combined with fine-tuned risk assessment tools, extensive use of scoring models and ratings and credit recovery processes, led to a significant improvement in credit quality indicators.

7.1.5 Profitability

The 2006 net income of euro 420.7 million resulted in a Return on Equity (ROE) of 14.7% and Return on Assets (ROA) of 0.81%, both ratios having improved when compared to 2005.

Results and Profitability (%)

	2005	2006	Change p.p.
Rate of Financial Assets	4.46	5.07	0.61
- Rate of Financial Liabilities	2.66	3.24	0.58
= Global Margin	**1.80**	**1.83**	**0.03**
+ Fees and Commissions	1.35	1.35	0.00
+ Capital Market Results	0.59	0.58	-0.01
= Gross Return on Financial Assets	**3.74**	**3.76**	**0.02**
- Operating Costs	2.09	1.96	-0.13
= Net Return on Financial Assets	**1.64**	**1.79**	**0.15**
- Net Provisions	0.78	0.53	-0.25
- Minority Interests and Tax	0.18	0.33	0.15
= Return on Financial Assets	**0.68**	**0.93**	**0.25**
x Weighting of Financial Assets	0.90	0.88	-0.02
= RETURN ON ASSETS (ROA)	**0.61**	**0.81**	**0.20**
x Placements Multiplier	22.16	18.01	-4.15
= RETURN ON EQUITY (ROE)	**13.54**	**14.66**	**1.12**

The improvement in profitability levels is underpinned by strong commercial growth allied to selective risk management.

Summing up the main points in the year under review, BES Group was able to:

- improve profitability levels;
- reinforce significantly its financial strength and asset quality;
- continue to increase productivity and efficiency levels;
- strengthen its competitive position in the main business lines, with the estimated average market share rising to 19.0%, from 18.0% in 2005.

7.2 Financial Analysis of Banco Espírito Santo

Previous note on the merger by incorporation of Crediflash into BES

In line with the decision of BES' Board of Directors, the legal merger of Crediflash, BES Group's credit and debit cards unit, into Banco Espírito Santo was executed on May 30th, 2006.

This operation was part of the ongoing streamlining process, and will permit to achieve recurrent cost savings as well as to promote revenue synergies, while following two main objectives: to better serve the clients and to increase the competitiveness of the Banco Espírito Santo Group.

Finally, the comparison of economic indicators between periods is influenced by the merger of BIC into BES occurred at the end of 2005.

7.2.1 Main activity highlights and business indicators *

	SIMBOL.	2004	2005	2006
BALANCE (euro million)				
Total Assets(1)	TA	43,370	59,643	68,773
Net Assets	NA	33,179	44,643	50,537
Interest Earning Assets (average)	$\overline{IEA}$	26,487	29,787	38,147
Capital and Reserves (average)	$\overline{KP}$	1,821	1,821	2,753
INCOME STATEMENT (euro million)				
Net Interest Income	NII	399	413	627
+ Fees and Commissions	FC	343	328	395
= Commercial Banking Income	CBI	742	741	1,022
+ Capital Market Results	CMR	271	260	177
= Banking Income	BI	1,013	1,001	1,199
- Operating Costs	OC	554	547	663
- Provisions and Taxes	PROV	254	264	278
= Net Income	NI	204	190	258
PROFITABILITY (%)				
Net Interest Margin	NII / $\overline{IEA}$	1.51	1.39	1.64
+ Return on Fees and Commissions	FC / $\overline{IEA}$	1.29	1.10	1.03
+ Return on Capital Market Results	CMR / $\overline{IEA}$	1.02	0.87	0.46
= Business Margin	BI / $\overline{IEA}$	3.82	3.36	3.14
- Weighting of Operating Costs	OC / $\overline{IEA}$	2.09	1.84	1.74
- Provisions and Taxes	PROV / $\overline{IEA}$	0.96	0.89	0.73
= Return on Financial Assets	NI / $\overline{IEA}$	0.77	0.64	0.68
x Weight on Financial Assets	$\overline{IEA}$/ $\overline{AL}$	0.86	0.87	0.86
= Return on Assets (ROA)	NI / $\overline{AL}$	0.66	0.56	0.58
x Placements Multiplier	$\overline{NA}$ / $\overline{KP}$	16.96	18.73	16.12
= Return on Equity (ROE)	NI / $\overline{KP}$	11.20	10.44	9.35

(1) Net Asset + Asset Management + Securitised Credit.
* 2005 and 2006 Balance-Sheet items already reflect Bic Merger that took place on 30/12/ 2005 and CREDIFLASH Merger in 30/05/2006; 2004 items are under NCA.

7.2.2 Activity

In line with the strategic framework in place over the last few years, the Group reported a strong commercial performance with major structural changes in 2006.

Activity Highlights (euro million)

	Dec 05	Dec 06	Chg (%)
Total Assets (1)	**59,643**	**68,773**	**15.3**
Net Assets	**44,643**	**50,537**	**13.2**
Loans to Customers (including securitised)	**29,570**	**33,089**	**11.9**
Other Loan to Individuals	13,106	14,650	11.8
- Mortgage	11,694	12,629	8.0
- Loans to Individuals	1,412	2,021	43.1
Corporate Lending	16,464	18,439	12.0
Customer Funds			
+ Deposits (2)	20,469	22,730	11.0
+ Debt Securities placed with Clients	3,799	3,572	-6.0
= On-Balance Sheet Customer Funds	**24,268**	**26,302**	**8.4**
+ Off Balance-Sheet Funds	11,167	12,651	13.3
= Total Customer Funds	**35,435**	**38,953**	**9.9**

(1) Net Assets + Asset Management + Securitised Credit + Other Off Balance Sheet Liabilities.
(2) Includes "Customer funds and other loans" and Deposit Certificates.

Credit continued to increase at a good pace, rising by 11.9%, including securitised loans. On-balance sheet customer funds rose by 8.4%, being outperformed by off-balance sheet customer funds, which were up by 13.3%.

Corporate loans grew by nearly euro 2 billion, corresponding to a year-on-year increase of 12.0%. In 2006 BES performed its fifth mortgage backed securitisation operation, in the amount of euro 1.4 billion, and the first securitisation of credit to small and medium sized national companies (SME), in the amount of euro 863 million.

With mortgage loans accounting for 38% of the loan portfolio, corporate credit remains the most representative component overall, with almost 56% of loan book, reflecting BES' strong and long-standing foothold in the Portuguese corporate fabric.

Asset Quality Indicators (euro million)

	Dec 05	Dec 06	Change	
			Abs.	Rel. (%)
Loans to Customers (gross)	25,737	27,504	1,767	6.9%
Overdue Loans	412	402	- 11	-2.5%
Overdue Loans > 90 days	378	360	- 19	-4.9%
Overdue and Doubtful Loans (B.Portugal)(a)	520	456	- 64	-12.4%
Provisions for Credit	736	755	19	2.5%
Overdue Loans/Loans to Customers	1.6%	1.5%	-0.1 p.p.	
Overdue Loans > 90 days/Loans to customers	1.5%	1.3%	-0.2 p.p.	
Overdue and Doubtful(a)/Loans to Customers (gross)	2.0%	1.7%	-0.3 p.p.	
Provisions for Credit/Overdue Loans	178.6%	187.9%	9 p.p.	
Provisons for Credit/Overdue loans>90 days	194.6%	209.8%	15 p.p.	
Coverage of Credit and Doubtful Loans	141.5%	165.6%	24 p.p.	

(a) According to Circular Letter nº 99/03/2003 of the Bank of Portugal.

The quality of BES' credit portfolio is underpinned by the systematic fine-tuning of risk management and the ability consistently shown by all participants in the process of risk assessment.

The ratio of overdue loans over 90 days (1.3% in December 2006 versus 1.5% in December 2005) and the corresponding provision coverage (210% in December 2006 versus 195% in December 2005) reflect the quality of the credit portfolio. Total overdue loans decreased by euro 11 million, while the corresponding provision charge was euro 19 million.

To optimise credit recovery, BES executed two sales of overdue mortgage credit during the year: (i) one, in May, in the amount of euro 21.3 million (associated credit falling due of euro 46.6 million) and (ii) another one in December, in the amount of euro 14.8 million (associated credit not yet due of euro 58.7 million).
Inherent impairment of these loans amounted to euro 43.0 million, the referred sales having no material impact on the year's results.

7.2.3 Results and Productivity

Regarding income generation, the Bank's performance in 2006 was characterised by growth in net interest income (+ 51.9%) and in fees and commissions (+20.4%). Despite the performance of capital markets and other results, and of operating costs, net income reached euro 257.5 million, corresponding to a year-on-year increase of 35.4%.

Income Statement (euro million)

	2005	2006	Abs.	Rel. (%)
Net Interest Income	**412.9**	**627.2**	**214.3**	**51.9**
+ Fees and Commissions	327.9	394.8	66.9	20.4
+ Capital Market Results and Other	260.4	176.6	-83.8	-32.2
= Banking Income	**1,001.2**	**1,198.6**	**197.4**	**19.7**
- Operating Costs	547.4	663.0	115.6	21.1
= Gross Results	**453.8**	**535.6**	**81.8**	**18.0**
- Net Provisions	236.2	199.4	-36.8	-15.6
Credit	133.1	136.2	3.1	2.3
Securities	33.8	6.5	-27.3	....
Other	69.3	56.7	-12.6	-18.2
= Profit before Tax	**217.6**	**336.2**	**118.6**	**54.5**
- Tax	27.4	78.7	51.3	187.2
Net Income	**190.2**	**257.5**	**67.3**	**35.4**

An extraordinary provision of euro 10.8 million was charged in 2006 for the merger of Crediflash. In 2005 another extraordinary provision had been charged, amounting to euro 57.6 million, to cover the costs arising from the merger of BIC into BES.

The increase in operating costs mainly reflects the merger of BIC and Crediflash. Without these effects, operating costs show an increase of 2.5%, with a very positive impact on productivity and efficiency indicators.

Productivity and Efficiency Indicators

	2005	2005 adjusted(1)	2006	Change adjusted
Cost to Income (including markets)	54.7%	56.8%	55.3%	-1.5 p.p.
Cost to Income (excluding markets)	73.9%	70.6%	64.9%	-5.7 p.p.
Total Assets (2) per Employee (thousand euros)	11 ,732	9,827	11,284	14.8%

(1) Amounts adjusted by the impacts of the mergers of BIC and Crediflash.
(2) Net Assets + Asset Management + Securitised Credit.

7.2.4 Proposed distribution of BES net income

Under the terms of Article 376 (section b) of the Companies Code, and in compliance with Article 30 of the Bank's articles of association, the Board of Directors proposes that the following distribution of the year's net income be submitted at the General Shareholders' Meeting:

Proposed distribution of net Income (euros)

For legal reserve	26,000,000.00
For distribution to shareholders	200,000,000.00
For other reserves	31,451,170.53
Net Income	**257,451,170.53**

The proposed dividend on 2006 net income corresponds to a gross value per share of euro 0.40, payable to all existing shares at the end of the year.

7.3 Financial Analysis of the Main Business Units

7.3.1 Banking

Banco Espírito Santo de Investimento, S.A.

Head Office: Rua Alexandre Herculano, 38, 1269 -161 Lisbon - Portugal; **Share Capital:** euro 70 million; **BES Group holding:** 100%

BES Investimento had a very good performance in 2006, with banking income growing by 30.5% from 2005, to euro 164.1 million, of which 40% was generated by the international business. Net income reached euro 60.0 million, corresponding to a year-on-year increase of 20.0%. This good result translated into a return on equity (ROE) of 29%, while the Cost to Income was 45.2%, down by 5 p.p. on 2005.

All business areas in general made very good progress, with an increasing number of transactions being performed in the international markets. The quality of BES Investimento's activity also deserved high international recognition, as shown by several prizes and awards won in 2006:
• "Renewable Deal of the Year 2006" by Project Finance International for financing the renewable energy portfolio of Enersis;
• "Transportation Deal of the Year 2006" by Project Finance International, for financing the M6 motorway transaction in the UK;
• "Best Investment Bank in Portugal – Real Estate Investment Banking", by Euromoney; and
• "Best recommendation for Iberian Companies" by AQ Research.

Consolidated figures (euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	3,634,889	4,589,762	26.3%
Capital and Reserves	175,622	183,815	4.7%
Customer Loans (gross)	981,092	1,406,360	43.3%
Client Deposits	1,414,201	1,341,983	-5.1%
Banking Income	125,798	164,139	30.5%
Net Income	50,019	60,014	20.0%

Banco Espírito Santo dos Açores, S.A.

Head Office: Rua Hintze Ribeiro, 2–8, 9500 - 049 Ponta Delgada - Portugal; **Share Capital:** euro 17.5 million; **BES Group holding:** 57.53%

In 2006 BES dos Açores' shareholding structure was reinforced: Santa Casa da Misericordia do Nordeste is a new shareholder.
During the year the bank pursued its policy of involvement in the local community. Among other initiatives, it entered a protocol with the Association of Azorean Immigrants (included in the New Residents project), also supporting and participating in the 1st National Forum of Immigrant Representative Structures, at Ponta Delgada.

In the emigration area BES Azores signed a protocol with Caixa Económica dos Portugueses de Montreal and with Portuguese Canadian Credit Union, as a way to promote closer ties with the emigrants from the Azores.

At the commercial level, growth was fostered by various initiatives taken during the year. Customer deposits increased by 19.6%. Customer loans were up by 14.5%, with residential mortgage credit rising by an impressive 22.4%. The cost to income also registered a marked improvement, dropping by 6.3 p.p. to 46.7%. BES Azores reported net assets of euro 388.5 million in 2006, and net income of euro 4.0 million, corresponding to year-on-year increases of respectively 25.6% and 7.0%.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	309,223	388,546	25.6%
Capital and Reserves	26,058	27,453	5.4%
Customer Loans (gross)	248,056	283,971	14.5%
Client Deposits	203,517	243,369	19.6%
Banking Income	11,909	12,617	5.9%
Net Income	3,754	4,015	7.0%

BANCO ESPIRITO SANTO
Espanha

Banco Espírito Santo, S.A. (Spain)

Head Office: Serrano, 88, 28006 Madrid - Spain; **Share Capital:** euro 86.6 million; **BES Group holding:** 100%

2006 marks the launch of the Iberia Project in Banco Espírito Santo. With a timeframe corresponding to the 2006-2010 period, this represents a major bet in our neighbour country. The aim is to implement a growth strategy supported by greater efficiency and competitiveness, and the high quality standards that characterise the services provided to our clients in Spain and Portugal.

The growth strategy will be deployed from an Iberian-wide perspective and focused on three key segments for the bank: private banking, affluent banking and corporate banking. In addition, and in order to capture synergies, it was decided to convert Banco Espírito Santo (Spain) into a branch of BES.

Customer deposits reached euro 1,490 million. Customer loans, at euro 2,066 million, show a year-on-year increase of 42.0 %. Corporate banking business volume was euro 1,913 million, while business volume in the affluent and private banking segments totalled euro 4,219 million.

Consolidated figures (euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	2,490,757	3,757,208	50.8%
Capital and Reserves	86,600	86,600	0.0%
Customer Loans (gross)	1,455,381	2,066,463	42.0%
Client Deposits	1,344,619	1,489,900	10.8%
Banking Income	49,831	59,710	19.8%
Net Income	1,443	8,623	....

BANCO ESPIRITO SANTO
ANGOLA

Banco Espírito Santo Angola, S.A.R.L.

Head Office: Rua Guilherme Pereira Inglês n.º 43 – 1º, CP 6459 Luanda – Angola; **Share Capital:** $US 10 million (euro 7,593 thousand); **BES Group holding:** 79.96%

In 2006 Banco Espírito Santo Angola (BESA) operated in a climate of greater stability at macroeconomic level, while competition increased sharply due to the entrance of new banks in the Angolan market. Falling inflation was followed by a steep reduction in interest rates, leading to a narrowing down of margins.

In its fourth year of activity, BES Angola expanded its geographical coverage in the country, now deployed in seventeen branches across six provinces. The bank's new head office, inaugurated this year, has the necessary conditions to accommodate the fast growth shown by BES Angola since its incorporation. The bank has consistently posted the best profitability and efficiency ratios in the Angolan market.

While providing a universal service, BES Angola has been particularly focused on addressing the needs of companies wishing to invest in Angola, providing advice on the local market and financing investment. The service provided to individual clients was improved and new products launched during the year.

Net income was strongly affected by the depreciation of the USD against the euro, totalling euro 34.0 million. Customer deposits reached euro 505.2 million, up by 56.7% from 2005, while customer loans totalled euro 233 million. BES Angola posted a cost to income of 37.8% in 2006 and shareholders' equity of euro 67.8 million (versus euro 39.5 million in December 2005).

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	390,806	604,097	54.6%
Capital and Reserves	2,931	33,825	....
Customer Loans (gross)	96,680	229,952	137.8%
Client Deposits	322,484	505,233	56.7%
Banking Income	56,307	58,932	4.7%
Net Income	34,561	34,011	-1.6%

Espírito Santo Bank

Head Office: 1395 Brickell Avenue, Miami, Florida 133131, USA; **Share Capital:** $US 16,973 thousand (euro 12,296 thousand); **BES Group holding:** 98.45%

Espírito Santo Bank continued to implement its strategic plan along the following lines: to increase net interest income through credit growth in specific segments; to expand income from products and services offered to private banking clients, in close cooperation with the broker/dealer; and to diversify the funding and deposits base.

The loan portfolio remained focused on the lower risk segments, posting significant growth, underpinned by increases in mortgage loans to individual clients, commercial real estate loans, and by Export Credit Agencies related business.

Espírito Santo Bank posted a loss in 2006, strongly influenced by non-recurrent costs, namely costs with the implementation of Basel II and Sarbanes Oxley projects, losses on the sale of securities and costs with the head office building.

The broker/dealer Espírito Santo Financial Services posted income growth of 80%, mainly supported by growth in securities custody services.

Assets under management of individual clients registered an increase of 5% in the year.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	363,861	330,994	-9.0%
Capital and Reserves	30,302	26,262	-13.3%
Customer Loans (gross)	229,986	258,237	12.3%
Client Deposits	238,696	228,943	-4.1%
Banking Income	13,015	11,206	-13.9%
Net Income	0	-1	.....

Banco Espírito Santo do Oriente, S.A.

Head Office: Av. Dr. Mário Soares, n.º 323, Edifício Banco da China, 28tº A e E-F, Macao, China; **Share Capital:** MOP 200 million (euro 18,961 thousand); **BES Group holding:** 99.75%

Southeast Asia continued to show must faster economic growth than either the United States or the European Union. Against this favourable background BES Oriente reinforced its position in the local and regional markets. The bank has as strategic objective to support BES Group's customers in their business activity in the region, and to promote business synergies between financial and non-financial areas of the Group. BES Oriente also seeks to leverage opportunities arising from the intention voiced by the People's Republic of China central government in using Macao as a platform for economic cooperation between China and Portuguese speaking countries.

The Macao Special Administrative Region (MSAR) is expected to post GDP growth in 2006 close to 15%, driven by tourism and gambling/entertainment industries strong development, the major infrastructure projects promoted in the territory, and also the exceptional terms of agreements negotiated with China's central government (namely the Closer Economic Partnership Agreements (CEPA) and individual visas) and several Chinese provinces. MSAR's development has also been underpinned by strong demand for commercial and residential property, maintaining growth rates in the construction industry at an exceptional level.

BES Oriente grew steadily in 2006, with total assets rising by 21.9% year-on-year, despite the pataca's 12% devaluation against the euro. Net profit reached euro 1,575 million, with customer loans and customer funds posting significant increases of respectively 33.1% and 10.1%

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	78,386	95,516	21.9%
Capital and Reserves	26,831	26,508	-1.2%
Customer Loans (gross)	36,441	48,492	33.1%
Client Deposits	10,079	11,094	10.1%
Banking Income	4,488	3,573	-20.4%
Net Income	2,731	1,575	-42.3%

Banque Espírito Santo et de la Vénétie, S.A.

Head Office: 45, Avenue Georges Mandel, 75116 Paris, France; **Share Capital:** euro 52,154 thousand; **BES Group holding:** 40.00%

Banco Espírito Santo et de la Vénétie's business growth in 2006 allowed it to considerably develop its activity of financing real estate operations, mainly short and medium term, while maintaining its traditional activity in corporate banking, leverage finance operations, and banking services to the Portuguese resident community in France.

While increasing its commercial activities, BES Vénétie also reinforced its funding base, particularly in the medium term.

Banking income grew by 16.2%, to euro 32.7 million. Earnings before taxes and profit distribution to the employees was euro 15 million, rising by 39.2% year-on-year, while net income for the year was euro 8.2 million. The cost to income ratio dropped to 47.1%, from 50.9% in 2005.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	1,247,066	1,216,063	-2.5%
Capital and Reserves	66,901	75,058	12.2%
Customer Loans (gross)	857,199	931,102	8.6%
Client Deposits	154,709	165,127	6.7%
Banking Income	28,114	32,661	16.2%
Net Income	10,869	8,208	-24.5%
Cost to Income	50.9%	47.1%	-3.8 pp

BEST – Banco Electrónico de Serviço Total, S.A.

Head Office: Rua Alexandre Herculano, 38, 1250 - 011 Lisbon - Portugal; **Share Capital:** euro 63 million; **BES Group holding:** 66.00%

In 2006 Banco BEST substantially reinforced its offer of asset management products, with a special emphasis on the investment funds area and equity trading. The customer base grew by 12% year-on-year, reaching nearly 45,000 customers, while assets under management rose by 42%, surpassing euro 782 million at the end of 2006.

The number of investment funds available for subscription more than doubled in 2006, to 1019 funds from 29 investment firms, allowing an effective coverage of all possible investment strategies. New funds included the first private equity fund with daily liquidity sold in Portugal to individual investors, and the first Commodities Special Investment Fund (SIF), also with daily liquidity. Thus total customer assets invested in funds increased by 52% year-on- year, allowing BEST to reach in 2006 and for the first time since the beginning of its activity, the first place in terms of foreign investment funds market share, according to the CMVM (Portuguese Securities Market Commission).

In securities trading, the bank increased its offer by launching Real Estate Investment Trusts (REITs) and Exchange Traded Funds (ETFs), allowing Clients a greater diversification in investment alternatives. REITs, a novelty in Portugal, allow investing directly in real estate assets from all over the world, without depending on the financial market's performance, while the ETF offer is the largest and more comprehensive in its kind in Portugal. The Margin Account, another innovation at national level, allows individual clients with a dynamic investment profile to leverage their investment in mutual funds and listed shares by resorting to credit with the more attractive spread in the market.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	256,894	323,617	26.0%
Capital and Reserves	27,246	23,227	-14.8%
Client Deposits	182,130	246,806	35.5%
Banking Income	5,677	10,771	89.7%
Net Income	-6,174	-1,574	....
Asset under Management (Private Individuals)	551,025	782,150	41.9%

7.3.2 Asset Management

Espírito Santo Activos Financeiros, SGPS, S.A.

Head Office: Av. Álvares Cabral, 41, 1250 - 015 Lisbon - Portugal; **Share Capital:** euro 11.75 million; **BES Group holding:** 85.00%

Espírito Santo Activos Financeiros, SGPS (ESAF), BES Group's holding company for the asset management business, operates in Portugal, Spain and Luxembourg.

Assets under management surpassed euro 19.6 billion in 2006, a year-on-year rise of nearly 24%. This performance was driven by an attractive product offer strategy, the launch of three new investment funds, eighteen closed-end real estate funds as well as new management mandates in CDOs (collateralized debt obligations) contracted to its subsidiary ESAF- Espírito Santo Gestão de Patrimónios.

In Luxembourg, assets under management increased by more than euro 100 million through the launch of two new investment funds, the ABS Opportunity Fund and the Caravela Global Compass.

In Spain, assets under management were in excess of euro 2.1 billion at year-end 2006, a year-on-year increase of 15%. Growth in the discretionary business reached 19%, while the investment funds activity rose by 12%.

Net income for the year grew by 12%, as a result of the increase in assets under management and a broader product offer.

Consolidated figures (euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	75,422	85,200	13.0%
Capital and Reserves	25,787	34,523	33.9%
Banking Income	38,537	45,129	17.1%
Net Income	20,326	22,911	12.7%
Assets under Management (euro million)	15,865	19,647	23.8%

7.3.3 Insurance

BES Vida- Companhia de Seguros, S.A.

Head Office: Avenida da Liberdade, 230, 1250 – 142 Lisbon - Portugal; **Share Capital:** euro 250 million; **BES Group holding:** 50.00%

On June 27th, 2006 BES Group and Crédit Agricole reinforced their partnership, each acquiring 50% of Tranquilidade-Vida, with Crédit Agricole assuming management control. On this date the company changed its name to BES Vida, Companhia de Seguros, S.A.. BES Vida's performance reflects the strategic guidelines established for the company, namely to consolidate its position as the leading provider of pensions. Total production was euro 1.3 billion, corresponding to a year-on-year increase of 15.8%. In Retirement Savings Plans, the company maintained its leadership position for the tenth consecutive year, with total production rising by 8.7%, to euro 515.7 million. Traditional products increased to euro 54 million (+9.6%), corresponding to a market share of 7.1% (6.8% in 2005), while capitalisation products production reached euro 721.4 million (+22.1%), raising the market share to 12.3% (8.6% in 2005). Mathematical provisions grew by euro 694.8 million, or 12.5%, totalling euro 6.2 billion at year-end. BES Vida posted net income for the year of euro 115.0 million, representing a year-on-year increase of 236.8%. Excluding extraordinary effects on results, namely the disposal of the broker channel, for euro 50 million, and the capital gains on the sale of BES securities (euro 42 million), as provided under the partnership agreement, net income would be euro 42.3 million, rising by 23.7% on 2005. Although maintaining a strict cost control policy, operating costs increased due to non-recurrent expenses, such as required to change the company's headquarters and corporate image, and those incurred in the sale of the broker channel. Equity increased by euro 52 million, to euro 329 million at the end of 2006, reinforcing BES Vida financial strength, with solvency margin coverage rising from 157% in 2005 to 173% in 2006.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	6,421,547	6,842,137	6.5%
Capital and Reserves	277,082	329,285	18.8%
Gross Premia Value	573,206	586,900	2.4%
Indemnities	611,085	653,620	7.0%
Operanting Costs	15,798	24,487	55.0%
Net Income	34,157	115,048	236.8%

BES - Companhia de Seguros, S.A.

Head Office: Avenida Columbano Bordalo Pinheiro, 75 - 11º, 1070 - 061 Lisbon - Portugal;
Share Capital: euro 15 million; **BES Group holding:** 25.00%

Within the scope of reinforcing the partnership between Espírito Santo Financial Group and Crédit Agrícole in bancassurance in Portugal, on June 27th, 2006 Espírito Santo, Companhia de Seguros, SA (Espírito Santo Seguros) changed its name to BES, Companhia de Seguros, SA (BES Seguros). On the same date, Crédit Agrícole raised its stake in the Company to 50%, assuming management control. The other 50% are held by BES and Companhia de Seguros Tranquilidade in equal stakes.

Apart from these changes, BES Seguros continued to develop its bancassurance activity in 2006, selling non-life insurance products to the individual banking customers segment. With total production reaching 49,460 contracts, the company had a portfolio of 337,000 outstanding contracts at the end of 2006.

Gross premium volume growth was weak, mirroring the overall trend in non-life insurance market. Still, control over operating costs and a sound technical result allowed BES Seguros to post net income in excess of euro 4.5 million, which represents 7.4% of the gross premium volume, and corresponds to a 5.8% year-on-year increase. At 94.3%, the combined ratio, net of reinsurance, remained at an excellent level, and even improved when compared to 2005 (94.7%). Shareholder's equity rose by 8.6%, to euro 24 million.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	79,103	88,908	12.4%
Capital and Reserves	22,037	23,928	8.6%
Gross Premia Value	61,798	62,188	0.6%
Costs of Claims *	41,782	41,636	-0.3%
Net Operating Costs	11,378	11,953	5.1%
Net Income	4,324	4,576	5.8%

(*) Net of reinsurance, including claim management costs.

Europ Assistance - Companhia Portuguesa de Seguros de Assistência, S.A.

Head Office: Avenida Álvares Cabral, 41 – 3º, 1250 - 015 Lisbon - Portugal;
Share Capital: euro 5 million; **BES Group holding:** 23.00%

In 2006 Europ Assistance had another year of excellent growth, maintaining its market share in the assistance insurance industry close to 30%.

Total gross premiums issued increased by 14.6% year-on-year, to euro 25.5 million. This performance is even more remarkable as it was achieved against adverse market conditions – the Portuguese economy continues to post marginal growth rates, and competition in the assistance insurance sector is increasingly aggressive. Net premium volume grew by 13.1%, reaching euro 23.2 million. In commercial terms, the year was marked by the acquisition of a number of important clients, while maintaining the existing customer base. These results translate the Company's efforts to foster customer loyalty and to develop products and solutions aligned to perceived market needs.

In 2006 there was a particularly sharp increase in the accident record, further stressing the trend of previous years. This was not only due to the fact that insurance assistance is an increasingly widespread concept but also due to the particularly adverse weather conditions witnessed throughout the year: very high temperatures in the summer and heavy rain in autumn. Approximately 460,000 new cases were filed during the year and roughly 1.35 million calls were taken. Cost-cutting was a clear management priority, focusing on both accident costs and fixed structural costs. Europ Assistance closed the year with net income of euro 1,082 thousand.

On the international front, Europ Assistance's Brazilian subsidiary again posted significant results; its subsidiary in Argentina turned out a profit for the second year in a run, and the Chilean subsidiary, in its first year in activity, naturally registered a small loss.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	23,892	29,164	22.1%
Capital and Reserves	8,199	8,996	9.7%
Gross Premia Value	22,220	25,468	14.6%
Net Income	1,060	1,082	2.1%

7.3.4 Specialised Credit

Besleasing e Factoring - Instituição Financeira de Crédito, S.A.

Head Office: Av. Álvares Cabral, 27 – 1º, 1269 -140 Lisbon - Portugal; **Share Capital:** euro 49,114 thousand; **BES Group holding:** 89.36%

In a year of domestic leasing and factoring industry expansion, Besleasing e Factoring outperformed the market, supported by BES Group's commercial banking network. The company also performed better than in 2005, maintaining the second place in the Portuguese market with a market share in leasing and factoring of 18.7% in leasing and 22.2% in factoring. Equipment leasing production increased by 17.0%, to euro 538 million, while real estate leasing production rose by 29.0%, reaching euro 403.5 million. In the factoring and confirming businesses, production volume was euro 3.5 billion (+12.4%), representing credit under management of euro 1.3 billion (+19.9%). Total production reached euro 4.6 billion, a year-on-year increase of 14.6%.

Underpinned by sharp production growth, the credit portfolio grew by euro 456 million, or 17.0%. Net income totalled euro 13.2 million, to which also contributed the good performance of the lease/factor product (+3.7%). A cost cutting policy permitted to keep the increase in operating costs below the inflation rate, at 0.6%. As a result, the cost to income improved, reaching 31.0%. The company maintained a strict loan granting policy, with the ratio of overdue loans to total loans remaining practically flat, at 1.36%.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	2,746,957	3,244,268	18.1%
Capital and Reserves	69,689	72,784	4.4%
Customer Loans (gross)	2,684,381	3,140,359	17.0%
Product Lease / Factor	42,213	43,763	3.7%
Net Income	12,962	13,244	2.2%
Property Leasing			
New Contracts (no.)	630	647	2.7%
Amount	403,473	520,603	29.0%
Equipment Leasing			
New Contracts (no.)	8,384	7,824	-6.7%
Amount	459,799	537,866	17.0%
FACTORING			
Portfolio of Receivables (gross)	3,110,246	3,494,409	12.4%
Portfolio under Management	1,111,561	1,332,865	19.9%

Locarent – Companhia Portuguesa de Aluguer de Viaturas, S.A.

Head Office: Lagoas Park Edifício 11 – 3º Piso, 2740 - 244 Porto Salvo - Portugal; **Share Capital:** euro 5,250 thousand; **BES Group holding:** 45.00%

A cycle of dynamic business growth was pursued in 2006, placing the company as one of the major players in the market.

Locarent currently employs 52 people, distributed by two broad geographical areas. The company has approximately 10,000 vehicles under management (euro 235 million in terms of acquisition cost), distributed by some 4,000 clients.

In a particularly adverse year, marked by falling car sales, these figures translate the good relationship established with the banking distribution network, allowing for increased penetration of the renting business in the segments of both corporate and individual clients.

The policy guidelines established for the reporting year allowed to reduce losses further. The company posted profits in the months of November and December and should reach break-even in 2007, thus anticipating the target established in its business plan.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	134,933	216,036	60.1%
Capital and Reserves	5,354	5,354	0.0%
Customer Loans (gross)	117,840	196,899	67.1%
Net Income	-2,381	-940	....

7.3.5 Others

ES Tech Ventures – SGPS, S.A.

Head Office: Avenida da Liberdade, 195, 1250 – 142 Lisbon - Portugal; **Share Capital:** euro 750 million; **BES Group holding:** 100%

During the year 2006, ES Ventures made significant progress in both the number and the quality of investment projects analysed, creating a Venture Capital Fund II, open to qualified investors outside of BES Group. The fund aims to reinforce investment in firms at their early-stage in the technology area or with an innovative business concept. The fund aims to raise a total of euro 100 million, euro 55 million having already been subscribed. The total amount invested by the fund was euro 15.9 million at December 2006, having acquired stakes in the following firms: (i) YDreams S.A., a Portuguese firm that develops technological solutions in the communication, education, entertainment and environment areas; (ii) Global Active, SA, a firm specialised in the management of forest systems, agriculture, environmental management and energy systems optimization; (iii) Inovamais S.A., a Portuguese firm that is part of the largest European private network of innovation services; (iv) Coreworks S.A. and Chipidea S.A., two firms developing integrated circuits projects for retail products and (v) Nanosolar Inc and Ultracell Inc, technology firms in the US that develop and sell, respectively, solutions for photovoltaic cells area and fuel batteries.

A final note on the 2006 performance of pmelink.pt: the first online business centre in Portugal for small and medium-sized companies, promoted under a joint-venture between BES, CGD and PT Groups, that surpassed euro 20 million in purchases made through the portal, corresponding to a year-on-year increase of 25%. Total turnover in the year surpassed euro 13.7 million, rising by 21% over 2005.

ES Tech Ventures also has equity holdings in some of the Group's international ventures concerns, namely in BES Vénétie and Bradespar.

(euro thousand)

Variables and indicators	2005	2006	Change
Net Assets	210,410	149,630	-28.9%
Capital and Reserves	50,579	33,544	-33.7%
Equity Holding Portfolio	177,344	124,203	-30.0%
Net Income	-515	17,783	....

8.0 Final Note

The form and content of this report follows applicable regulatory requirements, with their preparation being the exclusive responsibility of the Board of Directors of Banco Espírito Santo S.A.

The Board of Directors wishes to express its recognition for the trust shown by Clients, Employees, Shareholders and Supervision Authorities in BES and in the Group's financial institutions: the trust of our Clients was crucial for the Group to maintain a significant growth pace in the main business areas; the trust of our Shareholders in BES Group's business project was decisive for achieving the objectives established for the capital increase; the involvement and commitment of our Employees were critical for the performance achieved in 2006 and will be vital for the Group to meet the targets set for the future.

To the governmental and supervision authorities, the Board of Directors also wishes to address a word of recognition for their cooperation and the confidence shown in Banco Espírito Santo Group.

Lisbon, 27 February 2007

The Board of Directors

António Luís Roquette Ricciardi
Ricardo Espírito Santo Silva Salgado
Jean Gaston Pierre Marie Victor Laurent
Mário Mosqueira do Amaral
José Manuel Pinheiro Espírito Santo Silva
António José Baptista do Souto
Jorge Alberto Carvalho Martins
Aníbal da Costa Reis de Oliveira
José Manuel Ferreira Neto
Manuel de Magalhães Villas-Boas
Manuel Fernando Moniz Galvão Espírito Santo Silva
José Maria Espírito Santo Silva Ricciardi
Jean-Luc Louis Marie Guinoiseau
Rui Manuel Duarte Sousa da Silveira
Joaquim Aníbal Brito Freixial de Goes
Pedro José de Sousa Fernandes Homem
Patrick Gérard Daniel Coudène
Mário Martins Adegas
Luís António Burnay Pinto de Carvalho Daun e Lorena
Lázaro de Mello Brandão
Ricardo Abecassis Espírito Santo Silva
Bernard Henri Georges De Witt
José Manuel Ruivo da Pena
Jean Frédéric de Leusse
Amílcar Carlos Ferreira de Morais Pires
Bernard Delas
Miguel António Igrejas Horta e Costa
Nuno Maria Monteiro Godinho de Matos
Alberto Alves de Oliveira Pinto
José Eduardo Moura da Silva Freixa

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BANCO ESPIRITO SANTO

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