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Portugal Telecom Takeover defense



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Takeover

*1917, “an act of taking over” noun derivative of verbal phrase take over (1884), from take (v.) + over.
Attested from 1958 in the corporate sense.*

Online Etymology Dictionary, © 2001 Douglas Harper

“A corporate action where an acquiring company makes a bid for an acquiree. If the target company is publicly traded, the acquiring company will make an offer for the outstanding shares.”

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INTRODUCTION

This Masters Thesis aims to be used in class for teaching purposes. The primary objective of the case is to understand the way critical anti-takeover measures can be used in a hostile takeover environment. The case portrays not only all defensive tools used by PT against Sonaecom (conditioned by the Portuguese Securities Code) but also all major interactions with relevant stakeholders. Communication is positioned as a central tool to stakeholders' interaction. As a consequence of that, students are supposed to comprehend how PT used this instrument to implement its defensive strategy.

This Masters Thesis was written essentially from PT's perspective but it also includes all available Sonaecom's public statements and data. It joins several different points of view (from PT's CEO and top management to PT's employees and labor unions). Therefore, it is not supposed to match exactly to one's perspective of Sonaecom's takeover attempt but instead to be an aggregate view of the case. The main idea is to promote debate in order to create an interactive class environment among session's attendants.

Main areas developed in this Thesis are Mergers and Acquisitions, Corporate Communication and Corporate Governance. The case's recommended questions are in line with these areas. Suggested answers for these questions are balanced with some academic documentation that can be complemented with some in-class notes according to the session's objectives.

Thesis' structure is composed by:

1. **Case Study** – divided into three parts according to Sonaecom's takeover's timeline:

PART 1: the first part of the case starts on 6 February 2006 with Sonaecom's takeover bid announcement and ends on 15 February 2007, after Sonaecom upgraded its initial offer from €9.50 to €10.50 per PT common share;

PART 2: the second part of the case starts on 15 February with Sonaecom's upgrading bid and ends on 2 March 2007, some hours before PT extraordinary shareholders' meeting;

PART 3: the third and last part of the case happens on 2 March 2007 after PT extraordinary shareholders' meeting.

2. **Teaching Notes** – divided into a case's background, assignment questions and suggested answers for assignment questions:

BACKGROUND: an overview of Sonaecom's takeover; it takes stock of PT and Sonaecom's situation at Sonaecom's takeover attempt;

ASSIGNMENT QUESTIONS: 10 questions for learning objectives that cover the case study's main areas;

SUGGESTED ANSWERS FOR ASSIGNMENT QUESTIONS: guidelines for teaching purposes; the assignment questions are broad and therefore they can be deepened in accordance with the academic interest of the class.

CASE STUDY



Portugal Telecom Takeover defense

CASE STUDY – PART 1

Portugal Telecom – Takeover Defense

While preparing a presentation for a major shareholder, Henrique Granadeiro, Portugal Telecom's CEO, received an SMS on his mobile phone. It was late in the evening, and the anti-takeover team were very tired. It was February 15, 2007, and the objective of this second international roadshow, which had started one week before, was to demonstrate to its shareholders that €9.50 per share did not represent a fair value of the telecommunications group.

Henrique Granadeiro was looking through the window of the hotel meeting room in San Diego, USA when he read the message out loud "*Sonaecom upgraded its initial tender offer to €10.50 per share*". The whole team froze... after more than one year working on €9.50 per share everything had changed.

They were running out of time! Only two weeks were left before the Portugal Telecom's shareholders' General Meeting, where everything would be decided. They had to choose quickly whether to accept this new offer or to dive into a new roadshow, where it would be much more difficult to convince shareholders once again that this new price was still understating PT's fair value.

THE BEGINNING

Sonaecom's tender offer

On the evening of 6 February, 2006, Belmiro de Azevedo (Sonae SGPS's CEO¹) and Paulo de Azevedo (Sonaecom's CEO¹) announced their offer to purchase, in cash, all of Portugal Telecom's (PT) common stock at €9.50 per share and all of PT's convertible bonds at €5,000. It was a tender offer to a *Golden Shares*² company representing a 16% premium over PT's previous close (€8.18). At €10.7 billion³ in total equity value, the bid, if successful, would place Sonaecom as the principal Portuguese telecommunications company. This tender offer was, however, conditioned. Tender offer terms are described in **Exhibit 1**. On the one hand Sonae SGPS was only interested in PT if it could guarantee the majority of PT's shares (50.01%). On the other hand, due to the characteristics of PT's statutes, Sonaecom's tender offer would also need authorization from PT's shareholders General Meeting regarding the 10% maximum stake, beyond some amendments to PT's bylaws, namely the abolition of *Golden Shares* privileged rights and the ending of any limit to the casting of votes issued by one single shareholder. An approval of PT's bylaw amendments, at PT's shareholders General Meeting, would require super majority acceptance by all shareholders attending the meeting, as one third of rejections would be sufficient to halt the process.

¹ Sonae SGPS and Sonaecom were both companies from Sonae Group. Sonae SGPS was the holding of Sonae Group while Sonaecom was the Sonae's sub-holding for mobile, fixed communications and multimedia services.

² A-Class shares owned by the Portuguese government with privileged rights; for instance, these shares could be used against the execution of any acts or operations, for the implementation of a reorganization plan at PT.

³ 1,128.8565 million PT common shares x €9.50.

The next day, 7 February, Sonae SGPS announced their offer to purchase, also in cash, all of PTM's⁴ common stock at €9.03. It represented a 6.5% discount on the €9.62 pre-announcement closing price (6 February). Because PT had majority over PTM, under the terms of the Portuguese Securities Code, should PT's offer be successful, Sonae is required to launch a PTM offer.

During that day, after PT raised some questions about operational procedures and financing, Sonae SGPS revised its announcement by changing the offeror from Sonae SGPS to Sonaecom and by assuring that *“Sonaecom has secured the necessary financing for the acquisition of PT's entire share capital with the Santander Group. This financing commitment does not involve any guarantees from Sonae SGPS and is subject to a repayment schedule with a maturity of up to 7 years”*. It also stated that *“if necessary, a share capital increase is envisaged at Sonaecom for a maximum amount of up to €1,500 million”*. At the time, Santander Group was PT's principal bank for large financial operations.

That evening, Paulo de Azevedo presented his vision for PT, according to the four main strategic objectives for Sonae Group:

1. *“Strong shareholder leadership”*, in order to face the strategic crossroad and hard operational challenges;
2. *“Strong competition in every market segment”*, which meant that Sonaecom was available to accept regulatory restrictions regarding the selling of one of PT's access networks (copper or cable);
3. *“Clear international partnerships”*, because they had to add value from a technological and operational point of view;
4. *“Strengthening the competitiveness of PT in an increasingly global sector”* by refocusing the international growth strategy in the mobile sector towards controlling stakes in companies, ensuring effective economies of scale and competitive advantage to the combined group.

According to Paulo Azevedo, PT's internationalization re-focus and the merger of both mobile subsidiaries (Sonaecom's Optimus and PT's TMN) were a critical issues in this proposal, as they would be responsible for major synergies that would justify paying the tender offer premium. However some doubts remained unclear:

1. Some remedies from the Portuguese Competition Authority (PCA) were likely to appear in order to guarantee competition. For instance, a separation of copper or cable infrastructure might be a potential remedy, as the media pointed out, however, Sonaecom did not clarify what PT's disposable access network would be;
2. In addition, none of PT's international presence was aligned with Sonaecom's strategy and PT's stake in VIVO⁵ was not a strategic asset, and its results did not have a positive impact on PT, consuming almost all domestic cash flows from its largest subsidiaries, namely TMN, PT Comunicações and PTM. From Sonaecom's point of view, only stakes as big as 50.01% made sense if a company wishes to have future growth.

Portugal Telecom's first response

Following Sonaecom's press conference, PT's CEO at the time, Miguel Horta e Costa, communicated top management's position regarding the tender offer:

“The Board of Directors is of the opinion that the current and future value of PT is considerably higher than the offer price, and will inform the company's shareholders of its formal response once a formal offer document has been posted. In the meantime, shareholders are strongly advised to wait for the Board's recommendations, to be issued in due course.”

It was also mentioned that *“according to the Board of Directors' judgment this tender offer does not define a strategy or a long term vision for the PT Group, and it also contains a very high degree of uncertainty”*. According to Nuno Machado, head of PT's corporate finance unit:

“There are three main questions to answer in a context like this one:

- *Is the tender offer credible? Yes,*
- *Is the tender offer sustainable from the financing point of view? After Sonaecom's elucidation, yes,*
- *Does the tender offer create value for PT's shareholders? Definitely not!”*

⁴ PT Multimédia or PTM was PT's listed cable subsidiary; PT held 58.4% of PTM's common share.

⁵ PT's major international subsidiary; it was a 50% PT/Telefónica joint venture mobile company in Brazil.

After its tender offer announcement Sonaecom found itself in the media spotlight. During these first two weeks the media opted to only publish news about the offeror. According to some opinion leaders, this was not only the largest takeover in Portugal's history, but also a demonstration of the Portuguese economy's vitality. Under these circumstances, PT decided to maintain a low profile with the media and decided not to make any media communications. The current institutional campaign, which started in January 2006 had ended, and during the entire tender offer period all campaigns were restricted to product campaigns only. Nevertheless, during the tender offer period, the media would need feeding with much more information, and PT would have its opportunity to be heard. So, after the first weeks' dust had settled, PT's CEO started to state publicly that *"This tender offer is hostile, as it was not requested by PT's Board of Directors, and €9.50 does not represent a fair value of the PT Group"*. These arguments remained unchanged during the whole tender offer process.

Sonaecom's tender offer registration

On 27 February 2006, Sonaecom delivered the requests for registration of both public tender offers to the Portuguese Securities Market Regulator (CMVM) and launched the first prospectus draft related to the public tender offer for PT, justifying their intentions and plans for Sonaecom/PT. In that prospectus, Sonaecom first started to state that PT's offer was above comparable companies. In addition, Sonaecom expected that the offers would only commence after the 2005 dividend distribution. Taking into account the expected 2005 dividend (€0.385 dividend per PT share and €0.275 dividend per PTM share), together with the proposed offer (€9.50), the premium received by PT shareholders would increase from 16.1% to approximately 20.8% over PT's previous close. Later, Sonaecom outlined the purpose and plans of its offer for PT.

According to Sonaecom, the purpose of the offer was to purchase a number of outstanding shares that represented at least 50.01% of PT's outstanding share capital. In the event that Sonaecom acquired more than 90% of the outstanding voting rights of the share capital of the target company, Sonaecom reserved the right to use the compulsory acquisition legal mechanism⁶. If the offers were successful, Sonaecom intended to make changes to PT's Board of Directors, with the objective of ensuring that at least half of the Directors were designated by Sonaecom.

The offer set out to develop the strategic objectives previously presented on 7 February, taking into account Sonaecom's concerns regarding:

- **Corporate governance:** Sonaecom ensured that Sonaecom/PT would adopt the best corporate governance practices according to international standards, assuring the rigorous quality and transparency of the financial information provided to shareholders, thus contributing to the strict equality of treatment of all shareholders;
- **Conducting businesses after the offers:** no major changes to PT's businesses and operations were expected immediately after the offer. The Sonaecom/PT business merge would only take place after gathering additional information about PT and after reevaluating PT's businesses, operations, capitalization and management;
- **Human resources policy:** Sonaecom intended to maintain and develop its policy of continuous investment to develop a "Team of Excellence". It aimed to strengthen its value proposition to employees, seeking in the process to become an attractive and prestigious employer, one which employees could feel proud of.

The final statement was a commitment to fulfill all responsibilities arising from PT's pension fund.

⁶ Portuguese Securities Code - Title III *Public offers*, Chapter I *Common provisions*, Section III *Acquisition for the purpose of total control*, Article 194 *Compulsory takeover*:

"Any person that, following the launch of a general takeover bid over an offeree which is a publicly traded company subject to Portuguese law as its personal law, achieves or exceeds, directly or in the terms of no. 1 of article 20, 90% of the voting rights corresponding to the share capital up to the determination of the outcome of the bid and 90% of the voting rights covered by the bid may, in the subsequent three months, acquire the remaining shares for a fair consideration, in cash, calculated in the terms of article 188."

PORTUGUESE TELECOMMUNICATIONS BACKGROUND

The history

Portuguese telecommunications began in 1882 through a public concession to the Edison Gower Bell Telephone Company of Europe to manage the fixed telephone service in the two major Portuguese cities (Lisbon and Oporto). This was transferred five years later to the Anglo Portuguese Telephone Company (APT). The criticality of this sector, combined with great demand, led to a fast deployment all over the country, starting with the Lisbon-Oporto connection, in 1904. This deployment outside APT's area was provided by a public concession - Direcção-Geral dos Correios e Telégrafos, later CTT. As international connections were very expensive for CTT, it was decided, as had occurred previously with APT, to concede international telecommunications management to another privately held company, Marconi's Wireless Telegraph Company Limited, in 1912. This company, which only started its activity one decade later, as Companhia Portuguesa de Rádio Marconi (CPRM) had the international telecommunications monopoly for the Portuguese mainland, islands and colonies. So, in the beginning of the 20th century, there were two private monopolies in the most attractive markets (APT and CPRM) and one public monopoly in the least attractive market (CTT). This configuration remained unchanged until the 60s.

However, in 1968, Portugal did not renew the APT concession and its entire assets, namely its telecommunications' infrastructure in Lisbon and Oporto, were transferred to a new state held company called Empresa Pública de Telefones de Lisboa e Porto (TLP). During the latter part of APT's concession period, almost no investment was made in the telecommunications network and to wait one year for a telephone line was normal. In 1991, Teledifusora de Portugal (TDP) was created in order to implement a national broadcast infrastructure. Nevertheless, the main reforms in the Portuguese telecommunications sector started in the mid 90s when in 1994, a single national telecommunications operator, the Portuguese incumbent for telecommunications, entitled Portugal Telecom SA, was created merging at that time all state held telecommunications companies:

- TLP – set up in Lisbon and Porto to manage the telephone service concession in Lisbon and Oporto;
- CPRM – set up for the management of radio-telegraphy and wireless telephone;
- CTT – set up to manage the postal service and the telephone service in the rest of the country;
- TDP – set up to manage broadcasting infrastructures.

Between 1 June, 1995 and 4 December, 2000, a set of five privatization phases were established, ending with Portugal Telecom's share capital owned primarily by private shareholders. On 12 December, 2000, Portugal Telecom SA changed its denomination to Portugal Telecom SGPS, and became the holding company of the telecommunications group. On 31 December, 2005, the Portuguese state owned, directly or indirectly, only 6.93% of total common shares and all of PT's 500 *Golden Shares*.

Due to PT's monopolistic control over the national copper fixed access network, an essential infrastructure that was not replicable, it was critical to ensure that it had some regulatory obligations, due to its significant market power. In order to monitor and to control the sector, in 1989, a National Regulator Authority, the Communications Institute of Portugal (Instituto das Comunicações de Portugal) (ICP) was created with three main objectives (1) to act as a government advisory body, (2) market regulation and (3) radio-electric spectrum technical management. In 2002, ICP changed its name to National Communications Authority (Autoridade Nacional de Comunicações) (ICP-ANACOM). **Exhibit 2** presents a summary of the Portuguese telecommunications market by business segment.

FIXED COPPER OPERATORS

On 1 January, 2000, the Portuguese fixed telecommunications' sector (copper) was liberalized or, in other words, different operators were allowed to provide retail telecommunications services supported on the incumbent access network. PT's wholesale offers allowed fixed operators to access end users and to interconnect with PT's network at regulated prices. Since then, a large number of new fixed operators have entered the market, supported by the wholesale incumbent offering. At that point in time, operators' retail offers were essentially voice services, as well as narrow band internet access (through dial-up connections). However, in 2002, with Local Loop Unbundling⁷ (LLU) and ADSL wholesale access⁸ (ADSL) offers, the first broadband internet

⁷ A regulatory requirement that enables a competing service provider to purchase parts of the incumbent local exchange carrier's network in order to provide service to its customers. This offer allows operators to offer both voice and broadband internet access services.

⁸ A wholesale service that offers broadband internet access from the incumbent's network to the operator's network. It holds more value for the incumbent than ULL since the incumbent provides more broadband service components as well as benefiting from voice service fees.

access services started to emerge. This allowed fixed operators to start to differentiate retail offers and incumbents' market shares started to decrease. At that time, voice and broadband internet access, supported by DSL technologies⁹, were the core services for these operators. Nevertheless, due to network externalities, the telecommunications business requires scale (or critical mass). This scale is critical not only to reduce the average cost per user but to also decrease interconnection costs between operators. Consequently, the market started to concentrate. As a consequence of this, at the end of 2005, the two main players in this market, PT and Sonaecom, held 93.5% market share of broadband internet access over copper.

FIXED CABLE OPERATORS

A television service was launched in Portugal in 1957, based on analogical broadcasting like in all other Europe countries. Cable TV only appeared in Portugal in 1994. At that point, international experience showed that cable providers were typically regional, operating and developing their networks in specific geographic places, facing no competition (geographical monopolies). PT's cable operator started its Pay-TV activity in Portuguese major cities. Later on, it expanded its Pay-TV services to all over the country based either on its own cable infrastructure or satellite solutions. As cable infrastructure is excellent to deliver simultaneously more services than just TV with small marginal costs, cable operators in other countries started to offer broadband internet access services. PT's broadband internet access over cable offer began in 1999. At the end of 2005, the two main players in this market were PT and Cabovisão, holding 96.5% market share of broadband internet access over cable.

MOBILE OPERATORS

The first mobile operator in Portugal started its activity in 1989, held by CTT and TLP. Later, this operator, based on analogical technology (first mobile generation) was transferred to PT Group and renamed TMN. In 1991, ICP-ANACOM launched a public tender for the issuing of a license to operate using digital technology (second mobile generation– GSM 900 MHz). Telecel was successful and TMN was automatically assigned a GSM license (12.600 customers by year end). In 1992, both operators started their activity using GSM technology. In 1997, ICP-ANACOM launched another public tender for the issuing of a license to operate using digital technology (second mobile generation– GSM 1.800 MHz), where Optimus was successful and TMN and Telecel were automatically assigned to the GSM 1800 MHz frequencies. At the end of 1997 there were already 1.5 million subscribers. Optimus only started its activity in August, 1998. In 2000, ICP-ANACOM launched another public tender for the issuing of four national licenses to operate third mobile generation (IMT2000/UMTS). At the end of 2000 there were 6.7 million subscribers. However, after the newcomer, OniWay, gave-up its deployment of third mobile generation, only the three initial operators remained in the market (end of 2005):

1. TMN, Portugal Telecom's mobile operator (in activity since 1989) – Market leader with 46.4% market share;
2. Vodafone Portugal, Vodafone UK's mobile operator, which bought Telecel's license and network (in activity since 1992) – Second player with 33.0% market share;
3. Optimus, Sonaecom's mobile operator (in activity since 1998) – Third player with 20.6% market share.

Portugal Telecom

GROUP STRUCTURE

PT was a listed company, both on Euronext Lisbon and on the New York Stock Exchange. At the tender offer announcement, February, 2006, PT's major shareholders were Telefónica (Spanish incumbent for telecommunications), Portuguese banks (Caixa Geral de Depósitos Group or CGD, a state held company, and Espírito Santo Group or BES, a listed company) and investment firms, all of them with a long-term perspective for their investment portfolios. According to its vision and mission, the company was engaged in offering a comprehensive range of telecommunications and multimedia services in Portugal and other countries, covering all segments of the telecommunications sector: fixed, mobile, multimedia, data and corporate solutions. These telecommunications and multimedia services were available in Portugal, Brazil, several ex-Portuguese African colonies, and in growing international markets. PT's international presence spread to countries like Morocco, Guinea Bissau, Cape Verde, Mozambique, Timor, Angola, Kenya, China, São Tomé and Príncipe and Namibia.

⁹ DSL technologies allow fixed operators to provide both voice and broadband internet access services simultaneously over copper local loops.

PT's main telecommunications subsidiaries were:

- Domestic market:
 - Wireline (fixed copper communications): PT Comunicações, PT Prime and PT.COM;
 - Mobile (mobile communications): TMN;
 - Multimedia (fixed cable communications and multimedia services): PT Multimédia.
- International market:
 - Brazil (mobile operator): VIVO;
 - Others: fixed and mobile communications all over the world (Meditel, Unitel, MTC, CTM and others).

PT Comunicações (PTC) was PT's subsidiary for domestic fixed-line services, under the provisions of the Concession Agreement entered into with the Portuguese State, 20 March, 1995, for an initial period of thirty years, subject to renewal for subsequent periods of fifteen years. 11 December, 2002, according to the terms of the Modifying Agreement to the Concession Contract, PTC acquired from the Portuguese state the Basic Network of Telecommunications and Telex ("Basic Network"). PT Prime was responsible for corporate clients' solutions, and was also an Internet Service Provider (ISP) for large clients. ISP services for residential clients were provided through PT.COM, which also offered services relating to the design concept, design execution and managing of advertising and news space on internet portals.

PT Multimédia (or PTM) was the Group's sub-holding for multimedia operations, offering cable and satellite television on mainland Portugal, Madeira and Azores. PTM also provided other multimedia services in Portugal, namely the editing and selling of DVDs and movies through Lusomundo Audiovisuais and the distribution and exhibition of movies through Lusomundo Cinemas. In addition, PTM was also responsible for services related to the publishing of large circulation newspapers and the edition of radio programs, through Lusomundo Media, a subsidiary which was abolished during 2005. PTM went public on Euronext Lisbon in November 1999. PT Group managed PTM by holding 180.6 million of PTM's shares.

TMN was PT's subsidiary for domestic mobile services, under a GSM license granted by the Portuguese state in 1992 (for a period of 15 years) and a UMTS license obtained 19 December, 2000 (for a period of 15 years).

Internationally, VIVO was PT's main asset. Created from an equal stake joint-venture in 2002, by PT and Telefónica (Spanish incumbent for telecommunications), VIVO provided mobile telecommunications services in Brazil, benefiting from the merge of each group's mobile operations. Other international PT subsidiaries were in Africa and Asia, but with little impact on PT's consolidation accounts. In these subsidiaries, PT had different strategies for its stake of ownership. It controlled some of them while it only had minority stakes in others.

FINANCIAL HIGHLIGHTS

Since 2000, PT has been committed to a strong international strategy. This internationalization and dimension brought some risk to the top line but it was also responsible for diversification advantages¹⁰.

In 2001, PT started to increase its debt and to gradually restructure its capital structure. As a consequence of this augment in debt, coverage ratios were negatively affected, which motivated a negative revision of PT's ratings (Standard & Poor's or S&P from A+ to A and Moody's from A2 to A3).

In 2002, PT suffered a reduction of 3.5% in its operational incomes, due to Real/Euro depreciation and to an increase in domestic market competition. Meanwhile, a restructuring of PT's support activities, namely the launch of PT PRO, was responsible for a 5% increase in EBITDA margin, reducing PT's total negative effect. During 2002, PT's debt was restructured and reduced, which substantially improved PT's liquidity allowing it to maintain debt evaluations.

In 2003, PT recovered from the negative growth of 2002, continuing to reduce its debt and improving its liquidity, maintaining its ratings unaffected (S&P rating remained A while Moody's rating remained A3).

¹⁰ According to Bloomberg PT's equity levered beta was 1.18 at Sonaecom's tender offer announcement.

In 2004, PT turned over its negative net results by growing 119% from 2003, which allowed the company to launch a program to increase the shareholders' remuneration package by increasing dividends and share buybacks. However, some changes in the company's financial leverage reduced PT's S&P rating to A-.

In 2005, PT had a consolidated operational revenue growth of 7%, due to VIVO's contribution, which more than compensated domestic losses. Net debt saw an extraordinary increase as a result of a €300 million contribution to PT employees' health services plan combined with the expected increase in the shareholders' remuneration package. However, this debt increase did not affect the company's S&P rating level. **Exhibit 3** presents PT's financials.

PT also had some relevant obligations regarding post retirement benefits. At the end of 2005, the projected benefit obligations of PT's post retirement benefits including pensions, healthcare obligations and salaries to pre-retired and suspended employees amounted to €5,152 million (€3,274 million for pensions, €913 million for healthcare benefits, and €965 million for salaries to pre-retired and suspended employees). The projected benefit obligations were computed based on a discount rate of 4.5% for pensions and healthcare obligations, and 3.5% for obligations related to the payment of salaries to pre-retired and suspended employees. PT's post retirement benefit plans have been closed to new participants since 2000 (for healthcare) and 1994 (for pensions), covering approximately 33,200 employees (27% still in service) in the case of pensions and approximately 28,700 employees (30% still in service) in the case of healthcare obligations:

- Pension obligations: according to the Portuguese Insurance Regulator (PIR) rules, the pension plans for retired employees have to be fully funded. PT's pension obligations for retired employees, computed based on PIR rules, were fully funded. Regarding the funding of pension funds for pre-retired employees and employees still in service, this could be completed until retirement age. The estimated average working life of employees still in service was 15 years;
- Healthcare benefits and salaries to pre-retired and suspended employees: in Portugal there was no legislation covering the establishment of funds to cover post-retirement healthcare benefits and salaries to pre-retired and suspended employees. Therefore, PT had only to pay for these benefits when the healthcare services were actually rendered to pensioners and a corresponding claim charged to PT, and when salaries were paid by PT to pre-retired and suspended employees. Notwithstanding, PT created a shadow fund in March 2005 to cover healthcare benefits with an initial extraordinary contribution of €300 million.

Sonaecom

Created in 1994, Sonaecom went public on Euronext Lisbon in June, 2000. Sonaecom's major shareholder was Sonae SGPS (50.01%) followed by France Telecom (19.19%). Sonae Group was the largest Portuguese conglomerate group while France Telecom was one of the world's leading telecommunications players.

France Telecom (French incumbent for telecommunications) was the second-largest wireless operator and Internet access provider in Europe, and a world leader in telecommunications solutions for multinational corporations. At the end of 2005, France Telecom had more than 126 million customers on the five continents (220 countries and territories) and a total of net revenues of €49.04 billion and net income of €5.71 billion (year 2005). According to Sonaecom, France Telecom was considered a strategic partnership not only by its relevant international presence, which is critical in the telecommunications industry, but also by potential operating agreements due to its high level of knowledge and experience in the sector.

Sonae Group was a Portugal-based conglomerate accounting a total of net revenues of 7.17 billion and net income of €0.65 billion (year 2005). Sonae SGPS, the holding company that controlled and managed Sonae's portfolio of businesses, covered activities from industry, finance and retailing to telecommunications. At the tender offer announcement, February, 2006, Sonae SGPS held a portfolio of businesses grouped into four sub-holdings:

- Modelo-Continente, also known as Sonae Distribuição (food and non-food retail);
- Sonae Sierra (ownership, management and development of shopping and leisure centers);
- Sonaecom (fixed and mobile telecommunications, software consultancy, newspaper);
- Sonae Capital (tourism, construction, transportation and venture capital).

Sonae Distribuição and Sonae Sierra were two examples of leadership in their operating markets.

Sonaecom, the Sonae's sub-holding for the areas of telecommunications, media and software and systems integration, had an active role in the integrated management of the corresponding business units, identifying and exploiting existing synergies and company growth potential. Sonaecom was already one of the largest Portuguese telecommunications company (since 2000), basing its strategy on a proprietary national telecommunications infrastructure, in order to ensure network reliability, quality and minimize traffic management costs. Sonaecom's telecommunications subsidiaries were:

- Optimus, Sonaecom's mobile operator, launched in 1998;
- Clix, Sonaecom's ISP, acquired in 1999 as IP global and;
- Novis, Sonaecom's fixed operator, launched in 2000.

Sonaecom only achieved its first positive cash flow in 2003. Also in that year, from convergent efforts between Clix and Novis, for the first time Sonaecom launched voice and broadband services simultaneously and Sonaecom acquired KPNQwest Portugal, a reference operator in the corporate market. **Exhibit 4** presents Sonaecom's financials.

THE STORY

PT's first roadshow

Even with all of PT's efforts and multiple institutional campaigns, on the date of the tender offer announcement, PT's corporate image was still suffering from its negative past. After PT's initial merge, and as preparation for the sector's liberalization that was expected for 2000, in 1998, PT launched its new logo together with several institutional campaigns. However, in 1999, PT's corporate image for the Portuguese people and media was not at its best. It all started with a major demonstration against PT, in front of its headquarters, due to voice activation charges that were restored almost five years later, after a Supreme Court decision. In addition, after the sector's liberalization, operator attacks also worsened PT's brand by undermining, in several ways, PT's monopolistic position.

According to PT's view, corporate communication was an essential management tool that would be used as a strategic pillar in the tender offer battle field for value creation purpose. So, PT's communication strategy would focus mainly on major investors (through investor relations), minor investors (through media relations), the Portuguese government and regulators. While major investors would be targeted by one-to-one or focused roadshows, minor and disperse shareholders would be managed through official prospectuses, opinion makers and opinion leaders. The style of PT's communications for both the Portuguese government and regulators would be closed and assiduous. However, according to PT, a successful communication strategy had to take into account all stakeholders and to address them with the same message, using slightly different arguments. So, from the beginning, a set of potential discussion issues were defined and developed in order to be used in the future. According to the events' timeline, these issues could be triggered or not. To implement this strategy PT would focus on:

- **Centralizing** all internal and external communications in order to control the information flow from the company to the outside world;
- **Monitoring** all news and relevant data by reading and analyzing everything, looking for contradictions and flaws;
- **Having a consistent speech** with each stakeholder. These speeches could and should be different as long as they are consistent and address each stakeholder's problems or incentives.

According to PT's point of view, the media was seen as an environment builder that might be used to laterally influence all shareholders.

“Besides stock markets, the public's opinion is critical as an external environment builder. As shareholders are people that live in society, they are also affected by the environment. At the end of the day, each small conquest may be decisive. That's why we put so much effort into changing the public's opinion about PT during this process.”

At the beginning of March, exactly one month after the tender offer, and according to the Portuguese Securities Code (**Exhibit 5** presents the official takeover process) for the first time PT told the public why shareholders should not accept Sonaecom's offer:

- The offer premium and multiples were significantly less than precedent comparable transactions (**Exhibit 6** presents premiums and multiples of similar transactions);
- Assuming PT's share price four weeks prior to the tender offer announcement, when France Telecom's profit warning caused share prices of Europe's publicly traded telecommunications companies to fall sharply, Sonaecom's premium only represented a modest 5%;
- PT would shift to a high financial leverage situation (€16.3 billion including PT's net debt) supported almost only by PT, as Sonaecom would only undertake a rights issue of up to €1.5 billion;
- The offer's success was conditional on regulatory approval of unprecedented industry concentration.

According to PT, the main strategic pillars as to why shareholders should remain with PT were:

- PT had been a substantial contributor to the development of Portuguese society;
- PT had a strong track record of operational and financial performance, corroborated by PT's international assets;
- PT had delivered an attractive shareholder value so far and had a plan to deliver even more through a sharp focus on value delivery.

Therefore, PT's top management committed to an operating plan based on:

“(i) enhancing the performance of PT's operations in the evolving domestic competitive landscape, including initiatives such as aggressively rolling out triple-play VoIP offers and offering differentiated broadband services; (ii) segregating fixed line access, which potentially represents the first step towards monetization and regulatory relief; (iii) seeking to promote a model of shared utilization of mobile networks, which would facilitate the further penetration of 3G services and rapid deployment of mobile TV capabilities; (iv) continuing PT's existing partnerships and seeking to manage PT's international assets in a proactive and pragmatic manner in selected markets where PT has a clear competitive advantage; (v) continuing PT's focus on the operational enhancement of VIVO; and (vi) seeking to concentrate and crystallize the value of selected assets in Africa.”

In addition, PT's Board of Directors also outlined some operational targets:

“PT's plan should result in considerable value creation for shareholders, and is expected to produce €150 million in annual cost savings through streamlining operations and other efficiencies, and €100 million in annual savings from capex and working capital optimization to be progressively implemented until 2008. As a result, PT expects to generate 3.0 to 5.0% EBITDA growth and €5.0 to 5.5 billion in operating cash flow over the next 3 years (at current exchange rates).”

According to PT, these targets, combined with capital structure optimization and maintenance of the investment grade rating, would translate into a commitment of total shareholder remuneration in excess of €3.0 billion between 2006 and 2008, equivalent to approximately €2.66 per share, taking the form of an ordinary dividend per share of €0.475 for 2005 and an extraordinary return of capital via share buybacks, dividends or a combination of both.

The day after, 7 March, PT promoted a mega event meeting all its managers in order to raise moral and “gather the troops” for the difficult time that was approaching. 13 March, 2006, top management started its first PT investor roadshow based on these ideas.

PT's general shareholders' meeting

PT's annual ordinary general meeting was scheduled for 21 April, 2006. The agenda did not account for any amendments to PT's bylaws or any discussion point regarding Sonaecom's tender offer. Changes in PT's bylaws were postponed to an extraordinary shareholders' meeting. However, the approval of remuneration to shareholders and corporate bodies for the three year period 2006/2008 was a point on the agenda. As a result of this meeting, the ordinary dividend of €0.475 PT share for 2005 was approved and Henrique Granadeiro was appointed as PT's new Chairman, but he also took the position of PT's CEO. This was Henrique Granadeiro's requirement, due to the environment created by Sonaecom's tender offer. From Henrique Granadeiro's point of view, hostile takeovers are like wars and therefore an army can only be lead by one general. According to PT, Chairman and CEO remained different positions yet, temporarily they would be held by the same person. (**Exhibit 7** presents PT pre and pos general

meeting corporate governance model). In addition, a share buyback program up to a limit equivalent to ten percent of PT's share capital was also approved.

After finishing his management degree, in 1968, Henrique Granadeiro started to work for the Portuguese government with a set of relevant positions in his professional history. Private sector experience only came up in 1981 with a set of executive and non-executive board positions in several areas: industry, financial institutions and media. His knowledge of media people and the media's specific ways of working was definitely a competitive advantage that could be leveraged in the information and counter-information war. A change in PT's CEO was approved by the public's opinion (as new blood) and it also demonstrated that PT was really committed to achieving its pre-announced targets:

- Cost reductions: during Henrique Granadeiro's first days as CEO, he cut costs by cutting several benefits for top management, employees' health plans, as well as starting to negotiate reductions in benefits in order to assure PT's pension fund sustainability;
- Revenues increasing: Henrique Granadeiro knew that managing PT under a tender offer context would be very challenging as employees' focus and reducing uncertainty would be critical to achieving pre-announced targets. Thus, besides several internal marketing campaigns with pins, SMS, emails and conferences, his first message to PT's employees was *"there's more to life beyond Sonaecom's tender offer"*.

It was clear that hard times were to be expected. In addition, Portuguese law did not allow much flexibility for standard defensive strategies (**Exhibit 8** presents Portuguese Securities Code takeover restrictions for target companies). Therefore, in order to prepare for the tender offer battle, a specific crisis team was constructed to delineate innovative defensive strategies and to deal with investors and the media. This team, led by Henrique Granadeiro (National affairs) and Zeinal Bava (International affairs), was composed of three sub teams: the Financial Team (CFO and Corporate Finance Office), the Legal team (Competition Authority Office and internal lawyers) and the Communication Team (Investor and Media Relations). This team would be in touch daily during the entire process, meeting in a formal or informal way every time any relevant event might occur.

Nevertheless, external consultants also played a central role helping and supporting PT's crisis team¹¹. Typically during these times there are always fights between parties to hold the best allies. First move initiative and exclusivity contracts are the most effective ways to succeed. In addition, external consultant's costs are, on average, significantly high in these types of operations. Therefore, the financial strength, the future potential gains and the external influence of each party are also relevant factors to select the most interesting external consultants to each party.

Rival takeover bid announcement and the PT/PTM spin-off

2 June, 2006, "The Times" announced a rival takeover bid for PT:

"A Consortium of venture capital firms is preparing a €14 billion bid for Portugal's biggest phone group in a further private equity assault on the telecoms market, "The Times" has learnt. It is understood that six firms — Cinven, Permira, Providence, Blackstone, Texas Pacific and KKR — are close to tabling an offer for Portugal Telecom that could be just weeks away. Carlyle, another private equity house that had shown interest in the telecoms group, is understood to have opted to remain "on the fringes" of the consortium. A bid for the former state monopoly, which has nearly 50 million customers, would pitch the consortium against Sonaecom, a Portuguese conglomerate. (...) This private equity consortium is expected to bid substantially higher than Sonaecom's offer of €9.50 a share in order to have any chance of success."

Miguel Paes do Amaral was the person appointed by the media as the man behind this consortium. Paes do Amaral was the main businessman in the Portuguese media industry, owner of several relevant assets including TVI, a privately held television company group in Portugal. However, no comments were made by him or by PT. In the capital markets, the information conveyed by "The Times" had a strong impact, with PT shares appreciating 3.55% to €9.62.

¹¹ PT Group's external consultants were:

- Strategy and Operations advisors: McKinsey and Booz Allen;
- PT's M&A and Financial advisors: Citigroup, Merrill Lynch, Goldman Sachs, BESI (BES Investment Bank) and Financial Dynamics (public relations for financial area);
- PTM's M&A and Financial advisors: Morgan Stanley and UBS;
- Legal advisors: Garrigues Leónidas Matos and Vieira de Almeida (Portugal) and Simpson Thacher Bartlett (U.S.).

Sonaecom Group's M&A and Financial advisors were Santander and JP Morgan.

On 3 August, PT's Board of Directors announced its intention to spin off its interest in its subsidiary PTM, by way of a dividend in kind. In this spin-off, PT shareholders were expected to receive 4 PTM shares for each 25 PT shares owned, which at PTM's closing price 2 August, 2006, would have been equivalent to €1.47 per PT share. In addition, PT increased shareholders' remuneration package for the 2006-2008 period from €3.0 billion to €3.5 billion. Therefore, a maximum total of €5.3 billion value transfer to PT's shareholders was expected (already including the €536 million dividend paid in May 2006, after PT's last shareholders' meeting). In addition, PT's Board of Directors also announced its intention to reduce the expected funding period of post retirement benefits deficit to 6 years through a contribution of €1.0 billion over the 2006-2008 period, upon achieving an improved labor relations framework. This remuneration together with the contribution to fund retirement benefits which was expected to be delivered would keep the investment grade status. However, the implementation of this proposal would be subject to shareholders' approval at an extraordinary shareholders' meeting and would only be executed if Sonaecom's tender offer lapsed or ended. This would be the first anti-takeover measure performed by PT's Board of Directors.

The next day, 4 August, Sonaecom counter-attacked PT's initiative by negotiating the sale of one mobile license in case of takeover success with PCA, as this would enable opening the market to a new mobile operator after the PT/Sonaecom merger. After these announcements remaining doubts began to disappear as the Portuguese economic newspaper, "Semanário Económico", commented:

"No one believes in the possibility of a rival takeover offer from a Sonaecom competitor for PT, even inside PT. If until now Sonaecom management were the only ones to understand this, today even PT surrenders to this evidence. The reason is simple. The government has never welcomed this hypothesis." and "Paulo de Azevedo declined to keep PTM [in a tender offer success scenario]. Sonaecom has been informally asked by the Portuguese government to keep that company and thus abandon the takeover launched on PT."

The communication war

On 12 January, 2007, PT's Board of Directors launched a new prospectus supported by three main messages regarding Sonaecom's offer: (1) it does not offer PT shareholders fair value, (2) it does not offer any control premium and (3) it does not share synergies value.

Regarding synergies, PT underlined that, based on the public information available, Sonaecom's upside value was higher than the understated €2.0 billion of synergies initially indicated, which implied that PT shareholders would not get any synergy value benefit. According to PT, Sonaecom would be a huge beneficiary of an unprecedented market concentration in fixed line accesses, mobile subscriptions and broadband accesses. The takeover of PT would give Sonaecom extensive market dominance, with light remedies, creating valuable synergies.

PT also stressed its outstanding management skills and PT 20063Q operational results in domestic and international markets, as well as some achievements in cost cutting. According to this prospectus, financial discipline continued to be a pillar of PT's operations:

- €32 million of Opex savings in first 9 months, which was on track to achieve the 3-year objective of €150 million annual savings, through redundancies among all companies, rebalancing distribution channels, renegotiation with maintenance suppliers, reduction of distribution costs, monitoring of credit scoring and lower fringe benefits and healthcare costs;
- €140 million of domestic Capex and a change in net working capital savings achieved in the first 9 months through effective just-in-time inventory management, optimization of capital expenditure and renegotiation of suppliers' payment periods.

In addition, continuously decreasing PT's pension deficit would lower gross unfunded obligations and allow for significant cash flow benefits, namely at least €31.5 million per year improvement in free cash flow:

- Wages and salaries: 1.8% increase in 2006 vs. 4-5% historically (€18 million per year);
- Healthcare benefit plan: at least €340 million reduction in pension liability and an additional €70-90 million reduction could be obtained if volumes were reduced by 10% (at least €10 million per year);
- Improved labor framework: 600 redundancies vs. 500 initial estimate (€3.5 million per year).

PT had several slightly disorganized labor unions that were more concerned in competing with each other for new members than actually fighting in favor of PT workers' conditions. Most of them were not professional, composed only of PT workers that spent their spare time in the unions. PT's top management used this weakness, accompanied by the uncertain environment of a potential Sonaecom management, and combined with some internal negative marketing about the offeror, to achieve these reductions.

At this stage, PT reinforced its previous targets based on 2006 EBITDA proposals to investors:

- Fixed: Flat vs. Normalized 2005 EBITDA¹²;
- Mobile: between -3% and -2%;
- PTM: between 5% and 10%.

PT's prospectus ended with the 2006-2008 total shareholders' remuneration package estimated at €5.3 billion:

- Cash remuneration: PT shareholders would receive a total cash return of €3.5 billion (€3.2 per PT share) spread over an annual dividend per share of €0.475 (€1.6 billion for three years¹³) and an extraordinary dividend of €1.75 per PT share (€1.9 billion);
- PTM Spin-off: distribution of PTM shares to PT shareholders, in the ratio of 4 PTM shares per 25 PT shares, which was equivalent to €1.8 billion of value return at the current PTM share price (€1.6 per PT share).

“The proposal implies returning about half of Sonaecom's offer value, equivalent to €4.8 per PT share, to shareholders over the period 2006-2008, including an annual dividend yield of 7.7%¹⁴, while allowing shareholders to retain 100% ownership of the significant value creation opportunity available at PT.”

After PT's reaction, 19 January, Belmiro de Azevedo went on public television to say that there was a speculative bubble around PT's share prices and that he would only be willing to increase his offer if an oil-well or diamonds were found under PT's headquarters. 24 January, Sonaecom counter-attacked with a new prospectus based on the following message: *“Sonaecom offers premium value and cash certainty. Right now, PT offers uncertainty and an inferior value over more than 2 years”*. According to Sonaecom, PT's promise of possibly meeting up to 45% of Sonaecom's offer over 2 years with its standalone strategy was questionable and PT's top management was placing its own interests before shareholder value.

Later on, Sonaecom's prospectus underlined that the 7.7% dividend yield claimed by PT was flawed as it was a short-term focus and full of risk. According to Sonaecom, PT did not explain how it would generate the required net income to sustain its proposed dividend policy when after the PTM spin-off it would no longer contribute earnings or cash and PTC would face competition for the first time.

According to Sonaecom's prospectus PT management was hiding its poor financial performance as PT's best argument was zero improvement on consensus estimates of domestic expected EBITDA (0% growth for 2006, 2007 and 2008) while the truth was that expectations for the PT Group were down considerably (-12% for 2006, -14% for 2007 and -11% for 2008). For Sonaecom, despite PT's claims, it believed that PT had failed to supply the value it had proposed. In addition the increase in PT's expected ordinary dividend represented an additional value for Sonaecom's offer.

¹² Normalized 2005 EBITDA = €1,129 million reported - €190 million non-recurring items (impact of amendments in retirement policy, reversal of Angola provision and other non-recurring provision reversals).

¹³ Already includes the €536 million dividend paid in May 2006.

¹⁴ Sonaecom offer price of €9.50 per PT share minus proposed PTM spin off per share (€1.60) and proposed extraordinary dividends per share (€1.75) equates to €6.15, taking into account the proposed annual ordinary dividend per share for 2006-2008 (€0.475) implies a 7.7% dividend yield.

The main argument for Sonaecom was that even with the decrease in PT's Group performance over the last year and the increase in dividends, Sonaecom was still offering €9.5 per PT share. Sonaecom's prospectus ended with:

“Despite a number of negative factors, Sonaecom's offer remains unchanged at €9.5:

- *Pension liability may be higher*
 - *Value of liability could be €0.9 billion more (after-tax) using alternative assumptions*
- *PT has performed poorly in 2006*
 - *EBITDA down 5.6% 9M06 vs. 9M05*
 - *EBIT down 19.8% 9M06 vs. 9M05*
 - *Net income has improved compared to 9M05 only because of one-off tax items*
- *PT outlook has worsened*
 - *2006-08 consensus EBITDA projections have declined by at least 11% since Sonaecom's offer*
- *PT paid a higher dividend*
 - *Sonaecom offered €9.5 based on PT's then-planned €0.385 dividend*
 - *By paying €0.475 dividend PT shareholders are receiving €0.09 more i.e. €9.59*

Sonaecom's offer was fair before, but with PT's disappointing 2006 performance it is even more attractive today.”

PT's second roadshow

8 February, PT announced its 2006 full year financial results (unaudited). The highlights included a record highest net income ever of €867 million (an increase of 33% yoy) and the announcement of satisfying its proposals: Fixed EBITDA (flat yoy), Mobile EBITDA (-2.2% yoy) and PTM EBITDA (+ 8.1% yoy). According to PT, the increase in net income resulted primarily from:

- Lower income taxes: capital gain in 1Q06 (€53 million), adoption of voluntary taxation on capital gains (€142 million), and recognition of tax credit at VIVO (€134 million);
- Lower curtailment cost: redundancy program encompassed less employees and impact of ending the National Healthcare System protocol.

A strong cash flow performance based on free operational cash flow growth of 22% yoy to €1.6 billion, underpinned by working capital improvement, was also announced as well as a solid debt profile (net debt down €352 million in 4Q06 as a result of free cash flow generated and average cost of debt in 2006, excluding VIVO and PTM swaps, stood at 3.8%).

However, PT showed a decrease of 0.7% in operating revenues, reflecting VIVO's inability to offset domestic fixed and mobile business losses. These losses were explained, in part, by the reduction in mobile interconnection charges. Free cash flow also decreased (25% yoy) but was explained by PT as a 35% growth of free cash flow before net financial investments (net divestments of €365 million in 2005 in Lusomundo, Primesys and UOL IPO vs. net investments of €143 million in 2006, including the €108 million acquisition of MTC in Namibia and €19 million investment in the BES capital increase¹⁵). PTM's EBITDA was the only one with positive growth, despite being linked to the recognition of gains from past services. As a result of the takeover bid and the unusual shareholders' return package, S&P's rating was reduced to BBB- (stable).

As of 31 December, 2006, the projected benefit obligations of PT's post retirement benefits were reduced to €4,563 million (€3,074 million for pensions, €491 million for healthcare benefits, and €998 million for salaries to pre-retired and suspended employees). The projected benefit obligations were computed based on a discount rate of 4.75% for pension and healthcare obligations and 4.25% for salary obligations to pre-retired or suspended employees. The market value of funds amounted to €2,908 million, resulting in a gross unfunded obligation of €1,654 million (compared with 2005 market value of €2,516 million or €2,636 of gross unfunded obligation). The effective performance of the funds in 2006 was 6.8%, which compares with the expected rate

¹⁵ PT had several interests in BES, namely a joint-venture bank – Banco BEST (BES + PT). Therefore, PT opted to invest €19 million in BES due to BES capital increase in 31st May 2006:

“Banco Espírito Santo informs the market that, through the execution of the corresponding notarial deed, it increased yesterday its share capital from 1,500,000,000 Euros to 2,500,000,000 Euros, through the issuance of 200,000,000 new ordinary, registered, book-entry form shares, with nominal value of 5 Euros each, of which 50,000,000 shares were issued through the incorporation of reserves and 150,000,000 through new cash contributions in connection with the Public Offering for Subscription executed with preferential subscription by shareholders.”

of return of 6.0%. Over the last four years, the effective performance had been higher than the expected rate of return, notably 8.1% in 2003, 8.1% in 2004 and 8.4% in 2005.

In the end, the press was positively surprised by PT's financials, as one Portuguese economic newspaper, *Jornal de Negócios*, wrote:

“PT reaches record results with fewer taxes and health costs - Portugal Telecom today announced that net results of 2006 increased 33% to €867 million, the highest ever surpassing analysts' expectations. The payment of €315 million less in taxes and cutting costs with layoffs and the National Healthcare System (€294 million) explain the rise in profits in 2006, a year in which the telecommunications company saw the fall of EBITDA and revenue. Operating revenues in 2006 fell 0.7% to €6.343 billion and EBITDA fell 2.9% to €2.423 billion. Analysts relied on lower revenues (€6.304 billion) and on a lower EBITDA (€2.226 billion).”

After the presentation of the financial results and all press conferences, PT's tender offer's team flew to the US in order to start its second roadshow. Henrique Granadeiro knew that this might be the last opportunity to convince all international relevant shareholders of PT's management proposal.

THE REGULATORY ENVIRONMENT

Since the beginning Sonaecom's tender offer was conditioned by the PCA's authorization due to PT's privileged position and market concentration. This process which began in February 2006 was a stage for much news and tension between PCA, ICP-ANACOM and the Portuguese government. PCA was responsible for the transaction's final approval or rejection. However, PCA's final decision required a market analysis by the sector regulator (ICP-ANACOM). In addition, the Portuguese government, responsible for PCA and ICP-ANACOM, was also a PT's major shareholder (by holding 6.93% of total common shares and all of PT's 500 *Golden Shares*).

In May, PCA agreed not to oppose the PT/Sonaecom merger, as it was not likely to create or strengthen a dominant position, neither would it result in a significant obstacle for effective competition in domestic markets. However, due to PT's and Vodafone's requests, this process was subject to an in-depth investigation. This would take much more time for a PCA resolution and, consequently, more time for PT to schedule their extraordinary shareholders' meeting. At this time, state television announced the following:

“PT's CEO rejected criticism that the company is responsible for the delay in the decision of the Competition Authority on the takeover bid launched by Sonaecom, reaffirming that the postponement of this process actually will cause the operator's management several disadvantages.”

PCA only announced the final result 22 December, when this authority gave its final clearance to the transaction. During this period, PCA and ICP-ANACOM did not agree for several times in the midway decisions, namely in what it related with the merger of TMN and Optimus mobile operators. The Portuguese government, which initially did not oppose Sonaecom's tender offer, withdrew from the process by keeping a low profile with the media and opting not to make media communications about the subject. In the end, domestic and international media were surprised with the PCA's final decision, as stated in the *“Financial Times*¹⁶”:

“The hall of appalling regulatory decisions has a new member. The Portuguese Competition Authority's call to allow incumbent Portugal Telecom to be bid for by its main competitor, Sonaecom, gives a green light to an entity with just over 60 per cent of the mobile and broadband markets. The concessions demanded - virtual mobile operators and the disposal of PT's cable assets - were on offer anyway. The requirement that Sonaecom/PT support a new mobile network competitor is perverse. Shareholders should be delighted at the creation of an inadequately regulated monopolist in a capital-intensive industry with high barriers to entry.”

According to PT, this result was unbelievable stating that *“should PT have made an offer for Sonaecom, it would have been rejected in only 10 days”*. Nevertheless, this decision would require the implementation of a number of remedies, remedies used by Sonaecom to claim a reduction in synergies. **Exhibit 9** presents the Portuguese Competition Authority's final conditions and

¹⁶ “Portugal Telecom / Sonaecom”: Published: October 3 2006 (The Financial Times Limited 2008)

obligations. First synergies announced by Sonaecom were €2.0 billion (2 May, 2006), but then decreased to €1.5 billion (17 October, 2006) ending in €1.3 billion (2 January, 2007). According to Sonaecom, PCA's remedies were more aggressive than expected because:

- Fixed market:
 - To implement the horizontal separation of fixed networks (copper or cable);
 - To separate vertically if Sonaecom kept copper infrastructure (basic access infrastructure and core network).
- Mobile market:
 - To guarantee conditions to support new mobile operators with no infrastructure known as Mobile Virtual Network Operators (MVNO);
 - To divest more spectrum than expected in order to allow the entry of a new Mobile Network Operator (MNO), an operator with its own network.
- Content market:
 - To divest all content assets inside PTM;
 - To end content exclusivities; in order words, it would not be allowed to bundle context assets with sale of one of the fixed networks.

After this decision, all question marks had been removed and everything would be decided in the 2007 PT extraordinary shareholders' meeting. Now it would only be a matter of mathematics to determine what time PT had to convince shareholders of its position.

THE BID UPGRADE

During PT's second roadshow, 15 February, 2007, against Belmiro de Azevedo's and Paulo de Azevedo's previous statements, Sonaecom announced a bid upgrade to €10.50 per PT common share. After approximately a year from announcing the tender offer, this was finally a changing point that might reverse all previous beliefs. According to Sonaecom, this new value per PT share was the "price for peace" since it responded to some criticism of PT's top management and several relevant PT shareholders. **Exhibit 10** presents stock market evolution since Sonaecom's tender offer announcement until the upgrading of the bid.

Henrique Granadeiro and his team had to decide what to do. After being surprised during PT's second roadshow, they had to choose between Sonaecom's €10.5 per PT share or to enhance promised revenue increases and cost cuts. However, both decisions would have significant repercussions, not only on PT, but also on the Portuguese economy.

EXHIBITS

Exhibit 1 – Sonae’s tender offer terms

In accordance with and for the purpose of articles 175 and 176 of the Portuguese Securities Code it is hereby made public the decision of Sonae, SGPS, S.A. to launch a general tender offer for the acquisition of the shares representing the share capital of Portugal Telecom, SGPS, S.A. (hereinafter referred to as the “Offer”), pursuant to the following terms and conditions:

1. The offeror is Sonae, SGPS, S.A., a public company with its head office in Lugar do Espido, Via Norte, 4471-909 Maia, corporate body no. 500.273.170, registered with the Commercial Registry Office of Maia under no. 14.168, with a fully paid-up share capital of 2,000,000,000.00 Euros, and/or Sonacom, SGPS, S.A. and/or one or more companies, with head-offices in Portugal or abroad, under a control or group relation (*relação de domínio ou de grupo*) with Sonae, SGPS, S.A., which the latter may designate (hereinafter referred to as the “Offeror”).
2. The target company is Portugal Telecom, SGPS, S.A., a public company, with its head-office in Avenida Fontes Pereira de Melo, 40, Lisbon, corporate body no. 503.215.058, registered with the Commercial Registry Office of Lisbon under no. 3602/940706, with a fully paid-up share capital of 1,128,856,500.00 Euros (hereinafter referred to as “PT” or the “Target Company”).
3. The Financial Intermediary acting on behalf of the Offeror and providing assistance services in relation to the Offer, in accordance with and for the purpose of article 113, no. 1, paragraph b) of the Portuguese Securities Code is Banco Santander de Negócios Portugal, S.A., with its head office in Avenida Engenheiro Duarte Pacheco, Amoreiras, Tower 1, 6th floor, 1099-024 Lisbon, corporate body no. 502.519.215, registered with the Commercial Registry Office of Lisbon under no. 2011.
4. The securities that are the object of the Offer are the shares representing the share capital of the Target Company (hereinafter referred to as the “Shares”) and the convertible bonds issued by the Target Company pursuant to a resolution adopted on November 29, 2001, with a principal amount of 5,000.00 (five thousand) Euros (hereinafter referred to as “Convertible Bonds”).
5. The Offer is general and voluntary and the Offeror undertakes, in accordance with this preliminary announcement and the announcement of the Offer, to acquire the totality of the Shares and the Convertible Bonds that are the object of acceptance within the Offer.
6. Shares and Convertible Bonds will only be the object of acceptance within the Offer if they are fully paid-up, with all inherent rights attached and free from any encumbrances, charges or liabilities, as well as free from any restrictions or obligations, notably in relation to the corresponding economic and/or politic rights or their transferability. The acceptance of the Offer by addressees that in relation to it are subject to a foreign law is conditioned to compliance with the respective legal requirements.
7. As far as the Offeror is aware, there are no voting rights inherent to the Shares that are attributable to the Offeror in accordance with article 20, no. 1 of the Portuguese Securities Code.
8. The offered consideration shall be an amount of 9.50Euros (nine Euros and fifty cents) for each Share and an amount of 5,000.00 (five thousand) Euros for each Convertible Bond.
9. The launching of the Offer is subject to:
 - a) the granting of previous registration of the Offer with the Portuguese Securities Market Commission (Comissão do Mercado de Valores Mobiliários or “CMVM”);
 - b) the granting of the approvals and administrative authorizations that are required in accordance with Portuguese law or an applicable foreign law, notably a non-opposition decision from the Portuguese Competition Authority, in accordance with Law no. 18/2003, of June 11, 2003;
 - c) a declaration from the CMVM confirming the exemption of the duty to launch a subsequent mandatory tender offer as a result of the acquisition of the Shares and Convertible Bonds within the Offer, in accordance with article 189, no. 1, paragraph a) and no. 2 of the Portuguese Securities Code, even if subject to the maintenance of the respective assumptions.
10. The Offer shall be subject to the fulfillment, up to the term of the Offer period, of the following conditions:
 - a) acquisition by the Offeror, within the Offer, of a number of Shares that added to those held by the Offeror or by companies under a control or group relation (*relação de domínio ou de grupo*) (as well as by other entities that are indicated to be related with the Offeror under any other of the circumstances provided for in article 20, no. 1 of the Portuguese Securities Code, to the extent that the announcement of the Offer contains such a reference) represent, at least, 50,01 per cent. of the share capital of PT;
 - b) authorization from the General Shareholders Meeting of PT, even if conditioned to the Offer’s success, allowing the acquisition by the Offeror of a stake above 10 per cent. of the Target Company’s share capital, in accordance with article 9 of its by-laws, without imposing any other limitation;
 - c) amendment to PT’s by-laws, even if conditioned to the Offer’s success, in order that there shall not subsist any limit to the casting of votes issued by one single shareholder, either by itself or acting on behalf of another shareholder;
 - d) amendment to PT’s by-laws, even if conditioned to the Offer’s success, for the purpose of terminating with the privileged rights inherent to A class Shares or for the purpose of restricting them in order that they cannot be invoked against the execution of any acts and operations for the implementation of a reorganization plan of PT that shall be provided for in the Offer’s final materials, or waiver to the exercise of such privileged rights by the holders of such class of Shares in accordance with those same terms or even approval of those acts and operations or acceptance of the Offer by the holders of A class Shares, always on the assumption that and to the extent that such acts and operations.
11. For all due purposes, it is hereby referred that the decision to launch the Offer has been based on the assumption that, between the date hereof and the term of the Offer period, none of the following events shall occur with a material impact on the patrimonial, economic and financial situation of the Target Company on a consolidated basis:

- i. approval of resolutions by the competent corporate bodies of the Target Company, or of companies that are in a control or group relation (*relação de domínio ou de grupo*) with the Target Company, with head-offices in Portugal or abroad (hereinafter referred to as “companies in a control or group relation”), for the purpose of:
 - issuing shares, bonds or other securities or equivalent rights that grant the right to subscribe for or to acquire shares of the Target Company;
 - issuing shares, bonds or other securities or equivalent rights that grant the right to subscribe for or to acquire shares of companies in a control or group relation in an amount above 100 million Euros;
 - winding up, transforming, merging or making a split-off of the Target Company or of companies in a control or group relation with a value above 100 million Euros;
 - amending the by-laws of the Target Company or of companies in a control or group relation, except if those amendments are addressed to ensure the fulfillment of the conditions of the Offer;
 - distributing assets or reserves of the Target Company, without prejudice to the distribution of only an amount of 0.385 Euros per share, as dividends distribution in relation to 2005’s financial year;
 - redeeming or terminating by other form shares issued by the Target Company or by companies in a control or group relation;
 - acquiring, transferring or creating encumbrances, as well as promising to transfer or to create encumbrances on the shares issued by the Target Company, except if for compliance with obligations contracted up to the date hereof and of public knowledge;
 - acquiring, transferring or creating encumbrances, as well as promising to acquire, to transfer or to create encumbrances on holdings in other companies, except if for compliance with obligations contracted up to the date hereof and of public knowledge;
 - transferring or creating encumbrances, as well as promising to transfer or to create encumbrances, on assets of the Target Company or of companies in a control or group relation with a value above 100 million Euros, including undertaking debts, transferring (*trespassar ou ceder*) the ownership, the use or the exploitation of undertakings (*estabelecimentos*) of companies in a control or group relation or undertaking commitments for selling or transferring such assets or for undertaking such debts, except if for compliance with obligations contracted up to the date hereof and of public knowledge;
 - ii. filling up vacancies of members of the corporate bodies of the Target Company or of companies in a control or group relation without ensuring that the designated members may be removed without due cause (*sem justa causa*) against the payment of a compensation which amount shall not exceed the corresponding yearly remuneration;
 - iii. the removal of other members of the corporate bodies of the Target Company or of companies in a control or group relation being subject to the payment of compensations in an amount higher than that of the corresponding remuneration not yet due up to the expiry of the respective office period;
 - iv. the total remuneration of the members of each of the corporate bodies of the Target Company or of companies in a control or group relation for year 2006 and following years exceeding the total remuneration of the members of the same corporate body during 2004, except in relation to a yearly increase of no more than 10 per cent.;
 - v. performance of any acts by the Target Company or by companies in a control or group relation which are not within the ordinary management or which violate the neutrality duty of the management body provided for in article 181, no. 2, paragraph d) of the Portuguese Securities Code;
 - vi. material negative patrimonial changes of the Target Company or of companies in a control or group relation that do not arise from the ordinary course of business by reference to the situation evidenced in the respective Management Reports and Accounts released in relation to December 31, 2004 or, if available, in relation to the latest half-year or quarter balance sheet released following said date;
 - vii. awareness of events that may materially influence the valuation of the Shares but that had not yet been made public up to this date.
12. In addition, the decision to launch the Offer has been based on the assumption that, except in relation to the information available in the accounting documentation of the Target Company prior to the date hereof and to the information that has been disclosed by the Target Company also up to this date, there is not any provision of any agreement, contract or other instrument to which the Target Company or companies in a control or group relation (the first and the latter hereinafter referred to as “members of the Group of the Target Company”) are a party to pursuant to which, as a result of the launching of the Offer or of the acquisition or proposal to acquire, all or part, of the Shares or Convertible Bonds by the Offeror and with a material impact on the patrimonial, economic and financial situation of the Target Company on a consolidated basis:
- a) any loan or debt of any members of the Group of the Target Company that is not yet immediately due, becomes due or may be declared as immediately due or the ability of any of those members to contract loans or debts is withdrawn or limited;
 - b) is permitted the creation of (or becomes effective) any rights or encumbrances for the benefit of third parties over all or part of the business or assets of any member of the Group of the Target Company;
 - c) any agreement, right or obligation of any member of the Group of the Target Company terminates or is negatively modified or affected;
 - d) the interest or the business of the Offeror, of companies in a control or group relation (*relação de domínio ou de grupo*) with the Offeror or of a member of the Group of the Target Company in or with, respectively, any person, firm, company or body terminates or is materially and negatively modified or affected;
 - e) any member of the Group of the Target Company ceases to be able to carry out its business using its current name.
13. In the event that the Offeror comes to hold Shares that exceed 90 per cent. of the voting rights corresponding to the share capital of the Target Company, as a result of the Offer or other operations permitted by law and with relevance for the calculation of such percentage, the Offeror admits to make use of the compulsory acquisition mechanism provided for in article 194 of the Portuguese Securities Code, which shall cause the Shares and the Convertible Bonds to be immediately withdrawn from negotiation in a regulated market. The re-listing of the Shares and Convertible Bonds shall be prohibited for a period of two years.

Maia, 6 February 2006.

Exhibit 2 – Portuguese telecommunications operational numbers

Portuguese Telecommunications market	2000	2001	2002	2003	2004	2005	2006
As of 31 December							
Market Statistics							
Resident population ('000)	10,257	10,329	10,407	10,475	10,529	10,570	10,599
Number of households ('000)	5,019	5,019	5,019	5,047	5,100	5,100	5,100
PC penetration of homes	N/A	N/A	30%	32%	34%	36%	38%
Domestic Fixed (Copper)							
Voice: Main direct lines ('000)	4,321	4,385	4,351	4,281	4,238	4,234	4,234
PT's Market Share	99.7%	98.1%	95.3%	94.4%	93.3%	89.3%	78.6%
Sonaecom's Market Share	-	-	-	0.01%	0.03%	1.80%	3.90%
Broadband Internet Access: DSL ('000)	0	3	53	185	424	700	892
PT's Market Share	-	88.8%	82.4%	88.7%	91.5%	83.3%	76.4%
Sonaecom's Market Share	-	2.6%	7.2%	7.2%	4.3%	10.2%	17.1%
Domestic Fixed (Cable)							
TV: Pay-TV customers ('000)	1,056	1,343	1,551	1,675	1,717	1,793	1,854
PT's Market Share	89.90%	86.40%	84.30%	86.10%	84.40%	82.50%	79.80%
Sonaecom's Market Share	-	-	-	-	-	-	-
Broadband Internet Access: Cable ('000)	25	94	205	315	415	490	538
PT's Market Share	75.5%	66.2%	68.1%	73.1%	73.5%	71.0%	67.3%
Sonaecom's Market Share	-	-	-	-	-	-	-
Domestic Mobile							
Mobile Customers ('000)	6,665	7,978	8,529	9,351	9,959	11,447	12,226
PT's Market Share	44.1%	48.9%	51.9%	52.3%	50.7%	46.4%	46.7%
Sonaecom's Market Share	21.2%	24.0%	24.6%	24.7%	21.4%	20.6%	21.3%
International							
Brazil – PT's Customers ('000)	4,302	5,104	16,809	20,656	26,543	29,805	29,053
Others – PT's Customers ('000)	N/A	N/A	N/A	N/A	5,022	6,933	9,303

Source: ICP – ANACOM, INE, PT and Sonaecom

Exhibit 3 – Portugal Telecom’s financials

Portugal Telecom SGPS SA

Annual, Consolidated
Report

Euro million	2006	2005	2004	2003	2002
Revenue	6,343	6,385	5,967	5,764	5,582
Total Income	6,343	6,385	5,967	5,767	5,614
Operating Costs	5,228	5,028	4,623	4,489	4,490
Depreciation	1,210	1,121	972	958	1,106
Total Staff Costs	596	646	691	930	878
Operating Result	1,115	1,357	1,344	1,278	1,124
EBITDA	2,325	2,478	2,316	2,236	2,230
Net Int Exp/(Inc)	73	-13	177	373	358
Interest Payable	0	0	0	514	453
Interest Receivable	0	0	0	312	256
Pretax Profit/Loss	962	990	909	697	654
Tax	8	323	210	377	337
Net Profit/Loss	954	667	699	319	316
Net Attributable	867	654	623	240	391
Common Stk Dividends	526	445	395	0	0
Retained Profit/Loss	340	209	228	0	0
Total Current Assets	3,999	6,154	3,973	5,646	4,851
Cash & Equivalents	548	612	443	259	353
Receivables	1,734	1,984	1,602	1,517	1,605
Inventories	130	152	193	103	150
Fixed Assets	10,173	10,475	9,956	7,912	8,875
Total Assets	14,171	16,629	13,929	13,558	13,726
Total Liabilities	11,065	14,047	11,675	9,973	10,168
Current Liabilities	3,888	4,948	4,077	3,735	2,958
Long Term Debt	4,468	5,169	3,899	4,620	5,219
Deferred Liabilities	103	115	133	1,617	1,061
Minority Interests	851	754	568	644	447
Shareholders' Equity	2,255	1,828	1,687	2,941	3,111

Source: Reuters

Note: As of 1 January, 2005, PT introduced the new international accountancy standards IAS/IFRS (International Accounting Standards/International Financial Reporting Standards). As a consequence of that, Reuters's values are adjusted to match both the new and old accountancy standards. PT's official data for the 2004-2006 period is presented in the following tables.

Portugal Telecom SGPS SA

Cash Flow Statement

Euro million	2006	2005	2004	2003	2002
Net Cash - Operating	1,788	1,401	1,945	2,334	2,578
~Cash Receipts	7,392	7,188	6,765	6,509	6,522
~Cash Payments	-3,669	-3,809	-3,387	-2,797	-2,940
~Cash Taxes Paid	-54	-72	-67	144	-289
~Other Oper Cash Flow	-1,881	-1,907	-1,366	-1,522	-714
Net Cash - Investing	1,148	-1,911	-581	-460	-1,010
~Fixed Asset Purchase	-840	-776	-625	-616	-1,215
~Fixed Asset Sale	11	13	36	117	29
~Net FAsset(Pur)/Sale	-828	-764	-589	-499	-1,186
~Purchase Investments	-18,625	-12,769	-325	-425	-472
~Sale of Investments	20,272	11,326	21	4	1,312
~Net Investments	1,647	-1,443	-304	-422	839
~Other	329	296	312	461	-663
Net Cash -Acq/Dispos	0	0	0	-43	-947
Net Cash - Financing	-2,993	590	-1,192	-1,654	-486
~Dividends Paid	-581	-445	-297	-228	-129
~Sale/(Pur) of Stock	0	-328	-403	-196	169
~Issue/(Retire) Debt	-1,741	1,964	40	-620	-15
~Other Financing	-670	-600	-531	-611	-510
Exchange Rate Effect	-7	104	11	10	-45
Inc/Dec Cash & Equiv	-64	184	183	231	1,037
Cash & Equiv -Yr/Beg	612	428	245	2,298	1,231
Cash & Equiv -Yr/End	548	612	428	2,529	2,268
Cash Taxes paid	-54	-72	-67	144	-289

Consolidated Statement of Profit and Loss		Euro million		
	2006	2005	2004	
Operating Revenues	6,343	6,385	5,967	
Wireline	2,072	2,214	2,305	
Domestic mobile • TMN	1,502	1,557	1,606	
Brazilian mobile • VIVO	2,105	2,037	1,599	
Multimedia • PT Multimedia	667	629	599	
Other and eliminations	(2)	(51)	(142)	
Operating Revenues	6343	6385.4	5967.4	
Services rendered	5783.6	5836.9	5520.5	
Sales	461.2	447.5	365.8	
Other revenues	98	101	81	
Costs, expenses losses and income:				
Wages and salaries	668	667	632	
Post retirement benefits	(72)	(22)	59	
Direct costs	908	881	852	
Costs of products sold	597	652	596	
Support services	230	230	204	
Marketing and publicity	155	184	160	
Supplies and external services	1,026	959	811	
Indirect taxes	177	166	123	
Provisions and adjustments	230	172	169	
Depreciation and amortization	1,210	1,121	935	
Impairment losses	0	0	28	
Curtailement costs, net	20	314	166	
Losses on disposals of fixed assets, net	8	1	9	
Other costs, net	98	18	84	
EBITDA	2,424	2,496	2,363	
Wireline	1,073	1,129	969	
Domestic mobile • TMN	659	674	747	
Brazilian mobile • VIVO	496	507	499	
Multimedia • PT Multimedia	211	195	179	
Other	(15)	(10)	(31)	
Depreciation and Amortization	1,210	1,121	935	
Income from operations	1,214	1,375	1,428	
Other Expenses (Income)	127	333	286	
Curtailement costs	20	314	166	
Losses (gains) on disposal of fixed assets	8	1	9	
Net other costs	98	18	84	
Income before financ. & inc. taxes	1,087	1,042	1,142	
Financial expenses (Income)	125	51	233	
Net interest expenses	227	258	205	
Equity in losses (earnings) of affiliates	(131)	(238)	(21)	
Net other financial	29	32	49	
Income before income taxes	962	991	909	
Provision for income taxes	(8)	(323)	(210)	
Income from continued operations	954	667	699	
Income from discontinued operations	0	22	26	
Income applicable to minority interests	(87)	(35)	(102)	
Consolidated net income	867	654	623	

Source: Portugal Telecom annual reports

Consolidated Statement of Cash Flows		Euro million		
	2006	2005	2004	
OPERATING ACTIVITIES				
Collections from clients	7,392	7,188	6,765	
Payments to suppliers	-3,669	-3,809	-3,387	
Payments to employees	-711	-661	-784	
Payments relating to income taxes	-54	-72	-67	
Payments relating to post retirement benefits	-562	-700	-299	
Payments relating to indirect taxes and other	-608	-555	-270	
Cash flow from operating activities(1)	1,788	1,392	1,959	
INVESTING ACTIVITIES				
Cash receipts resulting from				
Short-term financial applications	20,266	10,934	13,379	
Financial investments	7	392	21	
Tangible fixed assets	11	13	36	
Intangible assets	0	0	0	
Subsidies for investments	0	2	3	
Interest and related income	239	262	263	
Dividends	36	21	16	
Other investing activities	54	12	33	
	20,613	11,636	13,752	
Payments resulting from				
Short-term financial applications	-18,501	-12,728	-12,613	
Financial investments	-95	-27	-292	
Tangible fixed assets	-818	-760	-609	
Intangible assets	-21	-16	-16	
Other investing activities	-29	-15	-36	
	-19,465	-13,547	-13,566	
Cash flow from investing activities(2)	1,148	-1,911	185	
FINANCING ACTIVITIES				
Cash receipts resulting from				
Loans obtained	16,284	24,240	17,152	
Subsidies	0	13	92	
Increases in share capital and paid-in surplus Subsidies	4	2	0	
Other financing activities	0	18	69	
	16,288	24,273	17,313	
Payments resulting from				
Loans repaid	-18,025	-22,276	-17,879	
Lease rentals (principal)	-33	-13	-25	
Interest and related expenses	-560	-487	-536	
Dividends	-581	-445	-297	
Acquisition of treasury shares	0	-340	-495	
Other financing activities	-81	-120	-39	
	-19,281	-23,683	-19,271	
Cash flow from financing activities(3)	-2,993	590	-1,958	
Change in cash and cash equivalents(4)=(1)+(2)+(3)				
	-57	72	186	
Change in cash and cash equivalents of discontinued operations	0	8	-14	
Effect of exchange differences	-7	104	11	
Cash and cash equivalents at the beginning of the period	612	428	245	
Cash and cash equivalents at the end of the period	548	612	428	

Source: Portugal Telecom annual reports

Portugal Telecom – Takeover defense

Consolidated Balance Sheet		Euro million		
As of 31 December	2006	2005	2004	
Current Assets	3,999	6,154	3,973	
Cash and cash equivalents	548	612	428	
Short-term investments	1,535	3,300	1,520	
Accounts receivable—trade	1,182	1,389	1,216	
Accounts receivable—other	219	244	207	
Inventories	130	152	193	
Taxes receivable	212	204	179	
Prepaid expenses	122	146	116	
Other current assets	50	106	113	
Non-Current Assets	10,173	10,475	9,956	
Accounts receivable—trade	1	1	1	
Accounts receivable—other	15	20	45	
Taxes receivable	125	117	63	
Prepaid expenses	3	3	6	
Investments in group companies	499	426	318	
Other investments	132	96	115	
Intangible assets	3,491	3,602	3,245	
Tangible assets	3,942	4,062	3,936	
Post retirement benefits	134	0	0	
Deferred taxes	1,167	1,388	1,423	
Other non-current assets	664	761	804	
Total Assets	14,171	16,629	13,929	
Current Liabilities	3,888	4,948	4,077	
Short-term debt	1,373	2,416	1,622	
Accounts payable—trade	636	716	730	
Accounts payable—other	479	414	546	
Accrued expenses	680	708	601	
Deferred income	216	208	226	
Taxes payable	317	237	168	
Provisions	105	163	118	
Other current liabilities	82	86	65	
Non-Current Liabilities	7,177	9,099	7,597	
Medium and long-term debt	4,468	5,169	3,899	
Accounts payable—other	0	2	18	
Taxes payable	26	32	26	
Deferred income	0	0	16	
Provisions	103	115	133	
Post retirement benefits	1,808	2,636	2,322	
Deferred taxes	90	335	328	
Other non-current liabilities	682	809	857	
Total Liabilities	11,065	14,047	11,675	
Share capital	395	1,129	1,166	
Capital issued premium	0	92	92	
Treasury shares	-188	-102	-190	
Legal reserve	83	179	154	
Reserve for treasury shares	0	125	88	
Accumulated earnings	1,965	405	376	
Equity excluding minority interests	2,255	1,828	1,687	
Minority interests	851	754	568	
Total Shareholders' Equity	3,106	2,582	2,254	
Total Liabilities and Shareholders' equity	14,171	16,629	13,929	

Source: Portugal Telecom annual reports

Consolidated Net Debt		Euro million		
As of 31 December	2006	2005	2004	
Short-term	1373	2416	1622	
Bank loans	407	408	481	
Bonds	0	900	585	
Exchangeable bonds	0	390	0	
Other loans	750	590	338	
Liability with equity swaps on treasury shares (1)	188	102	190	
Financial leases	28	26	29	
Medium and long-term	4468	5169	3899	
Bank loans	1103	1774	1373	
Exchangeable bonds	0	0	387	
Bonds	3134	3138	1848	
Other loans	0	31	91	
Financial leases	230	226	200	
Total debt	5840	7584	5522	
Cash, cash equivalents and short-term investments	2084	3912	1949	
Net debt	3757	3673	3573	

Net debt maturity profile		Euro million		
As of 31 December	2006	2005	2004	
2005	-	-	-543.3	
2006	-	-1498	1524.5	
2007	-711	537	458.4	
2008	466.80	296	507.10	
2009	1078	1280	959	
2010	326.8	464	77.8	
2011	124.4	121	66.5	
2012	1201.3	1196	46	
2013	61.7	61	25.9	
2014 (and following)	35.7	35	0.8	
2015 (and following)	177.9	1180	-	
2016 (and following)	995.1	-	-	
TOTAL	3757	3673	3123	
Average cost of debt (2)	5.7%	6.6%	6.2%	
Average cost of debt excluding Brazilian debt	3.8%	4.5%	4.7%	
PT's net debt maturity	7.4 years	9.2 years	3.5 years	
PT's net debt maturity excluding Brazilian debt	7.9 years	10.2 years	-	

Debt Ratings			
	Aug-2006	Mar-2006	Dec-2004
Standard & Poor's	BBB-	BBB+	A-
Moody's	Baa2	Baa1	A3
Fitch	BBB	-	-

Source: Portugal Telecom annual reports

- (1) This item corresponds to the notional amount of equity swaps contracted over 20.6 million PT shares for the share buyback approved in April.
- (2) According to the 10-year Treasury Bond issued by the Portuguese Central Bank during 2005 the risk-free rate was 3.45%.

Free Cash Flow	Euro million		
	2006	2005	2004
CAPEX	1001	943	761
EBITDA - CAPEX	1,423	1,553	1,602
Non Cash Items included in EBITDA	-52	-13	97
Change in Working Capital	228	-234	54
Operating Free Cash Flow	1,599	1,306	1,752
Net disposal (acquisitions) of financial investments	-143	365	-272
Interest Paid	-318	-202	-253
Contributions and payments related to PRBs	-280	-400	-299
Income taxes paid by certain subsidiaries	-51	-72	-66
Other cash movements	-28	52	-1
Free Cash Flow	780	1,050	862

Stock market data	Euro million		
	2006	2005	2004
As of 31 December			
Share capital (Euro)	395099775	1128856500	1166485050
Number of shares	1128856500	1128856500	1166485050
Price (Euro)	9.84	8.55	9.10
Market capitalization (Euro million)	11108	9652	10615
Gross dividend per share (Euro)	0.475	0.475	0.350
Dividend yield	4.8%	5.6%	3.8%
Net income (Euro million)	867	654	623
Pay-out ratio	62%	82%	66%
Price/transactions			
High (Euro)	10.44	9.80	9.45
Low (Euro)	8.04	7.33	7.83
Volume (number of shares)	1220	1178	1173
Traded value (Euro million)	12207	9666	10491
% of total traded volume (Eurolist by Euronext)	23%	31%	38%
Performance			
Portugal Telecom	15.1%	-6.0%	14.0%
PSI-20	29.9%	13.4%	12.6%
DJ Stoxx Telecom Europe	16.9%	-1.8%	11.9%

Source: Portugal Telecom annual reports

Exhibit 4 – Sonaecom’s financials

Sonaecom SGPS SA

Annual, Consolidated
Report

Euro million	2006	2005	2004	2003	2002
Revenue	836	843	880	838	789
Total Income	868	849	887	845	801
Operating Costs	819	821	812	829	859
Depreciation	136	128	125	130	130
Total Staff Costs	103	103	96	95	102
Operating Result	49	29	75	16	-58
EBITDA	184	157	201	146	72
Net Int Exp/(Inc)	12	8	14	13	16
Interest Payable	17	12	16	16	18
Interest Receivable	5	4	2	3	4
Pretax Profit/Loss	0	16	57	-8	-89
Tax	5	4	18	12	10
Net Profit/Loss	-5	12	39	-20	-99
Net Attributable	-14	2	18	-19	-65
Common Stk Dividends	-	-	-	-	-
Retained Profit/Loss	-14	2	18	-19	-65
Total Current Assets	377	442	281	376	382
Cash & Equivalents	126	209	53	144	132
Receivables	172	164	164	163	181
Inventories	15	23	13	8	16
Fixed Assets	1.344	1.01	777	833	841
Total Assets	1.72	1.452	1.059	1.209	1.223
Total Liabilities	811	765	618	806	805
Current Liabilities	325	284	291	328	483
Long Term Debt	461	456	305	420	309
Deferred Liabilities	20	5	4	4	9
Minority Interests	0	115	184	164	160
Shareholders' Equity	909	572	257	239	257

Source: Reuters

Sonaecom SGPS SA

Cash Flow Statement

Euro million	2006	2005	2004	2003	2002
Net Cash - Operating	119	145	204	164	70
~Cash Receipts	822	867	876	834	811
~Cash Payments	-554	-585	-567	-547	-637
~Cash Taxes Paid	-2	-3	-1	-3	-1
~Other Oper Cash Flow	-146	-134	-105	-119	-104
Net Cash - Investing	-182	-118	-126	-80	-106
~Fixed Asset Purchase	-112	-104	-125	-86	-113
~Fixed Asset Sale	3	4	5	3	3
~Net FAsset(Pur)/Sale	-110	-101	-120	-83	-110
~Purchase Investments	-107	-23	-12	-2	-2
~Sale of Investments	28	1	3	0	3
~Net Investments	-78	-22	-9	-1	1
~Other	6	5	3	3	3
Net Cash - Financing	-20	130	-167	-71	117
~Dividends Paid	-	-	-	-	-1
~Sale/(Pur) of Stock	-	-	-	-	-
~Issue/(Retire) Debt	-	146	-145	-32	-56
~Other Financing	-20	-15	-21	-39	173
Exchange Rate Effect	0	0	-	0	-
Inc/Dec Cash & Equiv	-84	158	-90	13	81
Cash & Equiv -Yr/Beg	209	52	141	125	44
Cash & Equiv -Yr/End	126	209	52	138	125
Cash Taxes paid	-2	-3	-1	-3	-1

Exhibit 5 – Takeover official process

Takeover major milestones according to the Portuguese Securities Code

Takeover days	Actions	Comments
D	Disclosure of the preliminary announcement of the takeover bid.	
D+7	Notification of the transaction to the relevant administrative authority.	
D+20	Deadline for both the draft prospectus submission and the takeover bid announcement to the target company, CMVM and Euronext stock exchange, as well as the submission of application for the takeover bid registration in CMVM.	Deadline of 20 days after the preliminary announcement bid to apply for registration of the takeover bid at the CMVM.
D+28	Board of Directors Report from the target company.	The target company's Board of Directors shall send to the offeror and to CMVM, within 8 days after receiving the draft prospectus of the takeover bid, its position on the opportunity and conditions of the tender offer.
D+97	Decision of the sector administrative authorities*.	
D+100	Decision of CMVM on approval / refusal of Public Offer Registration / beginning of the offer period.	Before the CMVM decision, the offeror should issue a bank guarantee to guarantee the payment of the takeover bid.
D+130	End of offer period.	Rival takeovers can only be launched until day 5 prior to the end of the initial takeover bid period. Reviews of the initial takeover bid can also only be performed until day 5 prior to the end of the initial takeover bid period if there is no other rival takeover bid.
D+133	Offer liquidation and possible mandatory Public Offer.	

* In the case of Sonaecom/PT, PCA took more time due to the process having gone through an in-depth investigation.

Major milestones in the Sonaecom/PT takeover process are presented in the following table:

Date	Events
6-Feb 2006	Sonaecom announces takeover offer for PT
7-Feb 2006	PT rejects offer
20-Feb 2006	Sonaecom notification to PCA
27-Feb 2006	Sonaecom requests CMVM registration
6-Mar 2006	PT rejects offer and publishes response
17-May 2006	PCA announces start of extended investigation into the implications of Sonaecom's offer
22-Dec 2006	PCA approves Sonaecom's offer
10-Jan 2007	CMVM registration of tender offer for PT by Sonaecom
12-Jan 2007	PT's Board rejects €9.50 offer
15-Feb 2007	Sonaecom revises its offer price to €10.50 per PT share

Exhibit 6 – Premiums, multiples and valuations

Public data provided by Portugal Telecom

As of March 2006

The **premium for the European telecommunications sector transactions** is calculated as the average of premia offered in selected takeover bids in Europe since 1999. The premia are calculated relative to an estimated prebid speculation date (i.e. leak to the market of the initial offer date and the date of improved deals). The sample of precedent transactions has been chosen based on the comparability of the transaction and includes the following:

Date	Target	Acquirer	Premium/(discount) to 1 day before announcement (or pre-bid speculation date)
05-02-2006	eircom	Babcock and Brown	11,7%
30-11-2005	TDC	Nordic Telephone Co.	38,9%
31-10-2005	O2	Telefónica	21,8%
18-07-2005	Versatel	Tele2	46,7%
07-07-2005	Saunalahti	Elisa Comm.	11,4%
08-11-2004	Infonet	BT Group	0,0%
14-09-2004	Song Networks	TDC	100,0%
01-04-2003	Sense Comm Intl	Reitangruppen	62,9%
02-07-2001	Eircom	Valentia Group	31,1%
21-03-2001	Soon Comm.	Elisa Comm.	66,2%
24-07-2000	SEC	Netcom	22,3%
23-06-2000	NetCom	Telia	13,8%
17-04-2000	Detron Group	Landis Group	40,3%
11-01-2000	Esat Telecom	BT	90,9%
14-11-1999	Mannesmann	Vodafone AirTouch	84,0%
20-10-1999	Orange	Mannesmann	21,7%
09-07-1999	Debitel	Swisscom	3,1%
20-02-1999	Telecom Italia	Ing C Olivetti & Co	26,5%
		Average	38,5%

The **premium for European unsolicited transactions** is calculated as the average premia offered in selected unsolicited takeover bids in Europe with a transaction value above \$10 billion since 1999. The premia are calculated relative to an estimated pre-bid speculation date (i.e. leak to the market of the initial offer date and the date of improved deals). The sample of precedent transactions is selected based on the comparability of the transactions and includes the following:

Date	Target	Acquirer	Premium/(discount) to 1 day before announcement (or pre-bid speculation date)
08-02-2006	BAA	Airport Development	45,1%
27-01-2006	Arcelor	Mittal Steel Co	81,8%
24-01-2006	BOC Group	Linde	39,0%
26-01-2004	Aventis	Sanofi-Synthelabo	28,1%
29-11-1999	National Westminster Bank	Royal Bank of Scotland	37,5%
14-11-1999	Mannesmann	Vodafone AirTouch	84,0%
14-09-1999	INA	Assicurazioni Generali	16,9%
05-07-1999	Elf Aquitaine	Totalfina	26,2%
09-03-1999	Paribas	BNP	48,6%
20-02-1999	Telecom Italia	Ing C Olivetti & Co	26,5%
		Average	43,4%

The **premium for Portuguese transactions** is calculated as the average premia offered in selected unsolicited takeover bids in Portugal with a transaction value above \$500 million since 1999. The premia are calculated relative to an estimated pre-bid speculation date (i.e. leak to the market of the initial offer date and the date of improved deals). The sample of precedent transactions has been chosen based on the comparability of the transactions and includes the following:

Date	Target	Acquirer	Premium/(discount) to 1 day before announcement (or pre-bid speculation date)
15-06-2000	Cimpor	Grupo de Investidores	13,3%
19-07-1999	BPSM	BCP	40,0%
18-06-1999	Mundial Confiança	BCP	80,5%
		Average	44,6%

As of January 2007

Precedent **transaction multiples** are calculated by dividing enterprise value by the last twelve months (“LTM”) EBITDA and OpFCF to the last quarter before announcement of each transaction. Sonaecom’s offer EV/ EBITDA and EV/OpFCF multiples are calculated based on PT’s 2005 EBITDA and OpFCF (PT’s LTM results at the offer announcement):

- Sonaecom’s offer firm value to EBITDA 2005 is calculated by multiplying PT shares by the offer price, excluding PTM and adjusting for net debt, minority interests and unconsolidated affiliates.
- PT’s EBITDA 2005 is calculated based on PT’s 2005 results and adjusted for post-retirement benefits.
- OpFCF is defined as EBITDA minus capital expenditure.

	Telecom Precedents	Sonaecom’s offer
EV / LTM EBITDA ⁽¹⁾	7.5x	6.3x
EV / LTM OpFCF ⁽²⁾	17.2x	9.9x

- (1) The reference to precedent transaction enterprise value to the last twelve months EBITDA multiples at announcement is based on the average for the following transactions: NTC/TDC (6.8x), Weather/Wind (7.7x), Telefónica /Cesky Telecom (6.4x), and the blended multiple for France Telecom/Amena and ONO/Auna transactions (9.3x).
- (2) The reference to precedent transaction enterprise value to the last twelve months OpFCF multiples at announcement is based on the average for the following transactions: NTC/TDC (11.7x), Weather/Wind (19.2x), Telefónica/Cesky Telecom (8.0x), and the blended multiple for France Telecom/Amena and ONO/Auna transactions (29.9x).

At €9.50 **PT multiples** are:

	2006E	2007E	2008E
EV/ EBITA ⁽¹⁾			
Portugal Telecom	6.9x	6.9x	6.7x
Peer Group used by Sonaecom ⁽⁴⁾	6.8x	6.7x	6.4x
EV/OpFCF ⁽²⁾			
Portugal Telecom	11.4x	11.0x	10.5x
Peer Group used by Sonaecom ⁽⁴⁾	11.7x	10.6x	10.0x
P/E ⁽³⁾			
Portugal Telecom	21.5x	15.3x	14.6x
Peer Group used by Sonaecom ⁽⁴⁾	15.1x	14.2x	13.8x

- (1) Enterprise Value (Equity Value + most recently Net Debt + After Tax Pension Deficit + Minority Interests – Associates – Tax asserts)/ EBITDA. In the case of PT, Enterprise Value also excludes equity swaps on own shares, PTM consolidated net debt and the PTM stake.
- (2) OpFCF defined as EBITDA minus Capex plus net post retirement benefit expense (gain).
- (3) Equity Value/Net Income (pre-exceptionals and consensus post tax curtailment projections and excluding proportionate PTM net income for PT).
- (4) Multiples and companies’ universe by Sonaecom in its offer materials.
- (5) If calculated correctly, PT’s multiples are in line with its peer group’s trading multiples which do not include any control premium.

Public data provided by Sonaecom

As of February 2006

Adjusted **average of the multiples** of Listed European Telecommunications Companies vs. multiples considered in Sonaecom's offer:

	2005E	2006E	2007E
EV/EBITA ⁽¹⁾			
Comparable's average ⁽³⁾	5.9x	5.2x	4.8x
Portugal Telecom ⁽⁴⁾	6.5x	6.4x	6.1x
Premium	10.2%	23.1%	27.1%
PER ⁽²⁾			
Comparable's average ⁽³⁾	12.9x	12.0x	11.01x
Portugal Telecom ⁽⁴⁾	19.1x	15.9x	13.7x
Premium	48.1%	32.5%	23.4%

- (1) Enterprise Value (Equity Value + Net Debt + Minority Interests) / EBITDA (Operational Results + Amortizations + Provisions).
- (2) Equity Value / Net Income.
- (3) Adjusted average (excluding maximums and minimums) of the multiples of Telefónica, Deutsche Telekom, France Telecom, Telecom Itália, Swisscom, Telenor, Belgacom and OTE calculated in February 2006.
- (4) Multiples implied in the offered consideration (based on consolidated indicators of PT and including the Dividend).

Source: Research reports of Investment Banks for the calculation of the PT multiples and JCF for the comparables multiples.

Analysts' Recommendations for PT Shares

Analyst	Date	Recommendation	Target Price	Target Date
ING	20/01/2006	Buy	9.5	31/12/2006
Citigroup	12/01/2006	Buy	10.5	31/12/2006
Espírito Santo	27/12/2005	Buy	8.8	N/A
ABN Amro	19/12/2005	Hold	7.9	31/12/2005
BPI	15/12/2005	Hold	8.2	31/12/2006
BNP Paribas	12/12/2005	Hold	9.2	N/A
West LB	12/12/2005	Hold	8.2	N/A
Deutsche Bank	05/12/2005	Hold	8.4	31/12/2006
UBS	05/12/2005	Hold	8.2	N/A
JP Morgan	05/12/2005	Buy	8.9	31/12/2006
Société Générale	24/11/2005	Hold	7.4	31/12/2005
Dresdner K	22/11/2005	Buy	9.8	N/A
Morgan Stanley	02/11/2005	Hold	8.7	N/A
Credit Suisse	28/10/2005	Hold	7.6	31/12/2006
Santander	13/10/2005	Buy	8.6	31/12/2006
Bernstein	11/10/2005	Hold	8.2	31/12/2006
BCP	07/10/2005	Buy	9.9	31/12/2006
Adjusted Average Target Price ⁽¹⁾			€8.67	

⁽¹⁾ Excluding maximum and minimum values

As of January 2007

Market analysis fair values for PT Shares (unaffected by the offer):

Date	Market analysts	Market analysis fair values for PT (unaffected by the offer)¹
13-12-2006	Sanford Bernstein	€8.05
13-12-2006	Exane BNP Paribas	€9.10
01-12-2006	Millenium BCP Inv	€11.50
28-11-2006	Deutsche Bank	€9.10
26-09-2006	Banco BPI	€8.02
15-09-2006	Lehman Brothers	€7.01
	Sonaecom offer	€9.50
		Median fair value per share = €8.58

As of February 2007

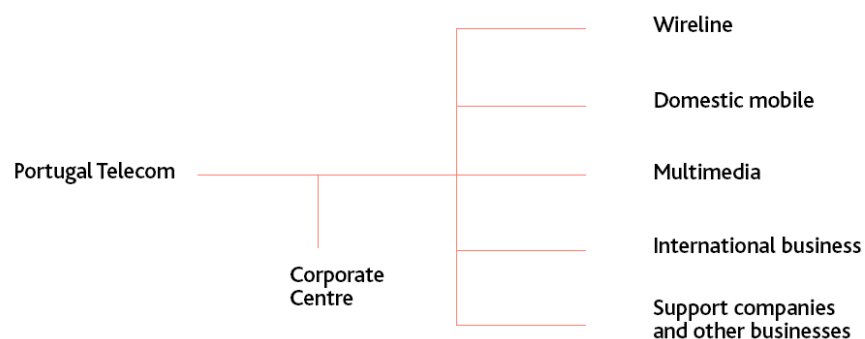
New adjusted **average of the multiples** of Listed European Telecommunications Companies vs. multiples considered in Sonaecom's offer:

	2007E	2008E	2009E
EV/ EBITA⁽¹⁾			
Sonaecom's offer	8.4x	7.9x	7.6x
Comparable's average	6.9x	6.7x	6.6x
Premium	1.5x	1.2x	1.0x
EV/OpFCF			
Sonaecom's offer	14.4x	12.7x	12.0x
Comparable's average	11.1x	10.4x	10.0x
Premium	3.2x	2.3x	2.0x
P/E⁽²⁾			
Sonaecom's offer	20.2x	17.8x	14.8x
Comparable's average	15.1x	13.5x	12.7.x
Premium	33.5%	31.9%	16.2%

(1) Enterprise Value (Equity Value + Net Debt + Minority Interests) / EBITDA (Operational Results + Amortizations + Provisions)

(2) Equity Value / Net Income

Exhibit 7 – Portugal Telecom’s corporate governance



End of 2005	Chairman	Ernâni Rodrigues Lopes	
	Executive Committee	Corporate Functions	Executive Functions
CEO	Miguel Horta e Costa	Strategy, internal audit, regulation and competition, internal relations, communication, image, sponsorship and group trademark, social responsibility, and safety.	Co-ordination of the Executive Committee
Executive Officers	Zeinal Bava	Investor and capital markets relations, accounting consolidation and financial reporting, treasury, and corporate finance.	TMN; PT Wifi; PT Multimédia; PT PRO; Previsão
Executive Officers	Carlos Vasconcellos Cruz	Internationalization, new markets research, project shaper - organization and leadership, and cooperation with Director Henrique Granadeiro in human resource management.	VIVO; PT Brasil; Medi Télécom; CVT; CST; CTM; Unitel; UOL
Executive Officers	Iriarte Esteves	Technology and network development and innovation.	PT Inovação
Executive Officers	Paulo Fernandes	Planning, management control, business development, real estate, purchases, project shaper - cost control.	PT Compras; SIMARC (Imobiliário)
Executive Officers	Henrique Granadeiro	Cooperation with the CEO in the strategic and regulatory agenda, human resources and training.	PT Foundation; PT ACS
Executive Officers	Rodrigo Costa	Information systems, cooperation with Director Iriarte Esteves for the development of technology, networks and innovation.	PT Comunicações; PT Corporate; PT.COM; PT SI

After 21 April 2006	Chairman	Henrique Granadeiro	
	Executive Committee	Corporate Functions	Executive Functions
CEO	Henrique Granadeiro	Strategy, regulatory management, competition, corporate communication and image, human resource and talent management policies, institutional relations, international relations, internal auditing, and legal services.	General coordination for the Executive Committee; PT Foundation
Executive Vice President	Zeinal Bava	Investor relations and social model sustainability project.	TMN; PT Multimédia; PT PRO; Previsão
Executive Vice President	Rodrigo Costa	Human resources, open networks project, integrated strategies for information and innovation services.	PT Comunicações; PT.COM; PT Corporate; PT SI; PT Inovação
Executive Officers	Luís Pacheco de Melo	Management planning and control, financial operations and treasury, financial reporting, corporate finance, and financial holdings.	PT ACS
Executive Officers	João Pedro Baptista	Business development, convergence and distribution strategy, holdings of PT group companies operating abroad.	PT Investimentos Internacionais; VIVO; Médi Télécom; Unitel; CTM; MTC; CVT; CST; Timor Telecom; UOL
Executive Officers	António Caria	Quality and customer satisfaction, strategies for services hiring, and integrated network strategies.	PT Compras; PT Contact
Executive Officers	Rui Pedro Soares	Marketing, security policies, relations with regions, local authorities and Portuguese language communities, real estate, and a "one shop" project.	PT Imobiliária

Source: Portugal Telecom annual corporate governance reports.

Short CVs of the PT and Sonacom representatives**Henrique Granadeiro**

Portuguese, 63 years old (as of 2006)

Elected for the first time in PT in 2003. Term of former office ended on 31 December 2005 and was re-elected in 2006 | Member of the Board of Directors of PT Multimédia – Serviços de Telecomunicações e Multimédia, SGPS, SA, since 2001 | Executive Member of the Board of Directors of PT Multimédia – Serviços de Telecomunicações e Multimédia, SGPS, SA, from 2002 to 2006 | Member of the Board of Directors of Espírito Santo Resources since 2005 | Member of the Board of Directors of OPCA – Obras Públicas e Cimento Armado, SA since 2005 | Chairman of the Executive Committee of Lusomundo Media, SGPS, SA from 2002 to 2004 | Chairman of the Executive Committee of Diário de Notícias from 2002 to 2004 | Chairman of the Executive Committee of Jornal de Notícias from 2002 to 2004 | Chairman of the Executive Committee of TSF from 2002 to 2004 | Chairman of the Executive Committee of Jornal do Fundão from 2002 to 2004 | Chairman of the Executive Committee of Açoreana Ocidental from 2002 to 2004 | Chairman of the Executive Committee of DN da Madeira from 2002 to 2004 | Chairman of the Board of Directors of Aleluia – Cerâmica Comércio e Indústria SA from 2001 to 2004 | Member of the Board of Directors of Parfil SGPS SA from 2001 to 2004 | Member of the Startegy Council of Banco Finantia since 2001 | Member of the Board of Directors of PT Multimédia – Serviços de Telecomunicações e Multimédia, SGPS, SA since 2001 | Member of the Board of Directors of Fundação Eugénio de Almeida since 1992 | Member of the Board of Directors of Controljornal SGPS SA from 1990 to 2001 | Member of the Board of Directors of Sojornal – Sociedade Jornalística e Editorial SA from 1990 to 2001 | President of Fundação Eugénio de Almeida from 1989 to 1992 | President of IFADAP – Instituto Financeiro de Apoio ao Desenvolvimento da Agricultura e Pescas from 1987 to 1990 | Managing Director of Fundação Eugénio de Almeida from 1981 to 1987 | Member of the Board of Directors of M.N. Tiago, Construções SA during 1981 | Member of the Board of Directors of Standard Eléctrica during 1981 | Portuguese Ambassador to OECD from 1979 to 1981 | Head of the Civil House of the President of the Republic of Portugal from 1976 to 1979 | He has a degree in Corporate Organization and Administration by Instituto Universitário de Évora (Sociology Department).

Zeinal Bava

Portuguese, 41 years old (as of 2006)

Elected for the first time in PT in 2000. Term of former office ended on 31 December 2005 and was re-elected in 2006 | Chairman of the Executive Committee of PT Multimédia – Serviços de Telecomunicações e Multimédia, SGPS, SA since May 2003 | Chairman of TV Cabo Portugal, SA since March 2004 | Chairman of the Executive Committee of TMN – Telecomunicações Móveis Nacionais, SA since December 2005 | Member of the Board of Directors of Portugal Telecom Investimentos Internacionais, SA since April 2004 | Member of the Board of Directors of Brasilcel, NV since December 2002 | Chairman of the Board of Directors of Previsão – Sociedade Gestora de Fundos de Pensões, SA since March 2003 | Chairman of the Board of Directors of PT PRO – Serviços de Gestão, SA since February 2003 | Executive Vice-President of the Board of Directors of PT Comunicações, SA from January 2004 to December 2005 | Member of the Board of Directors of PT Corporate – Soluções Empresariais de Telecomunicações e Sistemas, SA from June 2003 to April 2006 | Member of the Board of Directors of PT Sistemas de Informação, SA from May 2004 to April 2006 | Member of the Board of Directors of Portugal Telecom Brasil, SA from July 2002 to March 2004 | Member of the Board of Directors of Páginas Amarelas, SA from January 2004 to May 2005 | Member of the Board of Directors of PT Compras – Serviços de Consultoria e Negociação, SA from May 2003 to 2005 | Member of the Board of Directors of BEST – Banco Electrónico de Serviço Total, SA from May 2001 to October 2004 | Member of the Board of Directors of Telesp Celular Participações, SA from April 2001 to December 2003 | Member of the Board of Directors of CRT Celular Participações, SA from 2003 to 2005 | Member of the Board of Directors of Tele Sudeste Participações, SA from 2003 to 2005 | Member of the Board of Directors of Tele Leste Participações, SA from 2003 to 2005 | Member of the Board of Directors of Tele Centro Oeste Celular Participações, SA from 2003 to 2005 | Vice-President of PT Ventures, SGPS, SA from 2000 to 2002 | Director and Relationship Manager for Portugal of Merrill Lynch International from 1998 to 1999 | Executive Director of Deutsche Morgan Grenfell from 1996 to 1998 | Executive Director Warburg Dillon Read from 1989 to 1996 | Graduated in Electronic and Electrotechnical Engineering from University College, London.

Miguel Horta e Costa

Portuguese, 58 years old (as of 2006)

Elected for the first time in PT in 1995. His mandate ended on 31 December 2005 | Chairman of the Executive Committee of Portugal Telecom, SGPS, SA since 28 May 2002 | Chairman of the Board of Directors of PT Ásia, Limitada since July 2004 | Chairman of the Board of Directors of Portugal Telecom Investimentos Internacionais – Consultoria Internacional SA since April 2004 | Chairman of the Board of Directors of PT Prime, SGPS, SA since February 2004 | Chairman of the Executive Committee of PT Comunicações, SA since January 2004 | Chairman of the Board of Directors of PT Sistemas de Informação, SA since January 2004 | Chairman of the Board of Directors of PT Corporate – Soluções Empresariais de Telecomunicações e Sistemas, SA since June 2003 | Chairman of the Board of Directors of PT Compras – Serviços de Consultoria e Negociação, SA since May 2003 | Chairman of the Board of Directors of Fundação Portugal Telecom from March 2003 to December 2004 | Chairman of the Board of Directors of PT Ventures, SGPS, SA (ex-Portugal Telecom Internacional, SGPS, SA) since December 2002 | Chairman of the Board of Directors of PT Multimédia – Serviços de Telecomunicações e Multimedia, SGPS, SA since August 2002 | Chairman of the Board of Directors of Portugal Telecom Brasil, SA since July 2002 | Chairman of the Board of Directors of PT Móveis, SGPS, SA and TMN – Telecomunicações Móveis Nacionais, SA since June 2002 | Chairman of the Board of Directors of Telesp Celular Participações, SA | Chairman of the Board of Directors of PT Comunicações, SA since May 2002 | Vice-Chairman of the Executive Committee of Portugal Telecom, SGPS, SA from April 2000 to May 2002 | Vice-Chairman of the Board of Directors of PT Investimentos, SGPS, SA from 1999 to June 2001 | Vice-Chairman of the Board of Directors of Telesp Celular Participações SA from 1998 to November 2000 | Vice-Chairman of the Board of Directors of Multimedia – Serviços de Telecomunicações e Multimedia, SGPS, SA from 2000 to 2002 | Member of the Board of Directors of Telesp Participações SA from 1998 to November de 2000 | Member of the Board of Directors of Telesp, SA from 1998 to November de 2000 | Chairman of the Board of Directors of Portugal Telecom Internacional, SGPS, SA from 2000 to 2002 | Chairman of the Executive Committee of Portugal Telecom Internacional, SGPS, SA from 1998 to 2000 | Member of the Board of Directors of Telefónica, SA since 1998 | Member of the Board of Directors of SIC, SA from 1998 to 2000 | Member of the Board of Directors of Aliança Atlântica Holdings since 1997 | Vice-Chairman of the Board of Directors of Portugal Telecom Internacional, SGPS, SA from 1996 to 1997 | Vice-Chairman of the Board of Directors of Companhia Portuguesa Rádio Marconi SA from 1994 to 1995 | Non-executive member of the Board of Directors of Portugal – Companhia de Transportes Aéreos, SA since 1993 | Vice-Chairman of the Board of Directors of Banco ESSI, SA from 1992 to 1994 | Non-executive member of the Board of Directors of BES Investimento, SA since 1999 | Chairman of the Board of Directors and member of the Board of Directors of SIBS – Sociedade Interbancária de Serviços, SA from 1991 to 1995 | Chairman of the Board of Directors of Euroges – Aquisição de Créditos a Curto Prazo, SA since 1991 | Member of the Board of Directors of Banco Espírito Santo e Comercial de Lisboa from 1990 to 1992 | Vice-President of Associação Industrial Portuguesa from 1990 to 1994 | Secretary-of-State of External Commerce from 1987 to 1990 | Vice-Chairman of the Board of Directors of CTT and TLP from 1984 to 1987 | Chairman of the Board of Directors of Companhia Portuguesa Rádio Marconi SA from 1982 to 1984 | Director – General of CTT from 1981 to 1982 | Graduated in Economics from Universidade Técnica de Lisboa (I.S.C.E.F.).

Belmiro de Azevedo

Portuguese, 68 years old (as of 2006)

Diverse number of positions in the Efanor/Sonae Group from an early stage | Chairman of the Board of Sonae Group | Chairman of the Board and CEO of Sonae Capital, SGPS S.A. since 1999 | Member of the European Union Hong Kong Business Cooperation Committee, of the International Advisory Board | Member of the European Round Table of Industrialists | Member of the International Advisory Board of “Harvard Business School” | Member of Cotec Portugal “Encomienda de Numero de la Orden del Mérito Civil” from His Majesty D.Juan Carlos, King of Spain, the “Order of the Cruzeiro do Sul” form the President of the Brazilian Federal Republic | “Grã Cruz da Ordem do Infante D.Henrique” from the President of the Portuguese Republic, nomination of as “Honorary Fellow” of the London Business School | Member of the “Order of Outstanding Contributors to Sustainable Development” from the World Business Council for Sustainable Development | Graduated in Industrial Chemical Engineering at the University of Oporto in 1963 | PMD from Harvard Business School in 1973 | Financial Management Program from Stanford University in 1985 | Strategic Management – Wharton University in 1987.

Duarte Paulo Teixeira de Azevedo

Portuguese, 41 years old (as of 2006)

CEO of Optimus – Telecomunicações S.A. between 1998 and 2000 | Today, CEO of Sonae SGPS and holds a number of managerial and directorship roles in the Efanor/Sonae Group | Member of APGEI (Portuguesa Association of Management and Industrial Engineering) since 1988 | Member of EGP (Management School of Oporto) since 2000 | President of Apriltel (Association of Telecommunicators Operators) from 2001 until 2002 | Co-author of the book “Reformar Portugal” in 2003 | Member of the Advisory Group “Compromisso Portugal” since 2004 | Graduated in Chemical Industrial Engineering from the Lausanne Polytechnic School (Switzerland) in 1986 | Master in Business Administration – MBA (ISEE) in 1989 | Executive Retailing Program - Babson College in 1994 | Strategic Uses of Information Technology Program - Stanford Business School in 1996 | IMD - Breakthrough Program for Senior Executives – Lausanne in 2002 | Post-graduate degree in Business studies from the Oporto Institute of Business Studies | Belmiro de Azevedo’s son.

Exhibit 8 – Portuguese Securities Code takeover restrictions

Portuguese Securities Code (Decree-Law No. 486/99 of 13 November)

Title III - Public offers Chapter I - Common provisions Section I - General principles

Article 181 Duties of the target company

1. Within eight days of the receipt of the draft prospectuses and announcement of the bid and within five days of the disclosure of any addenda to the offer documents, the Board of the offeree company shall send to the offeror and to the CMVM, and disclose to the public, a report drawn up in the terms of article 7 on the opportunity and terms of the offer.
2. The report referred to in the preceding number shall contain an autonomous and reasoned opinion on at least the following aspects:
 - a) The type and amount of the consideration offered;
 - b) The offeror's strategic plans for the offeree company;
 - c) The repercussions of the bid on the interests of the offeree company, in general, and, in particular, on the interests of its employees and their terms of employment and the locations of the company's places of business;
 - d) The intentions of the Members of the Boards who are simultaneously shareholders in the offeree company, in respect of acceptance of the bid.
3. The report shall contain information on possible votes against, expressed in the resolution of the Board that adopted it.
4. If, by commencement of the bid, the Board receives from the employees, directly or through their representatives, an opinion on the repercussions of the bid on employment, it shall be disseminated as an appendix to the report prepared by the Board.
5. The Management body of the target company, from the publication of the preliminary announcement until the assessment of the result of the offer, should:
 - a) Inform the CMVM daily as to the transactions of its members, or individuals involved in any of the situations described in Article 20(1), in securities issued by the target company;
 - b) Supply all the information requested by the CMVM in the ambit of its supervisory functions;
 - c) Inform the representatives of its employees or, failing these, the employees of the content of the offer documents and the report prepared by it, as soon as these are made public;
 - d) Act in good faith, particularly, concerning the accuracy of information and honest behavior.

*(Rectified by Rectification Declaration No. 1-A/2000)
(Amended by Article 2 Decree-Law No. 219/2006 of 2 November)*

Article 182
Limitation of the powers of the target company

1. From the moment it has knowledge of the decision to launch a take-over for more than one third of the securities of the respective class, and until the assessment of the result or until the prior termination of the respective process, the Management body of the target company may not perform acts that materially affect the net equity of the target company and which may significantly affect the objectives announced by the offeror, apart from the normal day to day management of the company.

2. For the purposes of the previous sub-article:

- a) The target company has knowledge of the offer's launch upon receipt of preliminary announcement;
- b) Relevant changes in the net asset situation of the target company, particularly, the issuing of shares and other securities conferring the right to their subscription or acquisition and the entering into contracts representing the sale of important portions of the company's assets;
- c) The restriction includes acts enforcing decisions made before the period referred to therein which have not yet been fully or partially enforced.

3. Exceptions to the provisions of the previous sub-articles are:

- a) The acts resulting from the fulfillment of obligations assumed before the knowledge of the offer launch;
- b) Acts authorized by a shareholders' meeting called exclusively to such end during the period referred to in No. 1;
- c) Acts intended to seek competing offerors.

4. During the period referred to in No. 1:

- a) The period to disseminate the notification of a shareholders' meeting is reduced to 15 days prior to the meeting;
- b) The resolutions of the shareholders' meeting contemplated in paragraph b) of the preceding number, as well as any resolutions on early distribution of dividends and other income can only be adopted by the majority of votes required to amend the articles of association.

5. The offeror is responsible for damages incurred due to the decision to launch a take-over, taken with the main objective of placing the target company in the situation set out in this Article;

6. The regime laid down in this article shall not apply to takeover bids conducted by offeror companies which are not subject to the same rules or are controlled by a company not subject to the same rules.

7. In respect of companies which adopt the model referred to in paragraph c) of No. 1 of article 278 of the Commercial Companies Code, Nos. 1 to 6 shall apply, all necessary changes being made, to the Executive Board, the General Council and the Supervisory Council.

(Amended by Article 2 Decree-Law No. 219/2006 of 2 November)

General Statement of Opinion on Duties relating to Conduct while Takeover Bids are Pending

Given that several questions have been put to the CMVM regarding the required conduct while a takeover bid is pending, the Executive Board of the *Comissão do Mercado de Valores Mobiliário* (the Portuguese securities market regulator – CMVM) hereby issues the following general statement of opinion, under the terms of Article 370(2) of the Portuguese Securities Code:

1. The duty of secrecy which applies in cases where a takeover bid is being prepared:

a) Applies to all offerors, even potential ones, and all persons and entities working in conjunction with the offeror, regardless of the stage of the process, even if they merely entail preliminary contact, are subject to the duty to inform the market in the event of a leak of information which disrupts the normal formation of prices;

b) Requires steps to be taken to prevent its violation.

In the preparation of a takeover bid, potential offerors and any persons in any way acting in conjunction with them are subject to a duty of secrecy (Article 174 of the Portuguese Securities Code), and this duty applies from the moment at which any contact aimed at assessing the possibility of launching a takeover bid begins. If, for any reason, the process is made public, regardless of whether it is the offeror's initiative, the entity which is subject to the duty of secrecy must inform the market as to the situation of the process and preserve its confidentiality until such time as the preliminary announcement is published.

The process of preparing a takeover bid is, as a rule, relatively lengthy, and there is a greater risk of violation of the duty of secrecy. For this reason, potential offerors, subject to the duty of secrecy, must take all necessary steps to prevent the violation of this duty by any persons working in conjunction with it. In particular, so as to ensure this protection, confidentiality agreements must be entered into, and all persons involved in the process must be bound by these agreements.

2. The target company in a takeover bid is not permitted to directly or indirectly finance, even partially, or by any way to bear the cost of the granting of finance in relation to competing bids.

While a takeover bid is pending, Members of the Board of the target company are bound by duties of loyalty (Article 181.2 d), Portuguese Securities Code). These duties constitute the very foundations of the fiduciary management of company property and have several consequences, invariably in confirmation of the supremacy of the long-term interests of all shareholders. This prevents companies whose shares are targeted in a takeover process from financing competing bids, in definitive terms, even partially, either directly or through an intermediary or, by any means, from assisting in the attainment of financing for this purpose.

The Company Law confirms this conclusion, by prohibiting third parties from financing the acquisition of their own shares (Article 322.1, CSC – Commercial Company Act).

3. The management of the target company is not permitted to disclose privileged information to potential competing offerors.

The prohibition of the use of privileged information (Article 378, Cód.VM – Portuguese Securities Code) has a more important application when takeover bids are pending. This rule is based on the need to respect the equal treatment of investors and to prevent uneven access to information. Therefore, the duty to respect this prohibitive rule is imposed in relation to information to be transmitted to potential competing bidders. Thus, if the Board of the target company wishes to transmit sensitive information to a potential offeror, the information in question must first be made public.

4. The Board of the target company must issue a statement with regards to the bid in its annual report, which must be updated in the event of the takeover bid being revised in relation to aspects which are known to be significant as far as CMVM is concerned.

The Board of a company targeted by a takeover bid must, within eight days of receipt of the draft launch notice, submit a report on the opportunity presented and the conditions for the bid to the offeror and CMVM and publish it in the bulletin of the regulated market on which the target company has securities admitted to listing.

This, and this alone, is the moment at which it is procedurally appropriate for the Board of the target company to issue a statement on the merits of the bid, and in doing so, it must comply with all requirements as regards to the completeness, veracity, updatedness, clarity, objectivity and legality of the information it transmits, in observance of Article 7 of the Portuguese Securities Code.

The rules for the issue of the report by the target company apply to any bid, whether initial or competing. Thus, whenever the preliminary announcement of a takeover bid is issued, the target company must issue a statement within eight days of receipt of the draft documents pertaining to the bid, and must do so whenever a bid is announced and with regards to each bid.

In order to ensure that the information in the report to be issued by the target company adheres to the requirements set forth in Article 7 of the Portuguese Securities Code, it is vital that the report from the Board of the target company be updated in the event of amendments reputed by CMVM with significance to the documents for the bid, so as to reflect the new information contained in the bid documents.

5. Information to be made public while a takeover bid is pending, either by the offeror or the target company, must be harmonized with the content of the documents legally presented by these entities and must also adhere to the rules and principles governing information which is publicly disclosed.

When a takeover bid is pending, information made public, either by the offeror or by the target company, must adhere, not only to the principles enshrined in Article 7 of the Portuguese Securities Code, to be disclosed under equal conditions to all shareholders and to the market through CMVM's website, but must also be in keeping with the content of the documents presented in accordance with the law, which are also subject to the requirements of Article 7 of the Portuguese Securities Code.

6. The disclosure of publicity either by the offeror or the target company, or by anyone acting on its behalf or in its interest and related to the bid, even if prior to the presentation of the launch notice, is subject to CMVM's authorization.

The Portuguese Securities Code does not prohibit publicity relating to takeover bids; however this is subject to scrutiny by CMVM (Article 121). For this purpose, publicity is considered to mean any form of communication carried out in the business world with a view to directly or indirectly promoting or discouraging the acceptance of any takeover bid on securities. This includes the disclosure of publicity messages by the offeror, the target company or anyone acting on behalf of these or in their interest. The approval of publicity messages is aimed at safeguarding, above all, their conformity with the general rules on the content of information transmitted, in particular with regards to its veracity and objectivity. Permitted publicity must only refer to bids which are registered or the viability of registration of which has been ensured (Article 122, Cod. VM - Portuguese Securities Code).

7. Interference to the regular function of the securities market arising both from the acquisition of own shares by the target company and the disclosure of material information affecting the outcome of the bid may fulfill the legal characteristics of the crime of market manipulation.

Artificial interference in the quotation of securities, which merits punishment, could prove particularly damaging to the regular functioning of the market. In the context of a takeover bid, such practices may lead to an abnormal increase in prices, distorting the conditions for the presentation of a bid and the making of competing bids. The Board of the target company should guard against this when disclosing information which is material to the outcome of the bid and the acquisition of own shares, even more so because the Board is bound by special duties of good faith and loyalty (Article 181(2) (d), Portuguese Securities Code). In light of the above, it is also held that the acquisition of own shares in the context of a takeover bid, in light of its defensive scope, whether or not this is its sole purpose, does not benefit from the safeguards provided for in Article 8 of Directive 2003/06/EC, arising from Article 3 of Regulation (EC) no. 2273/2003, of 22 December, 2003.

8. Companies are not permitted, either directly or indirectly, to request representation by proxy at the General Meeting.

In Portugal, activities which actively contribute towards a company or members of its corporate bodies directly or indirectly obtaining powers of representation are prohibited, so as to prevent disturbances to the regular function of the General Meeting (Article 381, CSC). The preoccupations with good governance which are the basis for this prohibition are doubly important when takeover bids are pending, in light of the primacy of the decisions of shareholders at this sensitive juncture of a company's activity.

9. Any clauses waiving the responsibility of entities which are required to disclose information to the public, in particular with regards to forecasts for the future, shall be considered not binding whenever they violate the applicable legal rules.

Since the system of civil liability for the disclosure of information in the market is compulsory (Article 154, Cod. VM - Portuguese Securities Code), clauses which remove this liability with regards to information made public in documents relating to takeover bids are not permitted. Thus, any clauses removing the responsibility of entities which are required to disclose information to the public, in particular with regards to forecasts for the future, must be considered invalid whenever they violate the said legal rules.

10. The violation of legal rules based on this statement of opinion may constitute a very serious administrative infraction or a crime.

Conduct which violates the law, in the cases referred to in this statement of opinion, is considered to constitute a very serious administrative infraction, punishable with a fine of between €25,000 and €2,500,000.

Some of the aforementioned types of conduct may constitute crimes of insider trading and market manipulation, under the terms of Articles 378 and 379 of the Portuguese Securities Code.

The Executive Board of CMVM,
Lisbon, 21 March, 2006.

Exhibit 9 – Portuguese Competition Authority conditions and obligations

Press Release No. 28/2006

Portuguese Competition Authority clears Sonaecom/PT merger – with the attached conditions and obligations

1. The Authority's decision

The Portuguese Competition Authority has decided not to oppose the PT/ Sonaecom merger arising from the takeover bid launched by Sonaecom. The decision has conditions and obligations attached to it that are intended to guarantee compliance with the commitments assumed by the notifying party, in order to ensure that effective competition is maintained. The analysis carried out in Phase 1 showed that, on the basis of the notification, the operation could lead to the creation or strengthening of a dominant position that could result in significant barriers to effective competition in various markets for telecommunications and media in Portugal. Accordingly, the Competition Authority proceeded with an in-depth investigation phase (Phase 2). However, in light of the commitments assumed by the notifying party (Sonaecom), the Competition Authority has concluded that the projected operation does not result in the creation or strengthening of a dominant position that could result in significant barriers to effective competition. Moreover, it considers that implementation of the merger may substantially improve the sector's competitive structure, resulting in benefits for consumers.

2. Sonaecom's commitments

The Authority's clearance of the merger is subject to the observance of the commitments presented by Sonaecom, which are detailed below.

The conditions and obligations relating to fixed network activities consist of:

- a) Presenting a model for the horizontal separation of the fixed networks;
- b) Presenting a model for the operational separation of the basic network;
- c) Implementing the horizontal separation of fixed networks;
- d) Selling either the fixed copper network business or the fixed cable network business, as Sonaecom itself chooses.
- e) Implementing the functional separation of the basic network, in the case of divestment of the fixed cable network business;
- f) Instructing a trustee, approved by the Competition Authority, with the powers necessary to implement the sale, in the case that divestment of one of the networks is not carried out;
- g) Surrendering the FWA (Fixed Wireless Access) frequencies held by Sonaecom or PT, within a certain period;
- h) Extending the third-party access obligations currently arising from ORAC PT (Reference Offer of Access to Ducts) to all the ducts of Sonaecom-controlled companies;
- i) Appointing a trustee, in combination with the Authority, which, in the interests of the Competition Authority, will supervise compliance with the above commitments.

With regards to its mobile network activities, Sonaecom is subject to the following conditions and obligations:

- a) To guarantee access to any interested MVNOs (Mobile Virtual Network Operators, i.e. operators without their own network);
- b) To surrender radio spectrum frequency rights and the associated licenses, in order to allow the entry of a new MNO (Mobile Network Operator, i.e. a mobile operator with its own network);
- c) To divest itself of sites, possibly including the radio transmission equipment therein installed;
- d) To make itself available to sign an MVNO contract with the new MNO;
- e) To provide co-localization with the new MNO;
- f) To create conditions to diminish network effects, at the tariff level;
- g) To guarantee that the annual rate of variation in the retail prices for TMN and Optimus services does not exceed the average prices of a basket of European mobile operators or, alternatively, the progression of the INE consumer price index (price cap);
- h) To mitigate the conditions applying to customer loyalty programmes.

With respect to other activities (Media and Content), Sonaecom is also subject to the following conditions and obligations:

- a) The sale of film distribution and theatrical exhibition business, the wholesale marketing of videograms, the production and marketing of pay-TV channels, the use of Premium content television rights and the use of content transmission rights for mobile telephony and the internet;
- b) A guarantee of more effective competition in the content licensing business, particularly with the avoidance of the grant of exclusivities, accompanied by the granting of access to content in a manner that is reasonable, transparent and non-discriminatory.

3. The Authority's assessment

On the basis of these commitments, obligations and conditions, the Competition Authority considers that, if the operation materializes, the competitive structure of the telecommunications sector in Portugal will undergo a significant change, with the elimination of obstacles and constraints that were not only penalizing competing operators but, especially, consumers. If materialized, this merger will also contribute to the development of the Information Society.

This set of commitments allows for the effective elimination of constraints and barriers that were standing in the way of effective competition in the marketplace.

Among the commitments assumed, the Authority underlines the following as being of major importance: the structural separation of networks, the measures intended to facilitate the access of competing operators to the fixed (cable and copper) networks hitherto held by the incumbent, Sonaecom's disinvestment of various PT Group assets, in particular in the media and content field, and the introduction of contestability in the mobile communications market, with the creation of conditions for the entry of new operators.

This ruling also includes various mechanisms for supervising compliance with the obligations and conditions assumed by Sonaecom, on which the Competition Authority's non-opposition depended. These mechanisms allow the company's phased compliance to be monitored and verified. Supervision will be the responsibility of the Competition Authority, which, in some cases, will carry it out directly and, in others, via trustees who will report to the Authority and to ANACOM.

The Authority consulted ANACOM, ERC (Regulatory Body for Communications) and ISP (Portuguese Insurance Institute), who issued opinions that, under the terms of the Competition Law, are obligatory but not binding.

4. The development of the case

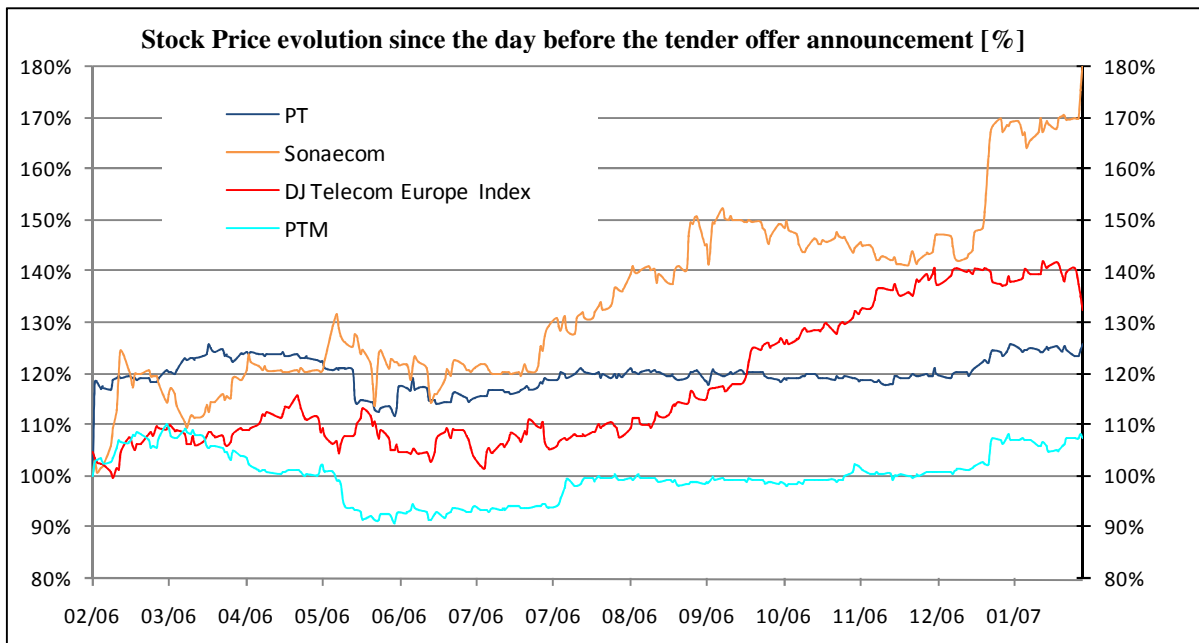
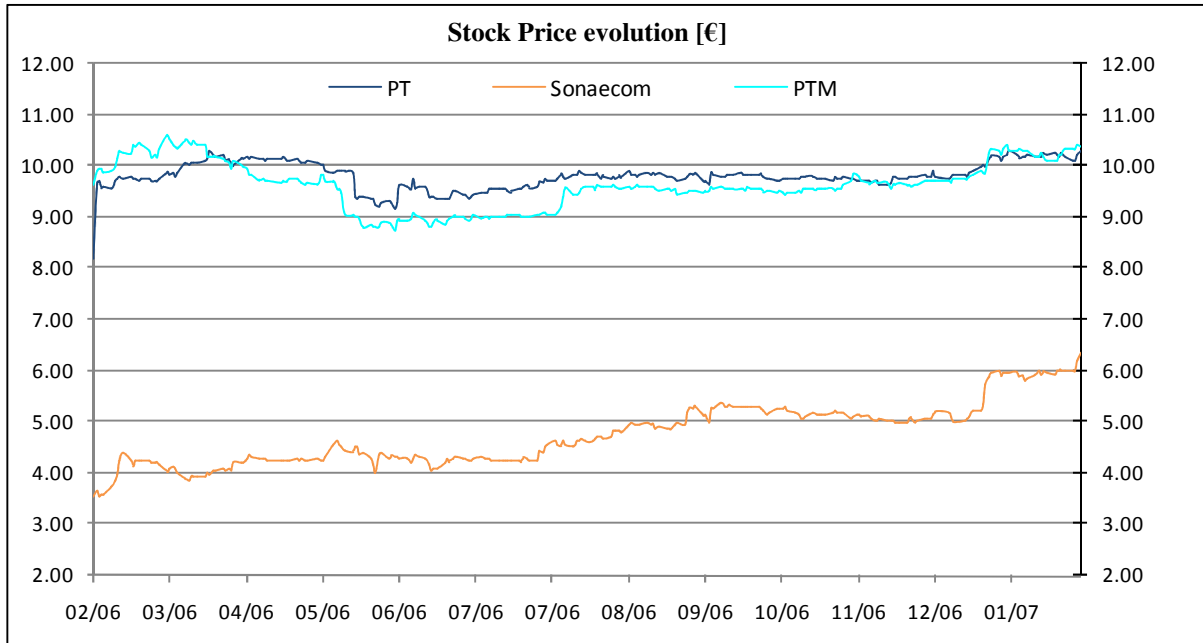
The merger was notified on 20 February, 2006. On 9 June, the Authority ruled that the case should pass to the in-depth investigation phase 3. Between 11 August and 5 September, the Authority carried out a market test and received contributions from 25 of the bodies consulted. On 27 September, it issued its Preliminary Decision and between that date and 27 October the public hearing of interested parties took place. On 5 December, a new Preliminary Decision was issued, with the prior public hearing of interested parties terminating on 20 December.

In this operation, the Competition Authority used 81 working days. Sonaecom used 54 working days, during which the time limit for the procedure was suspended. The legal time limit was suspended for another 45 working days for the public hearings of interested parties.

Lisbon, 22 December, 2006.

Exhibit 10 – Stock market

Time period from 06.02.2006 to 15.02.2007





Portugal Telecom Takeover defense

CASE STUDY – PART 2

Portugal Telecom – Takeover Defense

Henrique Granadeiro was discussing the recent events with Zeinal Bava, over lunch. Victory was not yet guaranteed as some shareholders had not yet taken their decision. After Sonaecom announced its Portugal Telecom (PT) bid upgrade from €9.50 to €10.50 per PT share, on 15 February, 2007, PT's top management rejected the offer once again. According to PT, this hostile tender offer continued to provide neither a fair value nor future synergies to current shareholders.

The PT extraordinary shareholders' meeting day had finally arrived. It was 2 March, 2007, and Henrique Granadeiro was worried whether they had followed the best defensive strategy against this hostile takeover. Both the company and country's attitude changed significantly towards corporate restructuring. It had been a tough, challenging work to run a €14 billion company and to deal, for more than one year, with the different stakeholders.

Decision time was imminent. The shareholders would decide the telecommunications group's future in just a few hours...

SONAECOM UPGRADING BID

On 15 February, 2007, after more than a year insisting that there would be no upgrade to its initial offer, Sonaecom finally raised its initial bid from €9.50 to €10.5 per PT share. The PTM¹⁷ offer of €9.03 per share remained unchanged. This new offer represented a 28% premium over PT's previous close since the first announcement on 6 February 2006 (€8.18). According to Sonaecom this would be the best and final offer for PT shareholders. **Exhibit 1** presents Sonaecom's new tender offer terms.

Sonaecom's new prospectus went public on 16 February, 2007. According to this prospectus, this new cash offer represented a significant premium to PT's fundamental value reflecting the payment of transaction synergies:

- €3.6 billion premium for similar change of control transaction multiples;
- €3.1 billion premium for current Telco peer trading multiple even despite a 33% Telco market rally¹⁸;
- €2.1 billion premium for market analysts' fair valuations.

According to Sonaecom, this offer was pricing-in transaction synergies and paying current PT shareholders immediately in cash. Sonaecom was the one assuming the execution risk of extracting these synergies. If the PT articles amendment was not approved on March 2, 2007, Sonaecom's offer would lapse and fail. Not voting at the PT extraordinary shareholders' meeting was effectively voting against Sonaecom's offer.

¹⁷ PTM was a traded company on Lisbon's Euronext stock market. PT Group managed PTM by holding 58.4% of PTM's stock.

¹⁸ M&A-Free Telco Index that includes companies such as, Belgacom, BT Group, Deutsche Telekom, France Telecom, Swisscom, Telefónica, Telekom Austria, Telenor and Vodafone. Index is based on non-weighted prices (Source: Datastream as of 14 February, 2007).

PORTUGAL TELECOM'S RESPONSE AND SONAECOM COUNTER-OFFENSIVE

PT's takeover team was in San Diego on its second roadshow when they first received the Sonaecom bid upgrade announcement. In fact, it was not at all surprising for PT's takeover team as for some time they had already been telling major shareholders that the rules of the game would change entirely. The next day PT's team flew to Mexico City. Due to the lack of time for PT's to respond to Sonaecom, the team divided into two sub-teams, one to present PT's current proposal to their Telmex shareholder and the other to analyze and study PT's next steps. The first idea was to launch a €11.50 per share competitor offer for only a certain number of shares. However, as it would not include all PT shares, according to the Portuguese Securities Code, it would translate into a worse market offer than Sonaecom's, and therefore illegal. Afterwards, PT's team did not return to Portugal from San Diego, as was previously scheduled, but flew directly from Mexico City to Portugal, in order to meet the legal requirements regarding the tender offer process.

PT's official position about Sonaecom's new offer only came up 20 February, 2007. According to PT, this offer of €10.50 per PT share remained inadequate as:

- *“PT's value has increased by €1.0 billion since Sonaecom's initial offer in February 2006 which is in line with the increase of the revised offer;*
- *PT shareholders are not receiving any share of the synergy value benefit, estimated in an independent analysis prepared by external consultants Booz Allen Hamilton¹⁹ to be worth €2.6 billion (two brands – one network) to €2.9 billion (one brand – one network);*
- *Sonaecom's share price has increased by c. 112% since the announcement of its original offer, confirming the above and the fact that the offer price represents a bargain for Sonaecom shareholders at the expense of PT shareholders;*
- *The offer is opportunistic in light of the European telecom sector index increasing by 23% since Sonaecom announced their unsolicited offer on 6 February 2006.”*

Therefore, PT revised the shareholders' remuneration package. The revised package consisted of:

- Cash remuneration of €4.2 billion, equivalent to €3.8 per PT share over the course of 2006-09 by:
 - The acquisition of own shares for 16.5% of PT's outstanding share capital at a price of up to €11.50 per share, implying a total amount of up to €2.1 billion;
 - The payment of the May 2007 dividend equal to €0.475 and a commitment to an annual dividend payment of €0.575 per PT share for 2008 - 2009 post completion of the acquisition of own shares, equivalent to a dividend yield of 6.9%²⁰ (post PTM spin-off) at €10.50 price per share.
- PTM Spin-off
 - Distribution of 180.6 million PTM shares to PT shareholders equivalent to €2.0 billion or €1.8 per PT share²¹.

According to PT, the impact of the revision of the shareholders' remuneration package should not have a material impact on the financing costs of Portugal Telecom, with Moody's and Standard & Poor's keeping their respective rating of PT unchanged.

¹⁹ PT disclosed Booz Allen Hamilton study in all its components:

1. One Brand – One Network (Mobile-synergies NPV equal to €2.61 billion, Fixed-synergies NPV equal to €0.33 billion, Remedies NPV equal to minus €0.06 billion);
2. Two Brands – One Network (Mobile-synergies NPV equal to €2.31 billion, Fixed-synergies NPV equal to €0.25 billion, Remedies NPV equal to minus €0.04 billion).

²⁰ Sonaecom offer price of €10.50 per PT share minus the proposed PTM spin-off per share at market (€2.12) equates to €8.38, which taking into account the proposed annual ordinary dividend per share for 2006-2008 (€0.575), implies a 6.9% dividend yield. Proposed PTM spin-off per share at market is computed using the maximum future number of PT's outstanding shares which is equal to 925.6 million shares (1,128.8565 million of PT's shares minus the current 20.6 million shares from PT equity swap on own shares (relating to the share buyback program approved at the last shareholders' General Meeting) and minus the future 182.6 million own shares, which is computed by dividing the €2.1 billion of the new buyback program by €11.5 of the proposed PT share price).

²¹ Based on the current number of shares adjusted to exclude 20.6 million shares from PT equity swap on own shares, with a PTM share price of €10.85 as of 16 February, 2007.

Under this new package, the total remuneration to PT shareholders from 2006 – 2009 would amount to €6.2 billion, an increase from the previous €4.8 to €5.6 per PT share, which corresponded to more than half of Sonaecom's revised offer, while allowing shareholders to retain 100% of PT's ownership.

The next day, 21 February 2007, Sonaecom counter-attacked PT's prospectus with another one. According to Sonaecom, this "new" PT defense plan was misleading and clearly inferior to €10.50 cash per share. Firstly, no incremental value is given to PT's shareholders, only slightly higher distribution with higher execution risk, as PT switched from special dividend to share buyback at an uncertain price (€11.50 per share is a red herring) and PT's defense included 32% of total cash distribution in the form of an overvalued PTM stock. Secondly, PT's synergy analysis was flawed and misleading as no Portuguese Competition Authority remedies were included and terminal value growth rate geared towards artificially increasing the valuation. Thirdly, €10.50 per share offered a significant premium to trading comparables, transaction comparables and market analysts' fair valuations.

In addition, and in order to end market rumors about further bid upgrades, Sonaecom officially addressed this issue 22 February, 2007:

"Sonaecom has clearly stated 15 February, 2007 that its offer of €10.50 per Portugal Telecom share is final. For the avoidance of doubt, Sonaecom confirms that it is not interested in, and will not contemplate, any hypothetical structures that would deliver additional value to Portugal Telecom shareholders above €10.50 per share in whatever form."

PT's takeover team flew to London for its third and last roadshow.

FINAL ARGUMENTS

The last card played by Sonaecom took place 27 February 2007, when it announced the commitment to a shareholder remuneration plan equal or higher to the proposal presented by PT's Board of Directors and also the commitment to increase the free-float at the option of PT's shareholders. According to Paulo Azevedo (Sonaecom's CEO), Sonaecom decided to use the same weapons as PT. There was a media frenzy announcing that Sonaecom had equaled PT's offer.

According to Sonaecom, PT was proposing an alternative to Sonaecom's premium all cash €10.50/share offer comprising: a spin-off of PTM, a higher ordinary dividend pay-out through to 2009 and a 16.5% share buyback, which corresponded to a total of only €3.8 billion or the equivalent of €3.5 per PT share on an NPV basis. Due to the fact that there was still a risk that some shareholders would not accept the cash offer and would prefer to retain their shares for future dividends and/or eventual capital gain, instead of accepting the cash conditions provided by the tender offer, Sonaecom advanced to a new mixed offer that provided flexibility to choose between an all cash offer and a share exposure to PT future performance. Subject to the existence of distributable funds²², Sonaecom committed that Sonaecom/PT would make a minimum cash distribution of €5.7 billion (€5.1 per PT share) through dividends and potentially other forms of distribution to its shareholders during the period 2007-2010. Consistent with Sonaecom's strategy and financing plans, cash distributions would be made as quickly as permissible by cash flow generation including asset sales and, on this basis, Sonaecom would target the following distributions: €1.8 billion in 2007, €2.1 billion in 2008, €0.7 billion in 2009 and €1.0 billion in 2010.

After this last offer Sonaecom was confident of its success, and the next day, a member of Sonaecom's Board stated in an interview with Reuters:

"We are comfortable regarding PT's extraordinary shareholders' meeting; we do not believe that shareholders, even those that have opposed the takeover bid since the beginning, will vote against PT's bylaw amendments".

PT immediately attacked Sonaecom's new offer. In an interview to Agência Lusa, Henrique Granadeiro (PT's CEO) explained that the periods that applied to both proposals were not comparable; if one adjusted them it would be obvious that PT's proposal offered shareholders better returns.

²² Funds that could be generated by the company's business activity including asset sales and other restructuring (Sonaecom would vote favorably for any share capital reduction needed to maximize distributable funds).

"PT's Board of Directors undertakes to reward its shareholders with €5.7 billion between 2007 and 2009, while Sonaecom's proposal is limited to €4.7 billion for the same period".

Therefore, 1 March, 2007, PT officially stated that it would not change its last shareholders' remuneration package. According to PT's point of view, Sonaecom's new proposal (labeled by PT as Sonaecom's "last minute" capital return announcement) was not sufficient to persuade brokers, shareholders and the Press, as the significant value creation through an unprecedented wireless concentration was obvious to PT's shareholders who were looking to be adequately rewarded.

THE SHAREHOLDERS' RESPONSE

According to PT, Sonaecom's share price more than doubled since the takeover announcement (+ €1,335 million or +112.5%²³) or 18% since the announcement of the revised €10.50 offer, because none of the synergy value was being transferred to PT's shareholders. However, according to Sonaecom, this value transfer claim was inaccurate as Sonaecom was much smaller than PT and so, of course, its price would increase more. The truth for Sonaecom was that its market capitalization was only up €0.8 billion while PT's premium was €2.0 billion and the market recognized that the value was being split fairly between PT and Sonaecom shareholders.

Before tender offer announcement, February 2006, almost all major PT shareholders had a long-term investment perspective. However, at the end of the tender offer process, PT's shareholders structure was very different. Besides Telmex (Teléfonos de Mexico, S.A.), the Mexican incumbent for telecommunications, almost all new entrants were typically hedge funds, event driven, that only wanted to obtain substantial profits in a short-term period. **Exhibit 2** presents PT's shareholders.

At the PT extraordinary shareholders' meeting, almost all major Portuguese PT shareholders were against Sonaecom's tender offer. However, some doubts remained about international shareholders. The Portuguese government that owned PT shares both through Caixa Geral de Depósitos Group and PT *Golden Shares* did not clarify its position before PT's extraordinary meeting.

Telefónica, who was PT's largest shareholder and one of the leading telecommunications group in Europe and Latin America, was in favor of PT's bylaw amendments in order to secure exclusive control of VIVO, Brazil's largest mobile operator. However, Telmex, which came to PT suddenly during the summer through PT's own initiative, was expected to vote against Sonaecom as it was Telefónica's major rival in Latin America. Thus, the common belief was that the tender offer success would be decided only by a very slim margin, but a different "Slim" had entered the picture (Carlos Slim, Telmex's CEO). He might be decisive in the end. According to PT, this shareholder was a critical one not only because of his position against Telefónica, but also because he could bring new investors to PT's stock, as well as helping to put an end to current PT's shareholders remaining doubts, due to his strong credibility and recognition in the financial markets. Sonaecom stated that it had not met with Telmex.

In addition, during the tender offer process, an association for small shareholders was created. This association, called Commission of Minority PT Shareholders was very active in the media, defending its position against Sonaecom's tender offer. **Exhibit 3** presents PT's comments pre-General Meeting.

²³ Adjusted for Sonaecom capital increase announcement, in October, 2006. Sonaecom's Board of Directors approved a capital increase that was conditional upon registration, launch and success of the tender offer over PT's shares and convertible bonds. This capital increase would be made by means of the issue of 1,500 million new ordinary bearer shares with a nominal value of €1.00 each (share capital increase from €366,246,868 to €1,866,246,868).

THE LAST WEEK

The last week before PT's extraordinary shareholders' meeting was a mess of news, posts, events and data regarding Sonaecom's takeover. Politics was the order of the day, several comments from people of varying opinion. Opinion leaders were also very enthusiastic, sharing their forecasts that ultimately tended to be in PT's favor. These opinions were actually quite different from the initial ones when Sonaecom announced its tender offer for PT. Even PT's old, inherited image had changed significantly during this last year. PT was no longer an accommodated, monopolistic, telecommunications company, but rather a modern and flexible company able to cut inefficiencies and to fight against the major, Portuguese conglomerate. Accordingly, the media was inundating the public with real information or rumors about Sonaecom/PT.

In addition, the financial markets showed a relevant overall increase due to a boost in the stock prices of Europe's major telecommunications groups. This fact, together with PT's favorable impression on international markets, was helping to strengthen PT's offer. However, as some capital stock was still undefined, it was unclear as to how the story would end. (**Exhibit 4** presents stock prices in the last 2 weeks before PT's extraordinary shareholders' General Meeting).

Finally, the time had come for the shareholders of Portugal Telecom to choose whether to change PT's bylaws or not, by casting their vote at the PT extraordinary shareholders' General Meeting scheduled for 2 March, 2007. The result of this General Meeting would end PT's takeover defenses and allow Sonaecom to pursue its tender offer in the market or, in case of failure, would finish almost thirteen months of hard work and several battles between the parties. The war was almost coming to an end.

EXHIBITS

Exhibit 1 – New tender offer terms

CHANGE TO THE OFFER CONSIDERATION

In accordance with and for the purpose of articles 129, n. ° 3 and 184 of the Portuguese Securities Code, Sonaecom, SGPS, S.A. and Sonaecom, B.V. hereby inform of their decision to change the Offer consideration, increasing it from the previous 9.50 Euros per share to the amount of 10.50 Euros per share.

Consequently, point 10 of the Offer Announcement is amended as follows:

“The offered consideration shall be of 10.50 Euros (ten Euros and fifty cents), in cash, for each Share and will be made available on the third business day following the date of the special session of Euronext Lisbon that assesses the results of the Offer.” All references to the consideration offered made in the Offer Prospectus should also be considered as changed, according to the contents of this announcement.

Additionally, the Offerors irrevocably waive any possibility of further increasing the consideration offered, in the event it is considered that such possibility would exist, in accordance with the applicable legal and regulatory conditions.

Porto, 15 February, 2007

AMENDMENT TO THE PROSPECTUS

In accordance with article 142.º of the Portuguese Securities Code, Sonaecom, S.G.P.S., S.A. and Sonaecom, B.V. (hereinafter “Offerors”), taking into consideration the contents of their announcement headed “Sonaecom announces commitment to a shareholder remuneration plan equal or higher to the proposal presented by PT’s Board of Directors”, released yesterday on the website of the Portuguese Securities Commission (Comissão do Mercado de Valores Mobiliários), the Offerors hereby introduce the following changes to the Offer Prospectus:

— the second paragraph of point 2.8.1 (Purpose of the acquisition) is amended to the following:

“In the event that the Offerors acquire Shares and ADSs representing 90% or more of the issued and outstanding share capital and voting rights of PT as a result of the Offers or otherwise, the Offerors reserve the right to use the compulsory acquisition mechanism provided for in article 194 of the Portuguese Securities Code, which will cause the immediate delisting of the Ordinary Shares from Euronext Lisbon, without readmission for one year (and consequently the delisting of the ADSs from the NYSE) – under the condition that, after the completion of the secondary public offer identified in point 2.8.6, its participation in the share capital of PT remains above 90%.”

— the last paragraph of point 2.8.1 (Purpose of the acquisition) is amended to the following:

“In the event the Offer is successful, Sonaecom intends to change the composition of the Board of Directors of PT so that at least a majority of directors are appointed by Sonaecom. The implementation of the Sonaecom Project, as defined below, will be effected through the exercise by Sonaecom of its rights as a controlling shareholder of PT and, indirectly, its subsidiaries, in accordance with relevant legal and statutory powers and subject to applicable law. Prior to the acquisition of 100% of PT, all corporate and business transactions between companies in the PT Group and companies in the Sonaecom Group will be conducted on an arm’s length basis and, as such, with no value impacts on any minority shareholder. Whenever such transactions involve, on one side, PT or any of its subsidiaries and, on the other side, any subsidiary of the Sonaecom Group which is not under the control of PT, they will be supported by independent valuations by third party investment banks acting for the all interested parties.”

— a new point 2.8.6 is inserted (with the consequent renumbering of the subsequent points) with the following wording:

“2.8.6 – Shareholder remuneration plans and commitment to increase free-float. Sonaecom undertakes, as a controlling shareholder of the company, to pursue in PT, during the period 2007 – 2010, measures aimed at maximizing the funds distributable to shareholders. In the event the Offer is successful, Sonaecom will propose and vote favorably the distribution to shareholders of PT, that choose not to sell their shares, annual dividends and reserves in the following minimum amounts – under the condition that sufficient distributable funds²⁴ exist (or, when that is not the case, up to the amount of those funds):

²⁴ Funds that could be generated by the company’s business activity including asset sales and other restructurings (Sonaecom will vote favorably to any share capital reduction needed to maximize the distributable funds). Note that share capital reductions need to be approved by a qualified majority and that Class A share have a veto power on such decisions, as well as over distributions above 40% of the annual net income (this is also applicable to the remuneration package proposed by the Board of Directors of PT).

	2007	2008	2009	2010	Total 2007/2010
Total amount (€ billion)	1.8	2.1	0.7	1.0	5.7²⁵
Per share (€)	1.6	1.9	0.7	0.9	5.1

Note: Assuming the market price of PT's shares is equivalent to the Offer price of €10.5 per share, it is estimated that the proposed remuneration package might have a negative impact of €3.66/share in the market price of PT's shares, due to the extraordinary dividend distributions during the period 2007-2010. The extraordinary dividend distributions were calculated as the difference between the above mentioned distributions and the ordinary dividends announced by PT in the document published by its Board of Directors regarding the Offer price revision on February 20, 2007. It's important to note that the impact here referred is equivalent to the one mentioned in PT's document (€2.12/share). The only difference between the two values is due to the share-buy-back announced by PT being considered not to have an impact in the stock market price per share.

Additionally, and should Sonaecom acquire more than 60% of the share capital of PT under its tender offer, thereafter and for a period of up to three months starting after the end of the offer period, Sonaecom commits to PT shareholders of record as of 9 March 2007 to carry out a secondary public offer of shares in PT at the then prevailing market price, but in no event at less than €10.50 per share. Such commitment will be executed as long as the size of such share placement is greater than €200 million²⁶ value to ensure a meaningful transaction size. Such price will be adjusted by any gross dividends and/or other distributions to shareholders. With this initiative, PT shareholders will be able to acquire PT shares on a pro-rata basis to their shareholdings at the above mentioned date".

As a result of the suspension of the Offer, the Offerors will now accept the revocation of the acceptance orders until 6 March 2007, inclusive (instead of the previous defined limit of 5 days before the termination of the Offer period). The term for the Offer remains at 16:30 Portuguese time on March 9, 2007.

Porto, 29 February 2007.

²⁵ Source: Update of PT Board of Directors' report on the offer price revision, dated 20 February 2007 – total amount of shareholder remuneration package proposed by PT of €6.2 billion, not considering the amount of the 2005 dividend, already distributed in 2006, to the amount of €0.5 billion.

²⁶ To be calculated using the price per share stipulated in the secondary public offer, multiplied by the number of shares that will form part of the offer (number of PT shares acquired by the Offerors above 60% of PT's total share capital).

Exhibit 2 – PT's shareholders

Shareholders (5 February 2006)	No. of Shares	%	Geographical Distribution	Region	%
Telefónica	112,473,826	9.96%	USA and Canada		32.4%
Brandes Investments Partners	96,096,420	8.51%	Portugal		25.8%
Espírito Santo Group	94,387,699	8.36%	Continental Europe		29.8%
Capital Group Companies	63,193,870	5.60%	UK and Ireland		8.1%
Caixa Geral de Depósitos Group	58,053,018	5.14%	RoW		3.9%
Cinveste	29,080,000	2.58%			
Fidelity Group	23,592,185	2.09%			
Patrick Monteiro de Barros	23,000,000	2.04%			
Total Identified	499,877,018	44.28%			
Total number of shares	1,128,856,500	100%			

Shareholders (2 March 2007)	No. of Shares	%	Geographical Distribution	Region	%
Telefónica	112,473,826	9.96%	USA and Canada		26.3%
Espírito Santo Group	87,734,177	7.77%	Portugal		27.5%
Brandes Investments Partners	83,649,255	7.41%	Continental Europe		26.6%
Caixa Geral de Depósitos Group	57,740,600	5.11%	UK and Ireland		10.8%
Telefónos de México, S.A. De C.V. (Telmex)	38,460,000	3.41%	RoW		8.8%
Credit Suisse	26,414,267	2.34%			
Paulson & Co. Inc.	26,385,303	2.34%			
Stark & Roth Inc.	24,959,961	2.21%			
Fidelity Group	23,592,185	2.09%			
Fundação José Berardo	23,357,466	2.07%			
Grupo Barclays	23,216,664	2.06%			
Capital Group Companies	22,996,339	2.04%			
UBS AG	22,779,481	2.02%			
Ongoing Strategy Investments	22,600,000	2.00%			
Total Identified	596,359,524	52.83%			
Total number of shares	1,128,856,500	100%			

Source: PT's investor relations

Exhibit 3 – PT’s shareholders’ comments pre-General Meeting

Shareholder comments regarding PT’s Extraordinary General Meeting (EGM)

“The State has not given guidance regarding Caixa Geral de Depósitos’ (CGD) vote intention and abstained from voting. Through public (Golden Shares), the bylaw amendments to Portugal Telecom’s (PT) statutes is a matter of “neutrality” and because they understand this fact the bank’s voting would be “doubtful” from a legal point of view, said the Prime Minister.”

Jornal de Notícias, 22 February, 2007

“In a brief statement, Telefónica said it was “in the best interests of the company (PT)” for shareholders to vote on March 2 to change the company’s statutes which limit ownership.”

Reuters, 22 February, 2007

“On March 2, if the tender offer succeeds, we are sellers of our position, said Ricardo Salgado yesterday, during the presentation of BES’s annual results. This PT shareholder of reference, who owns about 8% of the carrier, has indicated that, given the current offer he is not available to vote in favor of the bylaw amendments of the telecommunications company.”

Diário de Notícias, 02 February, 2007

“Brandes said it has decided not to tender its stake to Sonaecom, which launched a 10.7 bln eur bid for the company earlier this month. Brandes said it believes Sonaecom’s €10.5 per share bid for Portugal Telecom is ‘significantly below’ fair value.”

AFX, 23 February, 2007

“Armando Vara, an Administrator of Caixa Geral de Depósitos (CGD) and the bank’s representative at Portugal Telecom, said today at the entrance to the General Meeting of the telecommunications company, that he will not abstain himself from voting on the bylaw amendments statutes. The Administrator of CGD did not clarify, however, if he will vote for or against.”

Publico, 02 March, 2007

“Teléfonos de Mexico (Telemex) is widely considered to be planning to vote against the removal of voting rights limits in the company statutes, a vital move before Sonaecom can go ahead with its bid for PT. Sonaecom has suggested that it would sell PT’s stake in Brazilian mobile telephone venture VIVO to joint venture partner Telefónica if its bid for PT is successful. Telefonica is Telmex’ main competitor in Latin America.”

AFX, 02 March, 2007

“In our view, at €10.5 the probability of Sonaecom getting an EGM passed and getting at least 50% offer acceptances have risen although we still believe that a further raised bid of over €11.0 would be required to have a realistic chance of eventually securing 100% of PT.”

Credit Suisse, 16 February, 2007

“Hedge fund Paulson & Co. does not intend to tender its shares in Portugal Telecom to smaller Portuguese telecom rival Sonaecom, people familiar with the situation said on Friday. Paulson, which declined to comment, owns a little more than 2% of Portugal Telecom shares.”

Reuters, 23 February, 2007

“Joe Berardo, who is also part of the opposition against Sonaecom’s offer, considered that the offer for the distribution of dividends is “dishonest” as the bidder did not explain “how they will pay the debt and the dividends”. Berardo also reaffirmed his intention to vote against the lifting of the caps on voting rights at the PT shareholders’ meeting.”

Portuguese News Digest, 28 February, 2007

“The President of Portuguese investment company Ongoing Strategy Investments, Nuno Vasconcellos, considered the remuneration offer made by Sonaecom to the shareholders of takeover bid target Portugal Telecom (PT) as “not credible”. Vasconcellos highlighted the fact that Sonaecom proposed the distribution of €5.7bn in dividends to PT shareholders by 2010, but with the safeguard that it will do this if “there are funds and cash to distribute.”

Portuguese News Digest, 28 February, 2007

“The President of PT’s small shareholders association has already responded to Sonaecom’s new proposal. The association that represents more than 1% of Portugal Telecom’s capital says that it will vote against the bylaw amendments statutes of the company in the next General Meeting.”

Comments from Jorge Neto, Commission of Minority Shareholders of PT.

RTP, 01 March, 2007

Brokers and investment banks comments regarding PT's Extraordinary General Meeting (EGM)

“We believe that PT's shareholder remuneration policy is quite attractive (23% dividend yield plus share buyback) versus the sector (6.2% dividend yield) and should support PT's share price if the bid fails.”

BANIF, 27 February 27, 2007

“Sonaecom has now committed itself to [...] a dividend package totaling a minimum of €5.7bn [between] 2007-2010 or an amount equivalent to €5.10 per PT share. We must remind investors that PT's own remuneration package amounts to €5.60 per share or €6.2bn from 2006-2010. We continue to believe that shareholders will be disappointed with the package offered by Group Sonaecom.”

Lisbon Brokers, 28 February, 2007

“The Board's decision makes sense from two perspectives. First, the Sonaecom offer is still too low. Taking into account sector performance and the €2bn or so of synergies created from bringing together PT's and Sonaecom's mobile networks, an offer of more than €11 a share appears necessary. PT's share buyback, announced on Wednesday, will take place at "up to" €11.50 a share, offering a hint of where PT sees fair value. The fact that Sonaecom's market capitalization has risen by €1.3bn since the bid battle began, far more than if it had merely performed in line with the market, suggests that it is some distance from the point of paying away the value of synergies to PT shareholders.”

LEX, Financial Times, 21 February, 2007

“We continue to recommend to PT shareholders not to sell on the tender offer because we think that PT's assets are worth more on a standalone basis (we value PT at €11.5 per share) than the €10.5 price offered.”

Millennium BCP, 28 February, 2007

“We believe that shareholders will vote down the change of articles at the EGM, waiting for a better offer or a pacman takeover from PT of Sonaecom.”

Fidentiis, 28 February, 2007

Exhibit 4 – Stock prices

Date	PT	PTM	Sonaecom	DJ EUROPE TELECOM Index
5-Mar-07	€9.60	€10.96	€4.61	€319.00
2-Mar-07	€9.90	€10.62	€5.52	€325.08
1-Mar-07	€10.06	€10.60	€6.30	€327.59
28-Feb-07	€10.07	€10.81	€6.34	€335.25
27-Feb-07	€10.13	€11.00	€6.02	€340.78
26-Feb-07	€10.13	€11.00	€6.26	€348.43
23-Feb-07	€10.15	€11.00	€6.34	€346.47
22-Feb-07	€10.18	€11.10	€6.57	€342.32
21-Feb-07	€10.17	€10.94	€6.50	€344.68
20-Feb-07	€10.28	€10.90	€7.36	€350.20
16-Feb-07	€10.24	€10.85	€7.50	€349.03
15-Feb-07	€10.29	€10.36	€6.37	€348.54
14-Feb-07	€10.21	€10.42	€6.20	€351.36
7-Feb-06	€9.69	€9.90	€3.65	€249.97
6-Feb-06	€8.18	€9.62	€3.53	€247.52

Date	PT	PTM	Sonaecom	DJ EUROPE TELECOM Index
5-Mar-07	117%	114%	131%	129%
2-Mar-07	121%	110%	156%	131%
1-Mar-07	123%	110%	178%	132%
28-Feb-07	123%	112%	180%	135%
27-Feb-07	124%	114%	171%	138%
26-Feb-07	124%	114%	177%	141%
23-Feb-07	124%	114%	180%	140%
22-Feb-07	124%	115%	186%	138%
21-Feb-07	124%	114%	184%	139%
20-Feb-07	126%	113%	208%	141%
16-Feb-07	125%	113%	212%	141%
15-Feb-07	126%	108%	180%	141%
14-Feb-07	125%	108%	176%	142%
7-Feb-06	118%	103%	103%	101%
6-Feb-06	100%	100%	100%	100%



Portugal Telecom

Takeover defense

CASE STUDY – PART 3

Portugal Telecom – Takeover Defense

Portugal Telecom’s extraordinary shareholders’ meeting started 30 minutes later than scheduled. Finally, D-day, Friday 2 March, 2007, when everything would be decided had arrived. Since the beginning Sonaecom’s tender offer was conditioned by PT’s statutes as it was a prerequisite for Sonaecom’s tender offer success. Therefore, before the market had the opportunity to decide whether to keep or to sell their shares to Sonaecom, some amendments to PT’s bylaws were necessary. It was PT’s shareholders’ meeting with the greatest attendance ever. After five hours the first shareholders started to leave the amphitheater and the results were announced:

“Shareholders of Portugal Telecom (PT) refused to change PT’s bylaws, putting an end to the takeover bid launched by Sonaecom:

- *Representatives of 43.2% of PT’s stock voted in favor PT’s bylaws amendments;*
- *Representatives of 10.0% of PT’s stock abstained from voting;*
- *Representatives of 46.8% of PT’s stock voted against PT’s bylaws amendments.”*

With 67.4% of total shareholding base, excluding abstentions, 52% of the shareholders represented at the meeting voted against the removal of article limitations. For PT this majority was considered a real victory, not a paper triumph in the general office, but true evidence that, in the end, the market believed in PT’s proposal and that its top management could achieve it. **Exhibit 1** details PT’s Extraordinary General Meeting results.

The lawyer Osório de Castro, who represented Sonaecom at PT’s extraordinary General Meeting, held in Lisbon, told reporters that he would not ask for impugnation. In statements to journalists before PT’s General Meeting, Osório de Castro said that if the takeover bid fell it would not be a court decision that would change things, or in other words, if PT’s bylaw amendments did not succeed, the tender offer would cease.

Caixa Geral de Depósitos Group (CGD), a Portuguese public bank managed by the government, voted against PT’s bylaw amendments *“We made an assessment of our interests and voted in accordance with these interests”*. The Portuguese government did not vote, but was also in line with PT’s proposal *“the Portuguese state accepted the vote of the majority of shareholders”*.

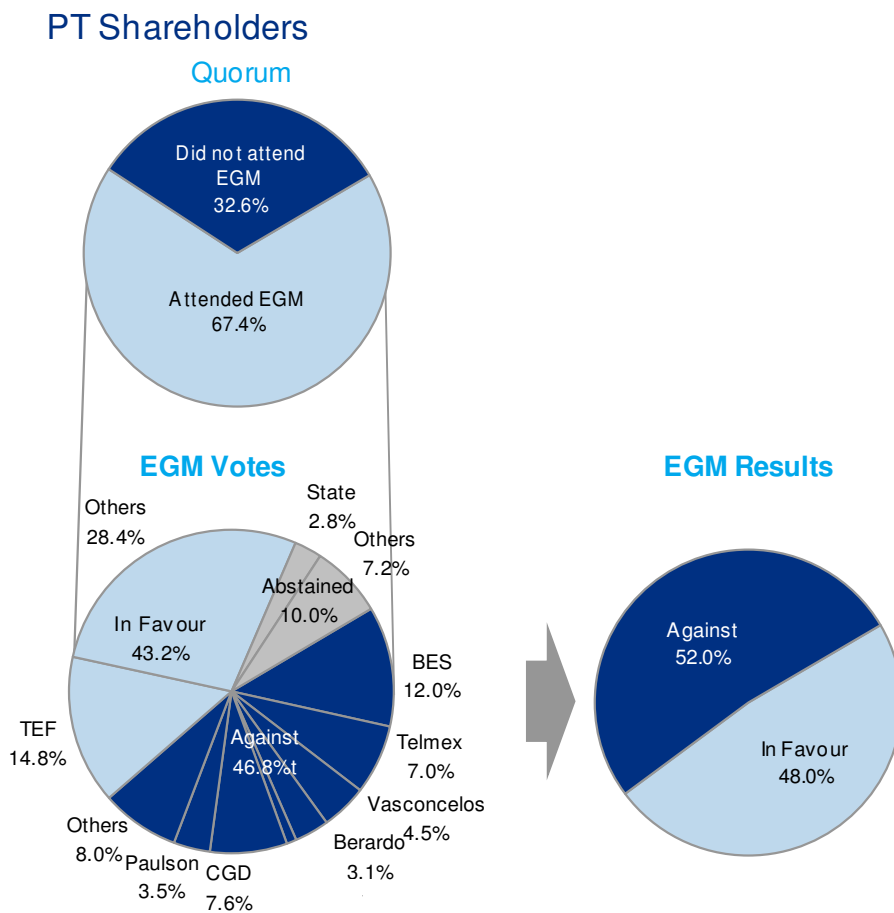
In the end, Henrique Granadeiro, Portugal Telecom’s CEO expressed his thanks via the media for the vote of confidence that was given to PT’s executive committee, recognizing the responsibility that this vote represented in the construction of a new future for the telecommunications group. His last statement was:

“It was finally established that the Sonaecom takeover bid did not succeed as there was no compliance with the required pre conditions. It is therefore with great pleasure that I announce that the process, in which we have been submersed for over 1 year, has come to an end, Sonaecom’s tender offer died”.

And so was the end of this hostile takeover...

EXHIBITS

Exhibit 1 – PT’s Extraordinary General Meeting (EGM) results



TEACHING NOTES



Portugal Telecom

Takeover defense

TEACHING NOTES

Portugal Telecom – Takeover Defense

BACKGROUND

Portugal Telecom (PT) was not only the Portuguese incumbent for telecommunications, but also the largest company in the sector offering a comprehensive range of telecommunications and multimedia services. Its presence was very strong in all its domestic operating markets, being the leader in fixed copper, fixed cable and domestic markets. Due to its history and its strategic position for Portugal, the Portuguese government continued to hold golden shares, with privileged rights, despite European Union pressure to end this level of public control over private companies. On 6 February, 2006, it was the target of an unexpected hostile takeover by Sonaecom. This tender offer arises in a very convenient situation for Sonaecom as:

- European publicly traded telecommunications companies share prices had been falling sharply for four weeks prior to the tender offer announcement due to France Telecom's profit warning;
- PT's Board of Directors commission service would end two months after Sonaecom's announcement;
- PT's financial position was fragile due to domestic regulations and international operational results (also from losses in currency exchange);
- There were some question marks as to the value of PT's international assets, namely several companies in Africa and VIVO in Brazil (due to the CDMA-GSM switch).

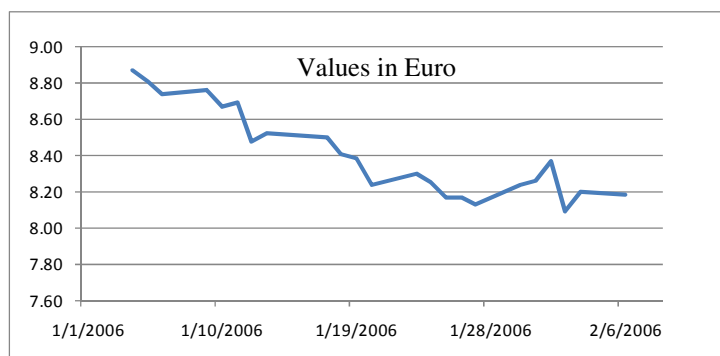


Figure 1: PT's stock evolution four weeks prior to the tender offer announcement

Due to the 58.7% stake held by Portugal Telecom in PTM (PT's cable subsidiary), Sonaecom's PTM tender offer was an obligation under the Portuguese Securities Code. However, as PT and PTM's management were the same, PTM was a second concern in a takeover and all relevant data was centralized in PT's prospectus. That is why this case is mainly centralized in PT's positions and responses. Nevertheless, it is important to take into account Sonaecom's offer price discount on PTM, as shown in the following figures.



Figure 2²⁷: Sonaecom’s offer versus PTM share price performance over the previous six months

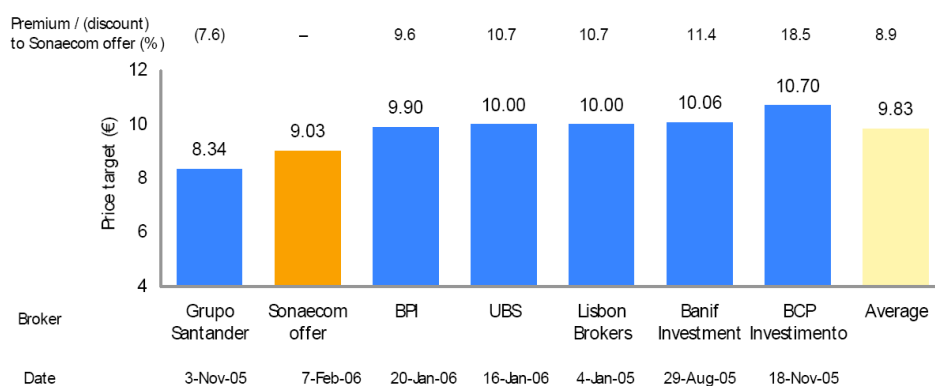


Figure 3²⁸: Sonaecom’s offer versus equity analyst price targets

The telecommunications industry requires scale, both to achieve economies of operation and to benefit from network externalities. That is why Sonaecom, the second largest operator in the domestic fixed copper market, but the third and smallest operator in the domestic mobile market, needed to grow so urgently. By merging with PT, Sonaecom would not only achieve relevant synergies, but also benefit from PT’s leadership in all domestic telecommunications markets (fixed copper, fixed cable and mobile). However, some antitrust issues were supposed to arise in Sonaecom’s proposal due to high market concentration. Therefore, Sonaecom started to ascertain the Portuguese government's feelings about the feasibility of its proposal. As far as the media were concerned, before the announcement of the takeover, the Portuguese government was not against Sonaecom. However, during the tender offer process, some doubts started to arise regarding:

- Market concentration;
- Tax reduction due to debt leverage;
- International control of Portugal Telecom;
- Disposal of international strategic assets in Portuguese speaking countries.

From a financing point of view, Sonaecom, as a subsidiary of Sonae Group, had a very stable position due to the strength of its holding company (total of net revenues of 7.17 billion and net income of €0.65 billion in 2005). Sonae SGPS is a Portuguese conglomerate covering activities in industry, finance, retailing and telecommunications. In 2006, Sonae SGPS held a portfolio of businesses grouped into four sub-holdings:

²⁷ PT Multimédia, Portuguese Securities Market Regulator (CMVM) - Material information (official prospectus) as of 6 March 2006.

²⁸ PT Multimédia, Portuguese Securities Market Regulator (CMVM) - Material information (official prospectus) as of 6 March 2006.

- Modelo-Continente, also known as Sonae Distribuição (food and non-food retail);
- Sonae Sierra (ownership, management and development of shopping and leisure centers);
- Sonaecom (fixed and mobile telecommunications, software consultancy, newspaper, joint venture with France Telecom);
- Sonae Capital (tourism, construction, transportation and venture capital).

Sonae Distribuição and Sonae Sierra are two examples of leadership in their operating markets. According to Sonaecom, only a capital increase of €1,500 million was required to perform the whole PT operation. Financial backing was negotiated with Santander Group, PT's main bank at the time. By dealing with Santander for this takeover, Sonaecom would be in a very competitive position compared with PT's financial situation.

In addition, Sonaecom benefited from France Telecom's help (Sonaecom's major shareholder after Sonae) that also wanted to expand its European control to PT. France Telecom was one of the world's leading telecommunications carriers (second-largest wireless operator and Internet access provider in Europe, and a world leader in telecommunications solutions for multinational corporations), with more than 126 million customers in five continents (220 countries and territories) as of the end of 2005 with a total of net revenues of €49.04 billion and net income of €5.71 billion (year 2005).

CASE STRUCTURE

This case is divided into three parts. The first two parts have specific learning objectives for students while the third part is only used to show Sonaecom's takeover results.

The first part of the case starts on 6 February 2006 with Sonaecom's takeover bid announcement and ends on 15 February 2007, after Sonaecom upgraded its initial offer from €9.50 to €10.50 per PT common share. It begins with the presentation of Sonaecom's takeover bid and then presents an overview of the Portuguese telecommunication market as well as Sonaecom and PT businesses and financials. Afterwards, all major and relevant moments of Sonaecom's tender offer are underlined such as:

- 06.02.2006: Sonaecom PT's tender offer announcement;
- 07.02.2006: Sonaecom PTM's tender offer announcement;
- 27.02.2006: Sonaecom requests Portuguese securities market regulator (CMVM) for registration;
- 06.03.2006: PT's first detailed advisory offer rejection explanation (official prospectus);
- 21.04.2006: PT's general shareholders' meeting (ordinary meeting);
- 02.06.2006: Rival takeover bid's announcement by "The Times";
- 03.08.2006: PT's announcement of PT/PTM spin-off;
- 22.12.2006: Portuguese Competition Authority final clearance for the transaction;
- 12.01.2007: PT's targets announcement and first shareholder remuneration package proposal (official prospectus);
- 24.01.2007: Sonaecom's counter-offensive to PT's first shareholder remuneration package proposal (official prospectus);
- 08.02.2007: PT's full 2006 financials announcement (annual report);
- 15.02.2007: Sonaecom's upgrading bid.

The second part of the case starts on 15 February with Sonaecom's upgrading bid and ends on 2 March 2007, some hours before PT extraordinary shareholders' meeting. It begins with Sonaecom and PT's reactions regarding Sonaecom's upgrading bid followed by the presentation of the positions of all relevant shareholders. The relevant moments underlined in this part are:

- 15.02.2007: Sonaecom's upgrading bid;
- 20.02.2007: PT's reaction to Sonaecom's upgrading bid (official prospectus);
- 21.02.2007: Sonaecom's counter-offensive to PT's reaction (official prospectus);
- 02.03.2007: PT extraordinary shareholders' meeting.

The third and last part of the case focuses on 2 March, 2007 after the PT extraordinary shareholders' meeting. PT extraordinary shareholders' meeting results are presented as well as the last comments from the most important characters.

- 02.03.2007: PT extraordinary shareholders' meeting.

This case also shows all relevant and official data and registration requirements for a takeover in order to contribute to a broad overview of a process such as this one. The time frame of the case is presented in Figure 4.

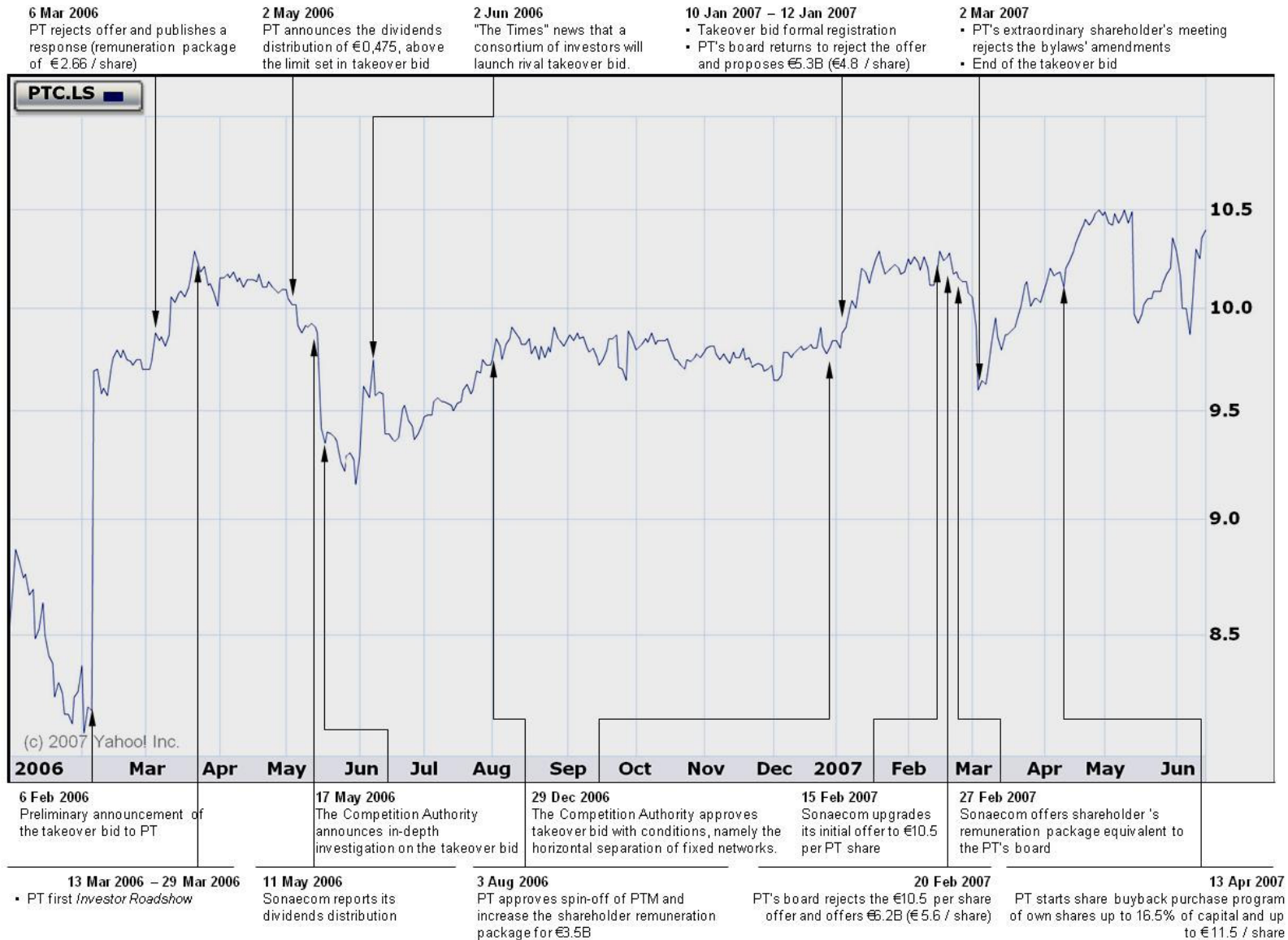


Figure 4: Takeover timeline

CASE LEARNING OBJECTIVES

The primary objective of the case is to understand the use of critical anti-takeover measures in a hostile takeover environment. The case portrays not only all defensive tools used by PT against Sonaecom (conditioned by the Portuguese Securities Code), but also all major interactions with relevant stakeholders. Communication is positioned as a central tool to stakeholders' interaction. As a consequence of that, students are supposed to comprehend how PT uses this instrument to implement its defensive strategy. In the end of the first part, students are asked to advise PT's board of directors as to PT's next steps after Sonaecom upgraded its initial bid. Finally, this case aims to present a complete and broad view of a long tender offer process.

Part 1

Specific objectives for the first part of the case are:

- To develop a consistent valuation of PT and compute Sonaecom's negotiation range along the takeover period, using all available data in the market (PT's financials, premiums, multiples and bank's price targets). This valuation should be divided into:
 - PT's standalone valuation
 - Adjustments due to synergies and regulatory remedies
- To identify PT's defense strategy and to analyze how PT implemented it through PT's reactions and prospectus:
 - By increasing ordinary dividends and offering extraordinary dividends
 - By proposing a PT/PTM spin-off
 - By adjusting its corporate governance structure
 - By dealing with regulatory and competition authorities
- To recognize the relevant stakeholders in a takeover environment, as well as the different phases of a takeover process. This includes financing, registration, official prospectus, regulatory and competition issues.
- To understand how to leverage communication as an essential management tool for value creation:
 - Corporate communication to public opinion
 - Investor relations to the financial market

Finally, students are supposed to make a recommendation to PT's board of directors regarding Sonaecom's €10.5 per PT share. In case of not accepting Sonaecom offer, students should propose guidelines for PT's new strategy, as well as alternative feasible shareholder package remuneration.

Part 2

Specific objectives for the second part of the case are:

- To adjust PT's valuation and Sonaecom's negotiation range taking into account last available information in the market
- To comprehend the role of capital markets and how they affect a targeted company in a tender offer environment regarding:
 - Company financial performance
 - Industry financial performance
- To understand the criticality of major shareholders and the importance of managing alliances with them

At the end of this part, students are supposed to accomplish a broad view of all Sonaecom/PT tender offer highlights and to recognize defensive strategies regarding capital markets.

Part 3

The main specific objective for the third and last part of the case is to understand, in the end, what the real incentives of major shareholders were. Afterwards, students are supposed to identify core critical factors in a defensive takeover strategy.

ASSIGNMENT QUESTIONS

Part 1

- 1) Why did Sonaecom launch Portugal Telecom's takeover bid?
- 2) Explain PT's takeover defense strategy. How did it compare to Sonaecom's takeover strategy?
- 3) What was the role of corporate communication in the defense strategy adopted by PT's top management? Explain the approach followed by PT to influence the decision of major stakeholders such as shareholders, media, official authorities and employees?
- 4) Explain PT's old corporate governance model. Do you consider the new corporate governance model to be aligned with shareholders' interests?
- 5) Analyze the valuation of PT.
- 6) Should PT accept the €10.50 per share offer? Why or why not? What would be your recommendation to the shareholders of PT?

Part 2

- 7) Explain the change in the remuneration package offered to PT's shareholders.
- 8) Do you think the remuneration package offered to shareholders constituted a good anti-takeover defense measure? What other motives might major shareholders have to support PT's management?
- 9) Do you consider Sonaecom's final offer reasonable? Why or why not?

Part 3

- 10) In the end, what were the key success factors of PT's defense strategy?

SUGGESTED ANSWERS FOR ASSIGNMENT QUESTIONS

Part 1

1) Why did Sonaecom launch Portugal Telecom's takeover bid?

The conventional view of the profile of the target of a hostile bid is an underperforming company that has a low stock price due to management inefficiency (Henry Manne). However, targets can be simply attractive investment opportunities due to strong growth perspectives or high levels of synergy. According to Franks and Mayer (1996) “there is little evidence of poor performance prior to bids”. Typical motives for inorganic growth are²⁹:

1. Maturing product line;
2. Regulatory or antitrust limits;
3. Value creation through horizontal and vertical integration;
4. Acquisition of resources and capabilities;
5. Value creation through diversification.

The first M&A-wave appeared during the industrial revolution, between 1897 and 1904. At that time, the primary strategic objective was the prevention of overcapacities and price deterioration through horizontal integrations. The second M&A-wave occurred between WWI and WWII, from 1919 to 1929, with the strategic objective of gaining both a market dominant position and control over the entire production cycle through vertical integrations. This phase ended with the well known stock crash in 1929. The third M&A-wave appeared in the 60s with the strategic objective of creating big conglomerates in order to extent the portfolio of products and services reducing, by that way, diversification risks. The fourth M&A-wave started in 1984 and ended in 1990 with the strategic objective of focusing on core competencies and developing synergies. The most recent M&A-wave started in the mid 90s, being characterized by mega-deals based on market globalization of the digital era.

Despite Sonaecom being a major Portuguese telecommunications operator, rendering services both in the domestic fixed (copper) market and in the domestic mobile market, it was not a leader in any market segment. Bearing in mind that the telecommunications business requires scale (or critical mass), due to network externalities, it is essential to benefit from the bandwagon effect. The bandwagon effect requires an initial effort to start, but then it maintains itself without further costs. Due to the high concentration of the market together with stable growth, only an inorganic growth was a solution to trigger the bandwagon effect. Looking at the major Portuguese telecommunications players one can infer that PT was the most interesting player to go for a horizontal integration:

- Vodafone: second major player in the domestic mobile market, but it was a subsidiary of Vodafone UK, a multinational company and one of the largest in Europe;
- Cabovisão: second major player in the domestic fixed (cable) market; it would place Sonaecom in a new market, but with a low level of synergies and once again with no leadership in any market segment;
- Portugal Telecom: first player in all domestic telecommunications markets, despite some antitrust conditions that might arise during the tender offer period, it would place Sonaecom as a leader in markets where it would be allowed to operate.

In addition, as a strong position in market share terms is also directly correlated with investment returns³⁰, Sonaecom would also benefit from higher returns. The right timing combined with a careful takeover preparation are also critical success factors. A takeover preparation includes arranging financial operation, attack tactics, as well as the communication strategy. The timing for Sonaecom was excellent as PT was in a delicate period:

- Europe's publicly traded telecommunications companies' share prices had been falling sharply;
- PT's board of directors commission service would end two months after Sonaecom's announcement;
- PT financial position was fragile due to domestic regulations and international operational results, and there were some question marks on PT's international assets value.

In this question, students are expected to think over the beginning of a takeover process and to analyze whether the offeror had the right motivations to go for an inorganic growth. Remember that only 20% of all M&A transactions are successful³¹ (the ones that actually create real value).

²⁹ Bruner Robert F., Perella Joseph R., “Applied Mergers & Acquisitions”, 2004, 1st edition, Wiley, p. 139.

³⁰ Bruner Robert F., Perella Joseph R., “Applied Mergers & Acquisitions”, 2004, 1st edition, Wiley, p. 127.

³¹ Bruner Robert F., Perella Joseph R., “Applied Mergers & Acquisitions”, 2004, 1st edition, Wiley, p. 30.

2) Explain PT’s takeover defense strategy. How did it compare to Sonaecom’s takeover strategy?

Hostile takeovers are rare and their outcomes uncertain. While defense tactics seek to delay the outcome and increase uncertainty about whether the target will be sold, and if so, at what price, attack tactics try to accelerate the outcome and to resolve uncertainty. The following table shows a summary of takeover attempt outcomes 1975-2000.

Table 1: Summary of outcomes of hostile takeover attempts 1975-2000³²

	Bids for U.S. Targets by U.S. or Foreign Bidders		Bids for non U.S. Targets by U.S. or Foreign Bidders	
Total M&A done deals	93,312	100%	174,971	100%
Total confirmed, unsolicited	1,151	1.2%	451	0.3%
Of those that were unsolicited:				
Friendly	111	9.7%	147	25.3%
Neutral*	669	58.1%	114	42.1%
Hostile	371	32.2%	190	32.6%
Total	1,151	100.0%	451	100.0%
Of those that were hostile:				
Target sold to hostile bidder	91	24.5%	71	37.4%
(over competing bids)	(28)	(7.5%)	(11)	(5.8%)
Target sold to another bidder	114	30.7%	47	24.7%
Successful defense, target not sold	116	44.8%	72	37.9%
Total	371	100%	190	100%

*Neutral is defined as either (1) the bid is independent of the board directors or (2) the neutral board of directors neither accepts the initial bid as friendly nor rejects the bid as hostile.

Source of data: Thomson Securities Data Corporation. The observations run from January 1, 1975, to November 1, 2000.

If “Prob” is the probability of a successful takeover, the bidder should only attack if the expected payoff is positive, or, in mathematical terms, if:

$$[\text{Prob} \times (\text{Intrinsic value} - \text{Price} - \text{Transaction costs})] - [(1-\text{Prob}) \times \text{Transaction costs}] > 0$$

or

$$[\text{Prob} \times (\text{Intrinsic value} - \text{Price})] - \text{Transaction costs} > 0$$

Defenses are implemented to protect companies and to push bidders to increase their offers. Bearing in mind the previous expression, defenses can work on all the different items in order to decrease the expected payoff for the bidder:

- Defenses can decrease “Prob” by delaying the process, by negotiation with friendly parties (like *white knights* or *white squires*) or by proposing alternatives such as restructuring programs;
- Defenses can decrease the perception of “Intrinsic value” by transferring value to shareholders (spin-offs, special dividends, asset sales), by raising antitrust issues to regulators, or by delaying the process (as the Intrinsic value is the present value of expected future cash flows);
- Defenses can raise “Price” by directly triggering takeover defenses (such as golden parachutes, poison pills or topping and breakup agreements) or by indirectly triggering takeover defenses (such as disclosing the knowledge of hidden assets);
- Defenses can raise “Transaction costs”, by raising several issues that require litigation, accounting and consultancy services.

³² Bruner Robert F., Perella Joseph R., “Applied Mergers & Acquisitions”, 2004, 1st edition, Wiley, p. 806.

The driver for the development of modern takeover defenses was the emergence of the hostile tender offers in the 1960s (third M&A-wave). During the following years several different attack and defense tactics were developed and implemented by companies all over the world. Table 2 presents the most common tactics of hostile takeover defenses and attacks that can be used, either individually or grouped.

Table 2: Classic tactics of hostile takeover defenses and attacks³³

Tactics of takeover defense:	Tactics of takeover attack:
<ul style="list-style-type: none"> - Proactive defenses (pre-Bid takeover preventive defense strategies), put in place in response to a general concern about a potential takeover attempt: <ul style="list-style-type: none"> o Poison pills to raise the cost of the takeover (<i>people pill, dead hand provision, scorched earth and fatman</i>) o Shark repellants to strengthen the target’s Board defenses <ul style="list-style-type: none"> – Staggered or classified board elections – Cumulative voting rights – Limiting when Directors can be removed o Shark repellants to limit shareholder actions <ul style="list-style-type: none"> – Limitations on calling special meetings – Limiting consent solicitations – Advance notice and super-majority provisions o Other shark repellants <ul style="list-style-type: none"> – Anti-greenmail and fair price provisions – Super-voting stock, re-incorporation, and golden parachutes - Deal-embedded defenses, to avoid potential competing bidders in friendly deals: <ul style="list-style-type: none"> o Breakup or topping fees o Asset lockups o Equity lockups o Toehold stakes - Reactive defenses (post-Bid takeover ad-hoc defense strategies), that respond directly to the hostile bidder and address the specific hostile takeover: <ul style="list-style-type: none"> o Share repurchase/greenmail o Standstill agreement o Counter tender (Pac-Man defense) o White knights and white squires o Employee stock ownership plans o Leverage recapitalization o Share buy-back plans o Corporate/Asset restructuring o Going private/LBO o Litigation <ul style="list-style-type: none"> – Regulatory protection – Legislative protection 	<ul style="list-style-type: none"> - Different forms of attack: <ul style="list-style-type: none"> o Purchase of target shares directly on the open market o Limiting the target’s actions through a “bear hug” o Tender offers: <ul style="list-style-type: none"> – Offer directly to the target board of directors – Offer directly to target shareholders – Coercive tender offer structures o Proxy contest and consent solicitation in support of a takeover (submit an acquisition proposal for approval by the target shareholders before the target’s annual meeting) o Challenge the target’s defenses through litigation - The choice among the different forms of attack depends on: <ul style="list-style-type: none"> o Attitude of target management and Board: the strength of target management to resist the unsolicited offer o Distribution of voting power: concentration, sophistication and shareholder incentives o Strength of target defenses in place: defenses such as poison pills that can be triggered in a takeover situation o Presence of competing bidders and/or white knight: demands an offer directly to shareholders through a tender offer, proxy contest or a consent solicitation

³³ Bruner Robert F., Perella Joseph R., “Applied Mergers & Acquisitions”, 2004, 1st edition, Wiley, p. 831-850; Presentation by Donald M. DePamphilis – “The Corporate Takeover Market - Common Takeover Tactics, Anti-Takeover Defenses, and Corporate Governance”; Steinbacher Jan, “Defense strategies against hostile takeovers”, 2007, bachelor thesis, p.11-30.

From the defense's point of view, PT was well protected by a pre-bid takeover preventive defense. That is why Sonaecom's offer was conditioned from the beginning by an authorization from PT's general shareholders. This authorization would require a majority acceptance of all shareholders attending the meeting, while only one third of rejections would be sufficient to block it. However, Sonaecom's offer was in-line with these proactive defenses:

- *Golden Shares* (500 A-Class shares), owned by the Portuguese government, with privileged rights; for instance, these shares could be invoked against the execution of any acts and operations for the implementation of a reorganization plan at PT;
- PT's bylaws that limited 10% maximum stake per shareholder as well as limited the casting of votes issued by one single shareholder up to 10%.

However, PT's post-Bid takeover ad-hoc defenses were conditioned by the Portuguese Securities Code. The management Board of the target company is not permitted, after a takeover intent has been announced, to implement measures on its own authority that can influence the success of the bid. Therefore, the main drivers of PT's defense strategy were:

- To offer special dividends, in order to transfer value to shareholders, and to fight a Sonaecom's cash offer with cash;
- To divest the cable company through a spin-off, in order to transfer more value to shareholders and to reduce the intrinsic value of PT;
- To repurchase shares, in order to financially leverage PT and to increase the prices and power of PT's shareholders;
- To delay the process by presenting arguments to antitrust regulators and soliciting in-depth investigations, in order to increase transactions costs and uncertainty about the outcome;
- To bring new strategic shareholders to PT's capital;
- To improve PT's image by working hardly in corporate communication, in order to improve investors' confidence and to improve the reputation of PT's top management.

In order to implement this strategy efficiently; PT considered that a power concentration (CEO/Chairman) was required. This requirement would be performed by a change in PT's corporate governance model.

From the point of view of attacks, Sonaecom had to make a cash offer directly to PT's shareholders, due to both the competing position between both companies and the proactive preventive PT defenses. That is why Sonaecom unexpectedly announced, a tender offer directly to PT's shareholders. In addition, Sonaecom tried to sell the idea that its tender offer was positioned almost like a "bear hug", as it was quite interesting to PT's shareholders taking into account PT's stock performance.

Transaction costs play also a critical role in these types of processes. According to public information, disclosed after tender offer failure, PT spent €37 million while Sonaecom spent €30.9 million (€ 22.4 million related to external consultants and advisors costs and €8.5 million for financial costs related to the bank guarantee).

Taking into account that PT did not need any bank guarantee for the operation, PT definitely wasted more money than Sonaecom on external consultants. This is actually in line with PT's fight for best consultants. This technique of monopolizing the consultants' market allows PT to not only reduce space for Sonaecom to get good advisors, but it also imposes the references and credit of PT's top management on the market, thus increasing PT's reputation this way.

However, in case of the tender offer's failure the offeror can reduce transaction costs through benefits from capital gains on target share prices. According to Sonaecom³⁴ *"Following the blocking of our public tender offer for PT in March 2007, we sold 11.3 million shares representing just over 1% of its share capital, which we had acquired in 2006, generating a capital gain of €2.5 million"*.

In order to properly prepare for a battle it is critical to study the opponent in order to understand them. However, in the real world, an offeror typically has to deal with a high level of information asymmetry and uncertainty in a takeover preparation. Firstly, companies typically disclose low levels of financial and operational data (sometimes with ambiguities). For instance, synergies' estimation, which is a very critical factor to define transaction price, is typically the most difficult component of value creation due to the lack of knowledge of the companies' operations. Benchmarks tend to be the easy solution. Secondly, the vagueness of the companies' real strategies does not help either offerors to choose the best form of attack.

³⁴ Sonaecom, Annual Report, 2007.

3) What was the role of corporate communication in the defense strategy adopted by PT's top management? Explain the approach followed by PT to influence the decision of major stakeholders such as shareholders, media, official authorities and employees?

During companies' regular activity they are subject to potential crises. Crisis can be defined as “*extraordinary events or series of events that negatively affects the reputation of an organization, the integrity of a product, the psyche and safety of employees, or the community*”³⁵. These crisis can be divided, according to their sources, into predictable crisis (like economics crisis such as bankruptcy, structural changes such as firing or restructuring, or contextual such as wars) and non-predictable crisis (like natural disasters, firm-related disaster, sabotages, market aggressions or financial crisis such as hostile takeovers). In the last years, crisis management (and specially crisis communication) has been much developed due to the importance of overcome success for the life of companies. Typical tools to manage crisis are:

- A Crisis Management Team, that should be heterogeneous and have top management's support; it is expected to deal with the crisis working on communication and to choose proper ways to pass the message (internet, intranet, hotlines, meetings, videos, publications, targeted mailings);
- An Incident Room, an office where the crisis team should control the whole operation, gathering all information and keeping the crisis management team in touch;
- A Crisis Manual, for potential predictable crisis with predesigned proceedings; in some cases it can include business recovery plans;
- A crisis communication plan.

Corporate communications are changing from unidirectional announcements to an interactive approach. This presents serious challenges from a traditional positioning, from the ivory tower, to real-time reactions to demands for information. In addition, nowadays there are several communication channels that should be carefully used according to the specificities of each stakeholder. Typical strategies for crisis communication³⁶ are:

- To choose a knowledgeable spokesperson to communicate the message;
- To ensure all messages are accurate and consistent with corporate operational and strategic plans;
- To provide opportunities for face-to-face communication whenever possible;
- To identify challenges and communication opportunities specific to the situation;
- To facilitate employee communication immediately following the crisis;
- To simplify language;
- To follow up messages with action.

As Public Relations (PR) represent the company face, they play a critical role for the crisis communication success. Therefore, any false step can destroy all previous work regarding company's image. Figure 5 shows a conceptualization of the communication pattern common to a PR-crisis situation.

In the case of PT, the newly appointed CEO, Henrique Granadeiro, assumed this role with a great degree of success. On the one hand, Henrique Grandeiro had experience in the media sector and he knew how media people worked and thought, which allowed him to use that to his own benefit. On the other hand, he set the example by announcing cuts in several benefits for top management, which was understood by public opinion as the company's new blood.

³⁵ Presentation by Anne Grinols – “United States Postal Service: Lessons in Crisis Communication” at Arthur W. Page Society, source Amiso M. George.

³⁶ Presentation by Amiso M. George at the Association of Business Communication conference, Fall 2001.

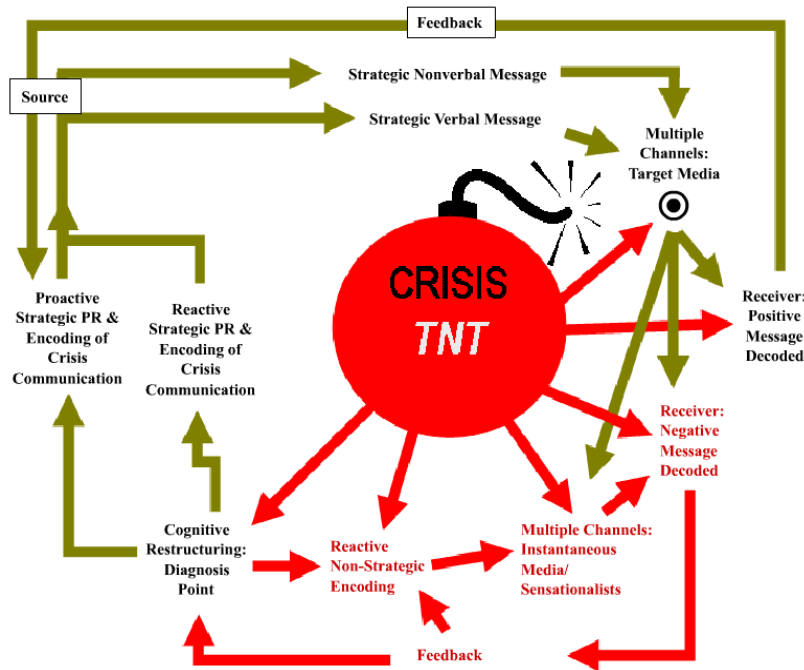


Figure 5: A Proactive Process Model for PR Crisis Communication³⁷

During a hostile takeover process companies are expected to be submerged in an information and counter-information war. Therefore, since the beginning, PT understood that corporate communication was an essential management tool to be used for value creation, especially for a company with a previously negative corporate image and its monopolistic position. Therefore, an A-team is a critical factor to succeed. Table 3 presents PT’s Crisis Team.

Table 3: Crisis Team elements and responsibilities

Roles	Crisis Team	Main roles	Stakeholders’ target
Leadership and National affairs	Henrique Granadeiro (CEO and Chairman)	Public Relations; Coordination; due to his experience of the media industry he was PT’s image and voice	National Media, Shareholders, Competition Authorities (Portuguese Government, ICP-ANACOM, PCA and CMVM) and employees
International affairs	Zeinal Bava (Vice-President)	Due to his solid image and extended experience in international capital markets, he was responsible for investors confidence	International Media and Shareholders
Financial Team	Luis Pacheco de Melo (CFO) Corporate Finance office	Analyze Sonaecom’s offer and recommend PT shareholder remuneration packages	Shareholders
Communication Team	Investor Relations Media Relations	Analyze and monitor capital markets Analyze and monitor news	Media and Shareholders
Legal Team	Competition Authority office and internal lawyers	Analyze competition authorities documentation and support management decisions from a legal point of view	Competition Authorities (ICP-ANACOM, PCA and CMVM)
Strategic, M&A, Financial and Legal Advisors	External consultants	Help and support PT’s crisis team in several areas of expertise	Indirectly, all type of stakeholders

³⁷ Corrigan Michael W., Mortensen Daniel, “Conceptualizing a Strategic Communication Process Model for Crisis Mode Public Relations Management”, 2004.

Nevertheless, it is important to state that besides the classic external consultant areas of expertise (such as Strategy, M&A, Financial and Legal); PT also required collaboration from public relations for the financial area - Financial Dynamics. This also emphasizes the importance that PT gave to its communication strategy.

PT’s communication strategy focused on centralizing all information (avoiding information outflows), monitoring all the adversaries’ moves (in order to find contradictions that might work for its loss of credibility) and aligning the message (that must be the same) for each different stakeholder. For PT, and especially in a crisis situation, all stakeholders should be considered (Investors, Media, Government, Regulators, Employees, Customers, Activist publics, Intra-industry players, Inter-industry players, Legislators, etc.) however, the main focus was on major stakeholders. Table 4 presents PT’s communication strategy for major stakeholders.

Table 4: Communication strategy for major stakeholders

Stakeholder	Importance	Communication Strategy Rationale
Shareholders	<ol style="list-style-type: none"> 1. Major shareholders (~50% of PT’s shares): the hard nucleus of the company 2. Minor shareholders (~50% of PT’s shares): although dispersed, they hold a relevant share in the company 3. The Portuguese government: owner of <i>Golden Shares</i> 	<ol style="list-style-type: none"> 1. Major investors: targeted through one-to-one or focused road shows 2. Minor shareholders: managed through official prospectus, opinion makers and opinion leaders 3. The Portuguese government : closed and assiduous communication
Media	<p>According to PT <i>“the public’s opinion is critical as an external environment builder. As shareholders are people that live in society, they are also affected by the environment”</i></p>	<p>Ending of the current institutional campaign; <i>“during the tender offer period all campaigns were restricted to product campaigns only”</i>.</p> <p>No media communications in the first two weeks</p> <p>One-message approach:</p> <ul style="list-style-type: none"> - This tender offer is hostile - It does not stand for the fair value of PT Group <p>Detailed official prospectus</p> <p>Work with opinion makers and opinion leaders</p>
Official Authorities	<ol style="list-style-type: none"> 1. Portuguese Competition Authority (PCA): the official authority responsible for allowing or not this takeover, due to the potential level of market concentration 2. CMVM (Portuguese securities market regulator): the official authority responsible for controlling the transaction process 3. ICP-ANACOM (industry regulator): the official authority that is responsible for regulating the industry sector 4. The Portuguese government: due to the high dimension of the operation and the criticality of the sector 	<p>Closed and assiduous communication (Legal team fully allocated to these stakeholders) working on:</p> <ul style="list-style-type: none"> - Requesting in-depth investigations - Creating uncertainties - Delaying the process
Employees	<p><i>“Henrique Granadeiro knew that managing PT under a tender offer context would be very challenging as employees focus and uncertainty reduction would be critical to achieve pre-announced targets.”</i></p>	<ol style="list-style-type: none"> 1. Several internal marketing campaigns with pins, SMS, emails and conferences 2. Main message from PT’s CEO <i>“there’s more life beyond Sonaecom’s tender offer”</i> 3. Labor unions support 4. PT’s pension fund sustainability

An active corporate communication, focused on most critical stakeholders, is able to keep these stakeholders close to the company in order to monitor them, while adjusting the message in the best way in order to turn it to the advantage of the company. PT’s communication strategy was implemented in the beginning, by the development of a set of potential discussion issues that might be used or not according to the timeline of events.

All this effort is critical not only to reach and to convince all current and future PT’s shareholders, but also to create a good reputation for PT’s top management. Remember that reputation management depends on how we behave, what others think or suppose about us, how others respect or judge us and what they say about us. In this question, students are supposed to understand that a good reputation is essential both to improve investor confidence and to make them believe in the message.

4) Explain PT's old corporate governance model. Do you consider the new corporate governance model to be aligned with shareholders' interests?

Corporate Governance can be defined as follows³⁸: “*Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return of their investments. How do suppliers get managers to return some of the profits to them? How do they make sure that managers do not steal the capital or invest in bad projects? How do suppliers of finance control managers?*”.

According to this definition, corporate governance focuses primarily on protecting the interests of investors as well as the methods used to implement that protection, or in other words, it becomes a problem of control³⁹. This is typically the Anglo-American approach. However, in Europe, all stakeholders are considered, which is a more global view than the American perspective is. The multiplicity in the interests of all stakeholders countervails the mere focus on the increase in shareholder value. According to Weimer and Pape⁴⁰, there are four different country-class governance structures: Anglo-Saxon, Germanic, Latin and Japan. Table 5 details the Anglo-Saxon, Germanic and Latin governance models.

Table 5: Types of corporate governance structures

Country Class	Anglo-Saxon	Germanic	Latin
Countries	USA UK Canada Australia	Germany The Nederland Switzerland Sweden Austria Denmark Norway Poland	France Italy Spain Belgium
Concept of the firm	Instrumental, shareholder-oriented	Institutional	Institutional
Board system	One-tier (executive and non-executive board)	Two-tier (executive and Supervisory Board)	Optional (France), in general one-tier
Most important stakeholder(s)	Shareholders	Debt holders and employees	Debt holders, the government, and employees
Level of importance of the stock market in the domestic economy	High	Moderated/High	Moderate
Active external market for corporate control	Yes	No	No
Ownership concentration	Low	Moderate/High	High
Performance-dependent executive compensation	High	Low	Moderate
Time horizon of economic relationship	Short Term	Long term	Long term

PT is a listed company both on the Euronext Lisbon and on the New York Stock Exchange, and therefore it has to incorporate most of Sarbanes-Oxley Acts and CMVM's recommendations regarding corporate governance issues. After the PT shareholders General Meeting, in 2002, PT introduced a new governance model where the Executive Committee became more operative, by strengthening its intervention in key decisions, as well as to involve second line officials in the debate of critical issues and to ensure the Board of Directors' involvement in the follow-up and in guiding supervision of strategic questions. This important statutory change, allowed the Chairman of the Board of Directors to be a different person from the Chief Executive Officer, ensuring therefore, a better separation between supervision and control functions and the tasks of daily management. The mentioned change also allowed all Executive Committee officers – including the CEO – to be selected by the Board of Directors from its own members. PT's Executive Committee consisted of 7 Directors, including the CEO, in order to ensure consensus. PT was under this Germanic corporate governance model until PT's General Shareholders Meeting, on 21 April, 2006.

³⁸ Shleifer/Vishny, “A Survey of Corporate Governance”, 1997, The Journal of Finance, Vol. 52, No. 2, p. 737-783.

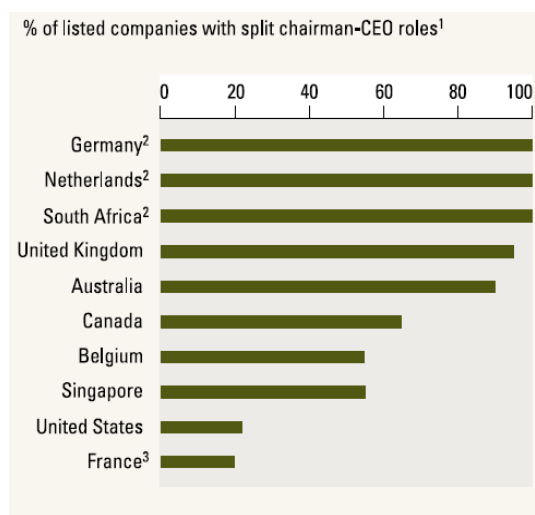
³⁹ Gerum, Kann, “Corporate Governance Gerechtigkeit schaffen?”, 2004, Managementforschung 14, p. 1-45.

⁴⁰ Weimer Jeroen, Pape Joost, “Taxonomy of Systems of Corporate Governance”, 1999, Corporate Governance, Blackwell, volume 7, number 2.

However, in the Sonaecom takeover context, after PT’s Shareholders General Meeting on 21 April, 2006, it was decided that, during this period, Henrique Granadeiro should simultaneously be CEO and Chairman of the Board (an Anglo-Saxon approach). In other words, the executive and supervisory responsibilities of the Board were condensed in one legal entity. Furthermore, this was as a requirement of Henrique Granadeiro due to Sonaecom’s tender offer environment as “*in war an army cannot be lead by two different generals, these positions would be temporarily managed by the same person*”.

This change can be explained by the reduction of “logistical” issues and time to answer what is necessary in this period. Since the governance model of the group is already considered to be consistent enough, the benefits from the empowerment of the CEO in this specific context are expected to be higher than possible market disruption. It is, nevertheless, interesting to frame such decisions in the context of a hostile bid fiercely opposed by PT, which certainly could be beneficial to the value creating potential of the deal, but could also end up diminishing the control insurances for minority shareholders, not represented in the decisive core of the company.

Figure 6 shows a country-analysis of the percentage listed companies with split positions for Chairman and CEO.



While in the United Kingdom, about 95% of all FTSE 350 companies adhere to the principle that different people should hold each of these roles, in the United States, by contrast, nearly 80% of S&P 500 companies combine them (a proportion that has barely changed in the past 15 years).

There are arguments to be made for both sides but it is critical to understand the pros and cons of the different approaches:

- 1) One-tier: more flexibility to react to market changes, facilitating decision making, particularly in emergencies, and helps a Board stay better informed about company matters. However, it has the risk that the CEO will focus on shorter-term goals, a concentration of power might also cause a loss of some transparency in the market;
- 2) Two-tier: check on the CEO’s power; a separate, independent Chairman can help to maintain a longer-term perspective.

However, a structurally independent Board will not necessarily exercise that independence. Some companies with a separate Chairman and CEO have failed miserably to carry out their oversight functions. On the one hand, Chairmen need to have power to control the CEO which is difficult when they usually come from the Board of Directors with strong ties to the other Board executives. On the other hand, Chairmen need to have commitment to the job in order not to oppose each action of the Board of Directors.

Figure 6⁴¹: % of listed companies with split Chairman-CEO positions

In this question students should be able to identify and weigh the arguments for both sides in order to infer if the new corporate governance model is actually aligned with shareholders' interests. In the end, major shareholders are expected to gain with the new model as they maintain their huge influence inside the company and have an open dialogue with the CEO, while minor shareholders will lose the control and the transparency that they had with the previous model.

⁴¹ McKinsey & Co, “The McKinsey Quarterly”, 2004, Number, p. 44.

5) Analyze the valuation of PT.

The discussion points on PT’s valuation, during the takeover period were focused mainly on the following topics. Students are supposed to identify, compute and discount these items in order to come up with PT’s equity valuation.

- i. **Enterprise Value:** from DCF, data from market analysts, premiums and/or multiples;
- ii. **Net Debt:** Gross Debt minus Cash, cash equivalents and short-term investments;
- iii. **After-tax unfunded obligations** due to pension deficit;
- iv. **Net synergies:** Synergies minus Remedies imposed by the Portuguese Competition Authority (PCA);

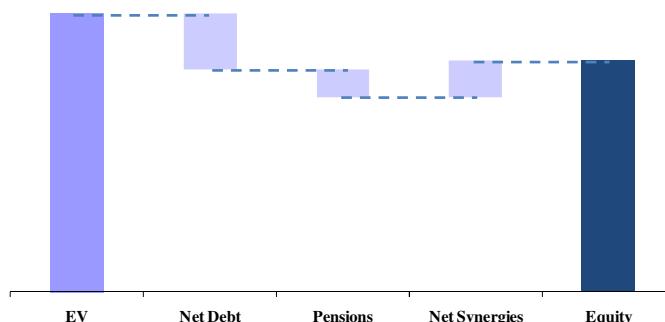


Figure 7: PT’s equity components (simplification)

In order to compute the present value of PT’s equity, it is obligatory to compute PT’s Weighted Average Cost of Capital (WACC), as is detailed in the following table.

Table 6: WACC calculation

Portugal Telecom (Stand alone)	Before Tender Offer announcement 06-02-2006	After Tender Offer announcement €9.5 07-02-2006	After Tender Offer announcement €10.5 15-02-2007
Risk-free rate	3.45%	3.45%	3.45%
Market risk premium	6.70%	6.70%	6.70%
Tax rate	27.50%	27.50%	27.50%
Equity			
Number of outstanding shares	1,128,856,500	1,128,856,500	1,128,856,500
Shares value	€8.18	€9.50	€10.50
Equity (market value)	€9,234,046,170	€10,724,136,750	€11,852,993,250
Equity levered beta	1.18	1.18	1.18
Cost of equity	11.36%	11.36%	11.36%
Debt			
Net Debt (book value)	€3,672,500,000	€3,672,500,000	€3,756,600,000
Interests paid	€201,600,000	€201,600,000	€317,500,000
Weighted average maturity of debt	9.2	9.2	7.4
Average cost of debt	6.60%	6.60%	5.70%
Net Debt (estimated market value)	€3,397,779,412	€3,397,779,412	€4,366,856,590
WACC	9.59%	9.77%	9.41%

Enterprise Value

In order to obtain a reasonable interval for PT's enterprise value, students are expected to use different methods (such as DCF, data from market analysts, premiums and/or multiples). With regards to DCF, as PT operating activities are relatively stable (mature domestic market), it is a good estimation to compute PT's enterprise value by using the Free Cash Flow (FCF) together with the average growth of the business which is approximately 3.2% ($EV = FCF(1+g) / (WACC-g)$). However, due to discontinued operations, namely acquisitions and contributions to Post Retirement Benefit (PRB), PT's FCF needs some adjustments. Table 7 presents an estimation of PT's FCF with adjustments both on acquisitions and on contributions to PRBs.

Table 7: PT's free cash flow without acquisitions (disposals) & contributions to PRBs

Euro million	2002	2003	2004	%	2005	%	2006	%	CAGR (02-06)
Operating Revenues	5,582	5,764	5,967		6,385		6,343		3.2%
Wireline			2,305	39%	2,214	35%	2,072	33%	↓
Domestic mobile • TMN			1,606	27%	1,557	24%	1,502	24%	→
Brazilian mobile • VIVO			1,599	27%	2,037	32%	2,105	33%	↑
Multimedia • PT Multimedia			599	10%	629	10%	667	11%	↑
Other and eliminations			(142)		(51)		(2)		
EBITDA	2,230	2,236	2,363	40%	2,496	39%	2,424	38%	2.1%
Wireline			969	42%	1,129	51%	1,073	52%	↑
Domestic mobile • TMN			747	46%	674	43%	659	44%	→
Brazilian mobile • VIVO			499	31%	507	25%	496	24%	↓
Multimedia • PT Multimedia			179	30%	195	31%	211	32%	↑
Other			(31)		(10)		(15)		
Depreciation and Amortization	1,106	958	935		1,121		1,210		
Income from operations	1,124	1,278	1,428	24%	1,375	22%	1,214	19%	1.9%
Other Expenses (Income)			286		333		127		
Curtailement costs			166		314		20		
Losses (gains) on disposal of fixed assets			9		1		8		
Net other costs			84		18		98		
Income before financ. & inc. taxes			1,142	19%	1,042	16%	1,087	17%	
Financial expenses (Income)			233		51		125		
Net interest expenses			205		258		227		
Equity in losses (earnings) of affiliates			(21)		(238)		(131)		
Net other financial			49		32		29		
Income before income taxes	654	697	909	15%	991	16%	962	15%	10.1%
Provision for income taxes	(337)	(377)	(210)		(323)		(8)		
Income from continued operations	316	319	699	12%	667	10%	954	15%	31.8%
Income from discontinued operations			26		22		0		
Income applicable to minority interests			(102)		(35)		(87)		
Consolidated net income	391	240	623	10%	654	10%	867	14%	22.0%
Cash Flow from Operating activities without Payments relating to post retirement benefits			2,257	39%	2,092	33%	2,350	36%	
CAPEX			761	13%	943	15%	1,001	16%	
Interest Paid			253		202		318		
Estimated Free Cash Flow without acquisitions (disposals) & Contributions to PRBs⁴²			1,244		948		1,031		

⁴² FCF without acquisitions (disposals) & contributions to PRBs estimated by the author based on presented assumptions; this information is not available in PT's annual reports nor is there any public data disclosed that allows for it to be precisely calculated.

Net Synergies

The following table shows the discussion summaries about net synergies arising from a potential Sonaecom/PT merger.

Table 8: Net synergies evolution for both parties

Date	Sonaecom	PT
2 May 2006	€2.0 billion (synergies)	-
17 October 2006	€1.5 billion (synergies)	-
22 December 2006	Portuguese Competition Authority (PCA) gives its final clearance to the transaction with some remedies	
2 January 2007	€1.3 billion (synergies less PCA's remedies)	-
20 February 2007	-	Between €2.52 up to €2.88 billion (synergies less PCA's remedies)

Without taking into account the values that obviously benefit each party, there is an important difference between PT and Sonaecom. While Sonaecom did not reference its values and changed them several times during the tender offer process, PT not only presented just one result from an external identifiable entity, but also disclosed all components as is shown in the following figure.

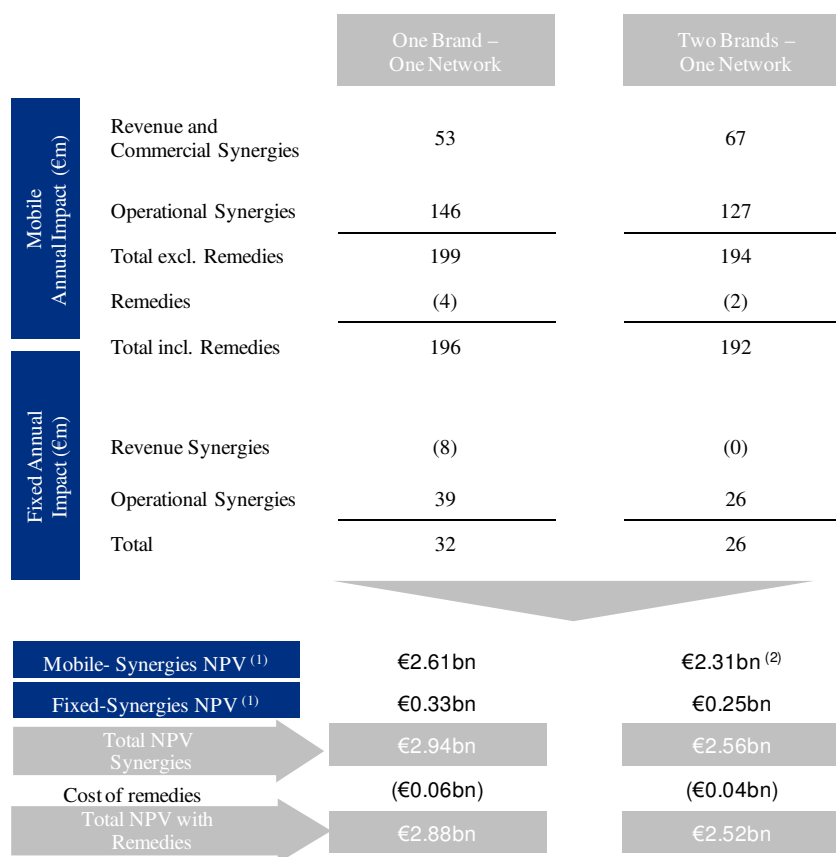


Figure 8⁴³: Net synergies according to PT

Source: External consultant analysis performed by Booz Allen Hamilton.

(1) Base case without remedies. Perpetuity growth rate at 2% for Mobile and 0% for Fixed.

(2) The NPV difference between the mobile one and two brand scenario corresponds to annual cash flow synergies of approx. €26m (less than 1% of total cost).

⁴³ Portugal Telecom, Portuguese Securities Market Regulator (CMVM) - Material Information (official prospectus) as of 20 February 2007.

Based on DCF analysis, the following table presents PT's equity value on a standalone basis.

Table 9: PT's equity prices according to DCF analysis

Portugal Telecom (Stand alone)									
WACC	8.50%			9.50%			10.50%		
Weighted average growth	2.00%	3.00%	4.00%	2.00%	3.00%	4.00%	2.00%	3.00%	4.00%
As of end 2005 (Million Euros except shares in Euros)									
EBITDA	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496
OpFCF without Payments relating to post retirement benefits	2,092	2,092	2,092	2,092	2,092	2,092	2,092	2,092	2,092
Free Cash Flow without acquisitions (disposals) & Contributions to PRBs	948	948	948	948	948	948	948	948	948
Enterprise Value (DCF)	14,869	17,744	21,898	12,886	15,014	17,916	11,370	13,012	15,160
Net Debt (estimated market value)	3,398	3,398	3,398	3,398	3,398	3,398	3,398	3,398	3,398
After-tax unfunded obligations	1,911	1,911	1,911	1,911	1,911	1,911	1,911	1,911	1,911
Equity Value	9,560	12,435	16,589	7,577	9,706	12,608	6,061	7,704	9,851
Equity Value per share	8.47	11.02	14.70	6.71	8.60	11.17	5.37	6.82	8.73
Implied EV/EBITDA Multiple	6.0x	7.1x	8.8x	5.2x	6.0x	7.2x	4.6x	5.2x	6.1x
Implied EV/OpFCF Multiple with adjustments	7.1x	8.5x	10.5x	6.2x	7.2x	8.6x	5.4x	6.2x	7.2x
As of end 2006 (Million Euros except shares in Euros)									
EBITDA	2,424	2,424	2,424	2,424	2,424	2,424	2,424	2,424	2,424
OpFCF without Payments relating to post retirement benefits	2,350	2,350	2,350	2,350	2,350	2,350	2,350	2,350	2,350
Free Cash Flow without acquisitions (disposals) & Contributions to PRBs	1,031	1,031	1,031	1,031	1,031	1,031	1,031	1,031	1,031
Enterprise Value (DCF)	16,182	19,311	23,832	14,024	16,340	19,499	12,374	14,162	16,499
Net Debt (estimated market value)	4,367	4,367	4,367	4,367	4,367	4,367	4,367	4,367	4,367
After-tax unfunded obligations	1,216	1,216	1,216	1,216	1,216	1,216	1,216	1,216	1,216
Equity Value	10,599	13,728	18,249	8,441	10,758	13,916	6,791	8,579	10,916
Equity Value per share	9.39	12.16	16.17	7.48	9.53	12.33	6.02	7.60	9.67
Implied EV/EBITDA Multiple	6.7x	8.0x	9.8x	5.8x	6.7x	8.0x	5.1x	5.8x	6.8x
Implied EV/OpFCF Multiple with adjustments	6.9x	8.2x	10.1x	6.0x	7.0x	8.3x	5.3x	6.0x	7.0x

According to Sonaecom public data, the following table presents PT's equity prices announced by market analysts.

Table 10: PT's equity prices according to market analysts

PT's target prices per share	Minimum	Average	Maximum
As of February 2006	€7.40	€8.67 ⁽¹⁾	€10.50
As of January 2007	€7.01	€8.58 ⁽¹⁾	€11.50

⁽¹⁾ Adjusted Average Target Price excluding maximum and minimum values

Therefore, PT's stand alone equity value, before Sonaecom's €10.50 per share announcement, lies somewhere between €7.0/€7.5 and €11.5/€12.0 (€9.53 as the central value). Students are expected to experience a real life valuation situation submerged with lots of information with some inconsistencies. Companies are typically very cautious regarding information disclosure and so, based only on public information, it is very difficult to really understand all financial items. In this case, PT presents itself as a complex organization, with many diverse business units and international assets, implying some adjustments for valuation purposes. However, in the end, students are expected to come up with a value (or range of values) coherent(s) with the different valuation methods used.

6) Should PT accept the €10.50 per share offer? Why or why not? What would be your recommendation to the shareholders of PT?

According to PT’s previous standalone valuation, this answer can go both ways. However, a good recommendation should appropriate as much as possible the potential new value creation through proper negotiation of net synergies.

Considering that PT’s standalone value before the €10.50 per PT share announcement was €9.53 (see DCF in question 5) the following figure shows that, for a €2.5B potential net synergies (PT’s net synergies lowest scenario), this new offer only gives 45% of the new value creation to PT (the appropriation of all net synergies would raise PT’s value to €11.7 per share).

In this scenario, Sonaecom keeps the remaining 55% of net synergies, which is actually in line with its share prices after raising its initial bid to €10.50 per PT share (€7.50 per Sonaecom share on 2007.02.16). However, €7.50 per Sonaecom share already includes some probability of tender offer failure (see Table 12 in question 7 – as of 2007.02.15 the probability of failure was equal to 100% - 79.4% = 20.6%). Therefore, if Sonaecom’s offer succeeds Sonaecom’s price per share would be even higher.

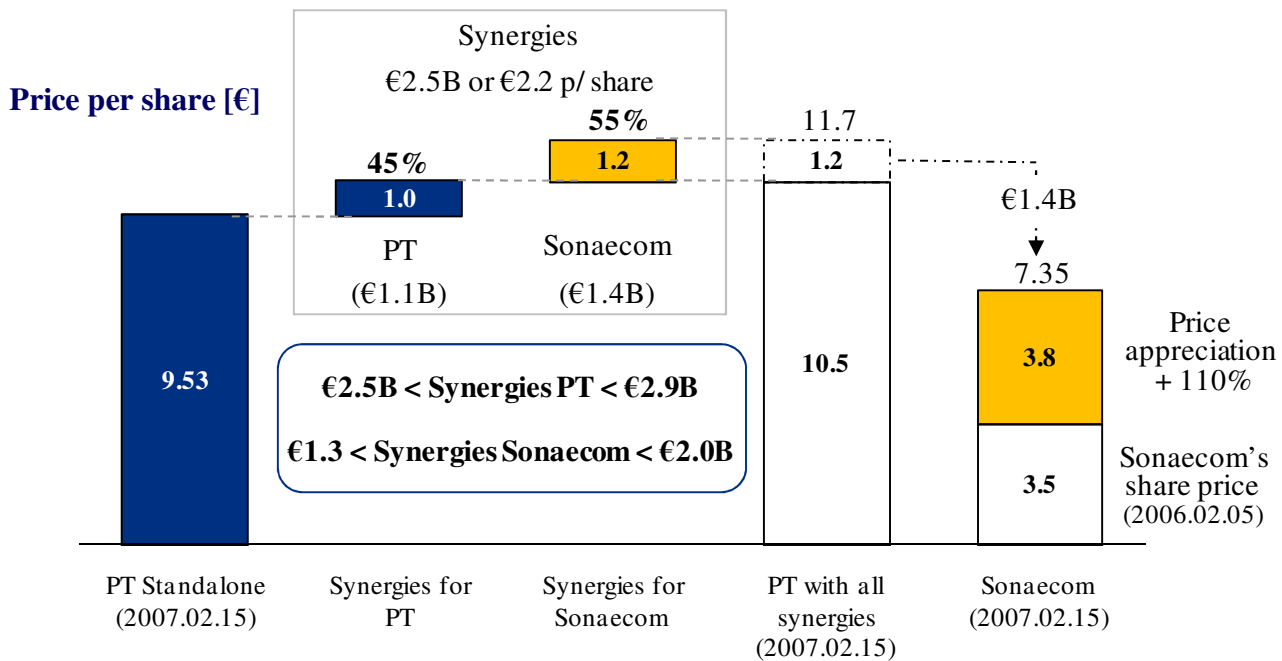


Figure 9: Net synergies split between PT and Sonaecom

PT’s management is supposed to maximize shareholder value, and therefore, to maximize the negotiation of new value creation through net synergies. However, sometimes it is difficult to know when to stop in order to actually gain anything. Probably, based on the considered assumptions, there might be room to increase the 45% of new value creation.

In long takeover processes, combined with tough battles, a target’s shareholders have also to incur additional takeover costs. In addition, the net synergies extraction process always implies potential risks to offerors. All of this should be taken into account when maximizing a target’s shareholder value:

- Takeover costs to target's shareholders:
 - o Defense costs through litigation, accounting and consultancy services;
 - o Lack of top management's focus on daily business;
 - o Due to restructuration's constraints, the company might lose some interesting business opportunities (either in acquisitions or in divestures).

- Offeror's merging risks:
 - o Level of experience and knowledge of the business, organization and merging processes by offeror's top management team;
 - o Operational and cultural risks of merging;
 - o Sector change and dynamic due to merger.

This last point turns out to be an important issue. As Sonaecom is required to renounce one of PT's telecommunication networks (cable or copper) a new large operator is expected to appear in the market changing the entire environment.

In addition, benchmarks can also be used to consolidate conclusions regarding PT shareholders' recommendations. Typical impacts on shareholder value are⁴⁴:

- Friendly transactions result in average abnormal returns to target shareholders of 20%;
- Hostile transactions result in average abnormal returns to target shareholders of 30-35%;
- Bidders' shareholders earn average abnormal returns of 2-3%;
- While mixed, empirical studies generally indicate that takeover defenses have no significant impact on abnormal shareholder returns.

In Sonaecom's hostile tender to PT, abnormal returns were:

- Target shareholders:
 - o 25.8% abnormal returns from 6 February 2006 to 15 February 2007 (from €8.18 to €10.29);
(28% premium over PT's previous close since the first announcement on 6 February 2006, from €8.18 to €10.50)

- Bidder shareholders:
 - o 80.5% abnormal returns from 6 February 2006 to 15 February 2007 (from €3.53 to €6.37).

From Sonaecom's abnormal returns one can infer that they are significantly higher than average benchmarks. This might corroborate with the previous net synergies split idea, suggesting that there might be room to increase PT's shareholder value (however, this would depend on the strategic plans of the other party).

In the end, students are supposed to gather all these ideas and recommend to PT's Board of Directors whether to accept or not this new Sonaecom offer, understanding the potential implications of each decision.

⁴⁴ Presentation by Donald M. DePamphilis – “The Corporate Takeover Market - Common Takeover Tactics, Anti-Takeover Defenses, and Corporate Governance”.

Part 2

7) Explain the change in the remuneration package offered to PT's shareholders.

PT and Sonaecom's official prospectus were deeply focused on value creation and value distribution. Value distribution was materialized into a sequence of remuneration packages to PT shareholders, as is shown in the following table:

Table 11: PT's shareholders remuneration packages

Date	Sonaecom		PT		Comments
	Value	Value per PT share	Value	Value per PT share	
06 February 2006	€10.7 billion	€9.50	-	-	Sonaecom presents its initial remuneration package to PT's shareholders
06 March 2006	€10.7 billion	€9.50	€3.0 billion + PT shares	€2.66 + PT share	PT presents its initial remuneration packages to PT's shareholders
03 August 2006	€10.7 billion	€9.50	€3.5 billion + PT shares	€3.10 + PT share	PT increases its initial offer after its General Shareholders Meeting
12 January 2007	€10.7 billion	€9.50	€5.3 billion + PT shares	€4.80 ⁴⁵ + PT share	PT increases its remuneration cash package to more than half of Sonaecom's offer through special dividends (allowing PT's shareholders to keep their shares)
15 February 2007	€11.9 billion	€10.50	€5.3 billion + PT shares	€4.80 + PT share	Sonaecom upgrades its initial offer to €10.5
20 February 2007	€11.9 billion	€10.50	€6.2 billion + PT shares	€5.6 ⁴⁶ + PT share	PT increases its remuneration cash package to more than half of Sonaecom's offer through special dividends and a share buy-back program (allowing PT's shareholders to keep their shares)
27 February 2007	€11.9 billion or €6.2 billion + PT shares	€10.50 or €5.6 + PT share	€6.2 billion + PT shares	€5.6 + PT share	Sonaecom goes for a mixed offer: 1) €10.5 Cash per PT's share or 2) Dividend remuneration keeping PT's shares

As financial markets express the aggregate beliefs of investors, they are crucial for understanding the remuneration package evolution. Thus, the probability of closing the deal can be defined, in mathematical terms, as:

$$P_{\text{current}} = (\text{Prob} \times P_{\text{Bid}}) + [(1-\text{Prob}) \times P_{\text{Stand-alone}}]$$

Prob is the probability that the takeover succeeds

P_{current} is the target's price on the considered date

P_{Bid} is the offer's price

By using the *P_{Stand-alone}* value as the pre-bid target's stock price and DCF target's price after the second bid (as fair estimates of PT's stand alone values), table 12 presents the estimated probability of the takeover success at each remuneration package date. As can be seen, since the beginning, investors' expectations were that Sonaecom would raise its initial bid of €9.50 per PT share.

Table 12: Estimated probability of takeover success

Date	Target's Price			Prob
	<i>P_{current}</i>	<i>P_{Stand-alone}</i>	<i>P_{Bid}</i>	
06 February 2006	€9.69	€8.18	€9.50	Expected higher bid
06 March 2006	€9.88	€8.18	€9.50	Expected higher bid
03 August 2006	€9.81	€8.18	€9.50	Expected higher bid
10 January 2007	€10.00	€8.18	€9.50	Expected higher bid
15 February 2007	€10.29	€9.53	€10.50	79.4%
20 February 2007	€10.28	€9.53	€10.50	77.3%
27 February 2007	€10.13	€9.53	€10.50	61.9 %

⁴⁵ Portugal Telecom, Portuguese Securities Market Regulator (CMVM) - Material Information (official prospectus) as of 12 January 2007.

⁴⁶ Portugal Telecom, Portuguese Securities Market Regulator (CMVM) - Material Information (official prospectus) as of 20 February 2007.

However, after Sonaecom raised its initial bid from €9.50 to €10.5 per PT share, investors decreased their beliefs of takeover success. As time went on takeover success probability fell from 79.4% to 61.9%.

This set of remuneration packages shows the intensive interaction and various battles both parties engaged in:

- i. Sonaecom starts with an initial bid of €9.50 per PT’s share ensuring that it will not be available to raise its offer; this allows Sonaecom to stagnate PT’s share prices avoiding huge speculations;
- ii. PT answers with a first counter offer; as the market considers it insufficient, PT is obliged to increase its offer to half of Sonaecom’s, in cash, through special dividends;
- iii. As the market pressures Sonaecom to raise its offer, it upgrades the initial €9.50 to €10.50; PT decides to increase its offer again to half of Sonaecom’s, also in cash, through special dividends and a share buy-back program;
- iv. In the end Sonaecom goes for an “almost equal” compared with the one that PT presented to its shareholders, while PT does not announce any change in its final offer.

In addition, it is important to carefully analyze the share buy-back program in PT’s last remuneration package: “*The acquisition of own shares for 16.5% of PT’s outstanding share capital at a price of up to €11.50 per share, implying a total amount of up to €2.1 billion*”:

- 1) On the one hand, it clearly indicates €11.50 as a reasonably priced target for PT’s shares. However, according to previous assumptions (see question 6), €11.70 per PT share represents PT’s equity value with all PT/Sonaecom potential synergies, and so, a ceiling for Sonaecom’s offer. Therefore, this was a clever way to push Sonaecom to a no profit deal;
- 2) On the other hand, the blended value in PT’s share buy-back program implies an increase of 20% both in value and in power. Therefore, this package offers more control for major shareholders inside the company (the ones with more power at PT’s extraordinary shareholders’ meeting), as is shown in figure 10.

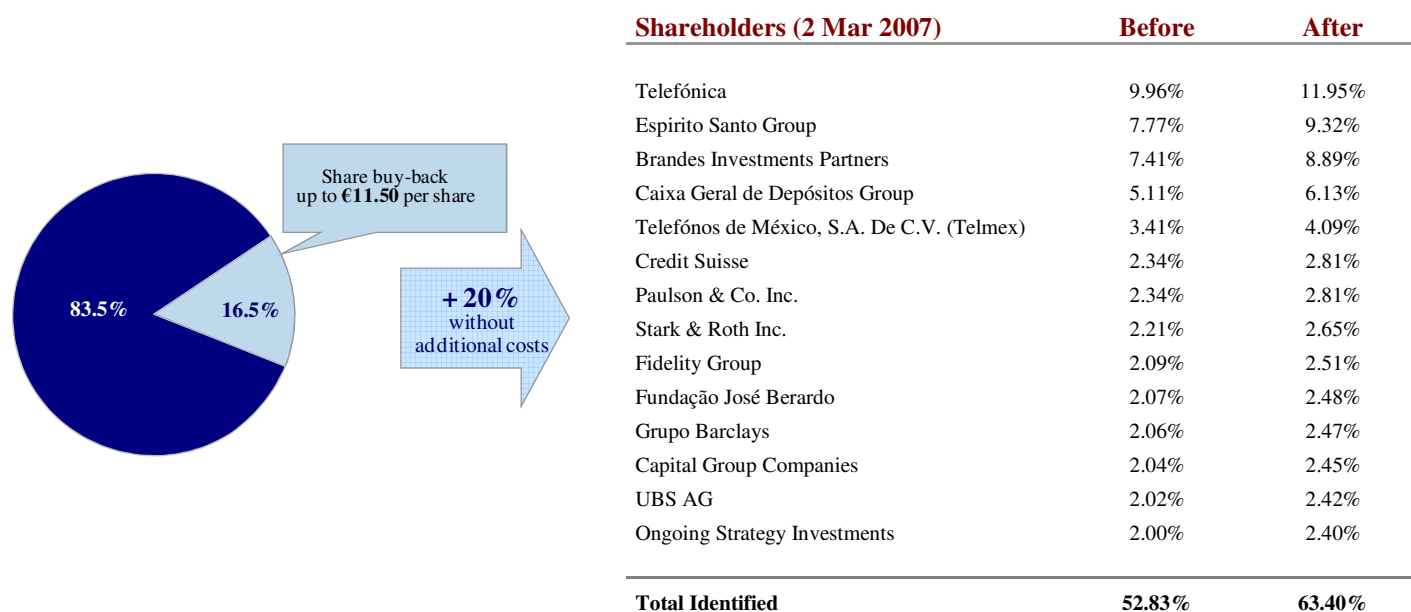


Figure 10: Blended value of PT’s share due to the proposed share buy-back program

In this question, students are supposed to understand the negotiation dynamics of this tender offer. Since the beginning PT did not announce the “fair” price for the tender offer, promoting an environment of uncertainty without disclosing its reservation price for the negotiation process. This technique allowed PT to always be attacking Sonaecom’s offer without the need to defend its position. However, PT’s last remuneration package implies a price which is expected to burn almost all potential net synergies, leaving Sonaecom without a business margin.

8) Do you think the remuneration package offered to shareholders constituted a good anti-takeover defense measure? What other motives might major shareholders have to support PT's management?

Even though PT's shareholders remuneration packages are an important tool for shareholders' decision, students are supposed to identify other incentives than straightforward cash or dividend solutions presented by Sonaecom and PT. The following table presents other potential incentives for PT's major shareholders.

Table 13: Co-laterals incentives for major shareholders regarding Sonaecom's takeover

Shareholder	Other motives beside PT's shareholders remuneration packages
Portuguese Government and Caixa Geral de Depósitos (Public held bank)	<ul style="list-style-type: none"> - JOBS (image): Unfriendly takeovers are normally associated with the loss of jobs and therefore draw media-effective and critical attention from labor unions; operating synergies are created through consolidation of functional areas such as Research & Development, Production or Marketing, which were separate before. - TAXES (cash): The high level of indebtedness required for this operation would have a huge negative impact on national taxes. - POWER (control): The loss of control in a strategic sector, such as telecommunications, can be a critical issue for future public negotiation purposes.
Telefónica	<ul style="list-style-type: none"> - VIVO (control / market power): the success of this takeover would place Telefónica with exclusive control of VIVO, Brazil's largest mobile operator, and therefore strengthen its position in Latin America.
Espirito Santo Group (Private held bank)	<ul style="list-style-type: none"> - POWER (control): Amendments in PT's bylaws would decrease BES's control of PT's top management. As the major Portuguese shareholder, it profits several ways from its great influence over PT, such as in financing, commercial and operations areas.
Telmex	<ul style="list-style-type: none"> - VIVO (market power): Being Telefónica's major rival in Latin America, Telmex had strong incentives to stop Telefónica growth in the Telmex market.

By bringing new shareholders (or new attackers such as *white knights*) to the game, with specific incentives rather than direct cash from the merger operation, it is possible to manage them according to the target's benefit. For that, one has to look for potential interested parties seeking indirect gains from the takeover's failure. Telmex (which is a company operating in a completely different market than PT) is one great example of that. Telmex's indirect benefits from Telefónica's non-expansion in Latin America were actually much more interesting than some potential direct cash earned from this takeover operation.

In this question, students are supposed to understand the complexity of the shareholders' decision making process, namely for major shareholders that have more money invested in the companies. In the end, a takeover's target can only offer efficiency increases, asset divestures or tax benefits due to higher financial leverages. However, an offeror can always offer the same benefits plus a portion of potential synergies. Nevertheless, by working a broad range of incentives properly, it is possible to indirectly influence decisions without the need to advance with more attractive cash packages and, by that way, unbalance the balance in favor of the target.

9) Do you consider Sonaecom’s final offer reasonable? Why or why not?

Sonaecom’s final offer, presented on 27 February 2007, is a mixed remuneration package with the objective of targeting both the shareholders that want to sell and those that want to keep their shares. On the one hand, Sonaecom offers €10.50 per PT share to shareholders that were willing to sell. On the other hand, Sonaecom offers a remuneration package exposure for PT future performance based on a set of special dividends.

“Due to the fact that there was still a risk that some shareholders would not accept the cash offer and would prefer to retain their shares for future dividends and/or eventual capital gain, instead of accepting the cash conditions provided by the tender offer, Sonaecom advanced to a new mixed offer that provided flexibility to choose between an all cash offer and a share exposure to PT future performance. Subject to the existence of distributable funds, Sonaecom committed that Sonaecom/PT would make a minimum cash distribution of €5.7 billion (€5.1 per PT share) through dividends and potentially other forms of distribution to its shareholders during the period 2007-2010. Consistent with Sonaecom’s strategy and financing plans, cash distributions would be made as quickly as permissible by cash flow generation including asset sales and, on this basis, Sonaecom would target the following distributions: €1.8 billion in 2007, €2.1 billion in 2008, €0.7 billion in 2009 and €1.0 billion in 2010”

However, Sonaecom’s package is not exactly equal to PT’s because, even delivering almost the same value, Sonaecom’s cash flows are offered later, and so it represents less value on a discount basis. Table 14 shows the cash outflows offered by both parties to PT shareholders.

Table 14: Comparison of PT and Sonaecom’s dividend offers

Euros per share	2007	2008	2009	2010	Total 2007/2010
Sonaecom’s special dividend offer	1.6	1.9	0.7	0.9	5.1
PT’s offer	0.475	4.235	0.575		5.2
Dividends	0.475	0.575	0.575	-	
Acquisition of own shares	-	1.86	-	-	
PTM spin-off	-	1.8	-	-	

In addition, Sonaecom’s final offer presents other potential problems:

- A dual offer might be understood by the market that Sonaecom’s €10.50 per PT share might not be the best choice;
- By offering a similar offer to PT’s offer, Sonaecom is playing in PT’s field, losing the competitive advantage of the attacker;
- Comparable offers are easier for shareholders to make up their minds and if one alternative is worse than PT’s offer the other might be probably worse still;
- By presenting a comparable offer, in the end, the image and reputation of each top management team will play a decisive role in the decision making process.

In this question, students are invited to think how Sonaecom should have managed the “takeover price”, namely which would have been the best strategy and what would be the maximum reasonable price that Sonaecom could offer. Should Sonaecom have announced the offer’s price increase before? Could Sonaecom raise its cash offer again?

Takeover’s price dynamics can be deeply analyzed through the “Positive Theory of Takeovers” and the “Free Rider Problem”. The main idea is that the bargaining power to extract takeover’s premium can go both sides (raider vs. shareholders). According to corporate stock structure, this theory explains the raider’s optimal strategy to choose the tender offer’s price. On the one hand, if all shares are completely dispersed, shareholders can extract the entire premium (except potential raider’s private benefit from control). This happens because with one share per shareholder everyone behaves as a perfect free rider. As no one feels that they can influence the takeover’s attempt outcome, they consider themselves as nonpivotal. On the other hand, concentrate ownership reduces free riding and increases raider’s profit. In this scenario, shareholders have the incentive to sell part of their shares in order to increase the takeover likelihood but also to keep the remaining shares to access the post takeover premium. However, the aim of this Thesis is not to look deeply at these mathematical models. For further analysis of this subject, students can be assisted with some in-class notes⁴⁷.

⁴⁷ Tirole, J., “The Theory of Corporate Finance”, 2005, 1st edition, Princeton University Press, p. 431-441.

Part 3

10) In the end, what were the key success factors of PT's defense strategy?

In this question, students are expected to compile all major ideas and to identify what the lessons learned with this case were. Like almost everything in life, victories come from hard work and also from a little bit of luck. In the same way, some success factors were the result of PT's work while others were from external positive conditions.

Main success factors resulting from PT's effort:

- Strong image of PT's new CEO:
 - o Change in PT's CEO plus the merge of the CEO/Chairman positions;
 - o Good reputation due to active marketing campaigns of the cost cuts and financial achievements;
- Communication strategy:
 - o PT's CEO assiduous communications (Public Relations);
 - o Proximity to major stakeholders (IR & Media, Regulators and Government);
- Alignment with shareholders' needs:
 - o Careful work on shareholder remuneration packages and co-lateral incentives;
 - o Bring new relevant shareholders to the game;
- Takeover management process:
 - o Crisis Team prepared for the task;
 - o Induction of delays in the regulators' processes.

Main success factors resulting from external positive conditions:

- Capital markets upside which translated into more value for PT;
- PT's good financial results in 20064Q (which confirm top's management good work).

In the beginning Sonaecom managed well the relationships with the Media, Regulators and the Portuguese government. However, in the end, the Regulators were the only ones who did not change their initial views. PT's huge efforts with a strong communication strategy clearly brought several benefits to its old image and reputation. By outperforming initial public opinion expectations, namely the appointment of a new CEO (new blood) that imposed rigid internal efficiency measures, PT's top management was able to convince its shareholders of its proposal. Of course it is always easier to overcome expectations when they are initially low. Therefore, PT's strategy in the beginning of Sonaecom's takeover attempt was to maintain a low profile in order to worsen preliminary public opinions of PT itself.

Transaction costs in a takeover operation (including external consultants and offeror's bank guarantees) can be heavy for both sides. As external advisors can only be on one side of the barricade, if this game played well it can reduce the consultant's market, like PT did. In case of failure, the offeror can benefit from capital gains on target share prices, reducing its transaction costs and increasing the expected payoff. Sonaecom benefited €2.5 million from these capital gains.

From a financial point of view, it is crucial to have a strong shareholders' remuneration package to offer. However, more importantly than that is to have a remuneration package strongly aligned to shareholders' needs, which can be much more than direct money from the transaction. Co-lateral incentives are a power tool in shareholders' decision making processes. Target companies are supposed to bring new shareholders to the takeover that could gain from these co-lateral benefits.

After a takeover situation, a target company has to pay its debt. This debt is paid whether the takeover succeeds or not. Increases in financial leverage, cost cuts, internal department restructuring, abatements on supplier prices and decreases in product quality are typical measures to take after a takeover process in order to pay either for synergies (if the takeover succeeds) or to increase efficiency (if the takeover does not succeed). In other words, all the value chain is affected by a takeover process (suppliers, employees and customers). The remuneration packages, offered either by the target company or by the offeror, give the target company the perfect negotiation weapons to decrease margins. Therefore, a value transfer is expected from the entire value chain to the shareholders. In PT's situation, the labor unions' weak negotiation position, either due to their internal competitiveness or due to the low level of professionalism, was also a critical factor to facilitate PT's top management's work regarding shareholder remuneration packages.

DEFENCE MANUAL

The key elements of an effective defence manual include:

- A summary of the bid process and timetable.
- A description of the directors' duties during the offer period.
- A description of the key tasks to be undertaken in the initial bid period.
- A summary of the rules governing the timing and effect of company announcements during the offer period.
- An analysis of both major shareholders and possible bidders.
- Updated budget and profit forecast.
- Company valuation by "sum-of-parts" and market capitalisation.
- Draft announcements. For example, announcements covering the following:
 - response to bid rumours;
 - holding announcements on receipt of an unsolicited offer;
 - announcement of rejection of an unsolicited offer.
- Draft Q&A media briefings.
- Draft board minutes appointing a board committee of independent directors (if necessary) to manage the bid.
- A description of any powers the company may have to require a (prospective) bidder to disclose its interests in the company's shares (in the UK, section 793 of the Companies Act 2006).
- Defensive tactics that may be specific to the company (for example, any prior analysis of regulatory or anti-trust issues, shareholder communication strategy and possible white knights).
- Analysis of the impact of a bid on the company's share incentive and pension schemes and on any employee retention arrangements.

It is important to remember that only a limited range of post-bid defensive tactics are available to a target. Therefore, it is highly advisable to develop a defense plan before a bid becomes imminent. Defense planning is an on-going process that should consider the overall company's activity (position in relevant markets, investor relations, business strategy, corporate governance, competitive profile, share register and possible bid predators). Such product (defense manual) will illustrate references and guidance for all involved in the offer process. This ensures a common and well defined methodology and activities ensuring targeted advice instead of basic procedure and scheduling. Figure 11 presents the main ideas to develop a takeover defense manual.

Nowadays, we are living in a corporate anorexia era. Corporate anorexia is the 1990s' response to business competitiveness. Anorexia is a human disease, as you may know. If applicable to corporations, it is also a disease and never a way to cure a problem/issue. One needs to understand that if a corporation is on a fear-and-denial mode, not seeing/understanding the real threats out there, it will never overcome problems. Cutting and reducing costs could be a severe hurting process if not followed by work and process restructuring. The global idea of reorganization is to focus on customer value, understanding the cost structure and value chain, in order to implement and to drive real cost control. Only this way is it possible to overcome challenges.

Companies are downsizing to appease stockholders. Mergers are also a value creation driver for the achievement of synergies and/or efficiency increases. Mergers or acquisition attempts are always responsible for major changes in companies. However, this shareholder value creation usually destroys value for all the other members of the value chain. Businesses driven by an obsessive compulsion for short-term efficiency can become caught up in a similar destructive pattern. Therefore, it is important to bear in mind a broad stakeholder view before and during a takeover process, not only focusing on short-term shareholders, but also on long-term stakeholders in the value chain.

Figure 11: Takeover defense manual⁴⁸

⁴⁸ Shaw Michael, Earl Jonathon, Smith Herbert, "Hostile takeovers and defences", 2008/09, PLC CROSS-BORDER HANDBOOKS www.practicallaw.com/acquisitions handbook.

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