

# Offer for PT's stake in Brasilcel

A unique value creation  
proposal for PT's shareholders

May 2010

*Telefonica*

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## **Telefónica's outstanding offer for Brasilcel should be discussed and voted by PT shareholders in an EGM**

- **Telefónica's unconditional €5.7bn offer for PT's stake in Brasilcel implies a 145% premium**
- **Offer allows PT to crystallize value they can't replicate standalone**
- **PT's directors rejected the offer without due consideration**
- **International shareholders should not be prevented from having their say**

# 1. Summary of Telefónica's offer

- **Material value creation for PT shareholders that PT cannot replicate on a standalone basis**
- **The Board of PT rejected the offer within 4 days**

# A unique and material value creation proposal...

## Terms of the offer letter

- Offer for PT's 50% stake in Brasilcel submitted on the 6th of May 2010
- €5.7bn cash offer
- Binding, unconditional and valid for one month
- Fully financed and no execution risk
- Closing within two months of acceptance
- Contemplated subsequent tender offer over Vivo ON shares at 80% of the price offered for PT's ON shares

## Merits of the offer

- **Full value offer, compelling to all shareholders**
  - Full value for Brasilcel (145% premium over current price) <sup>(1)</sup>
  - Represents 78% of the last one month average market capitalization of PT <sup>(2)</sup>
  - Implies a potential upside of c.50% or more to PT's share price
  - Unique value for PT not achievable on a standalone basis
- **PT would continue to be an attractive investment proposition and enjoy increased strategic flexibility**
  - Reduction of leverage
  - Fund pension deficit
  - Improved shareholder remuneration
  - Invest in Next Generation Networks
  - Consolidation of the Portuguese telecom market
  - Role in the Pan European telecoms consolidation
  - Reinvest proceeds in controlled growth telecom assets

(1) 145% over the average price of the last month previous to Telefonica's offer; (2) At the time of the offer

# ...was unduly dismissed by PT's Board

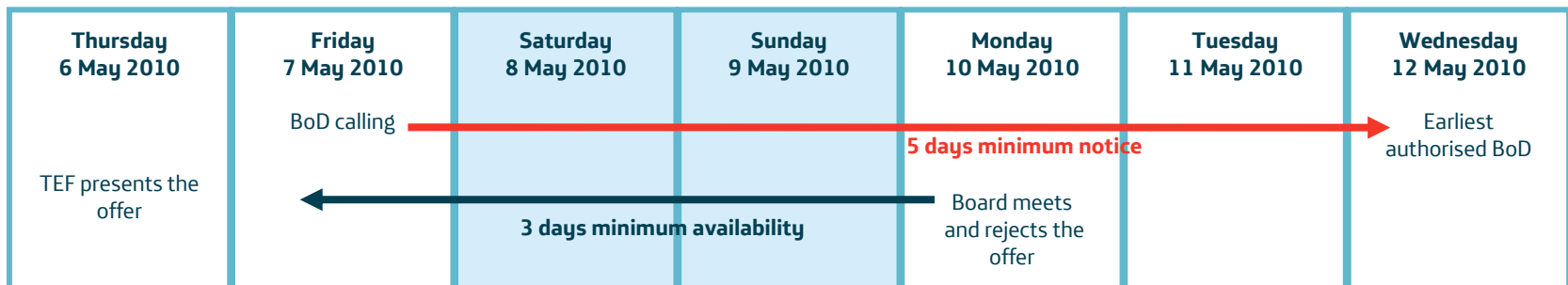
## PT's Board press release



## A rushed decision for a 145% premium offer

- Article 11 of PT's Regulamento do Conselho de Administração: "The meetings of the Board of Directors shall be convened [...] with a prior notice of 5 days [...] without prejudice of the cases of recognized urgency, and documentation [...] shall be made available 3 days in advance."
- An offer valid for 1 month does not require such urgent dismissal
- Documentation prepared for the Board has not been made public: rationale, valuation ...

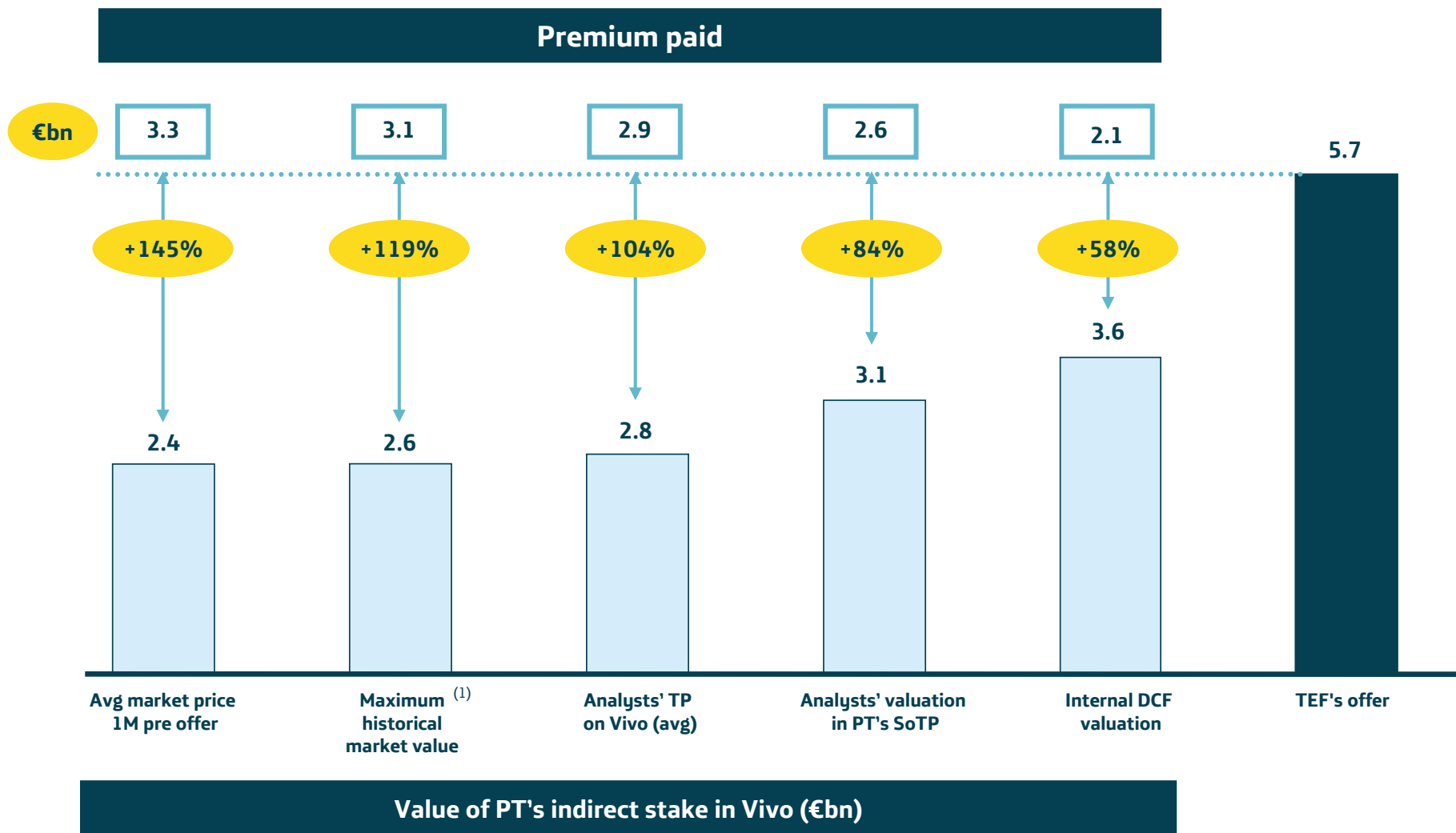
- At the time of Sonae bid:
  - Board acknowledged receipt of the offer the day after it had been received
  - Board took 1 month to reject the offer and deliver a valuation dismissal



## 2. Assessing the value of the offer

- **145% premium to market value**
- **PT shareholders benefit from most of the value creation of a potential Vivo-TSP combination**

# A full value offer for PT's 50% stake in Brasilcel ...

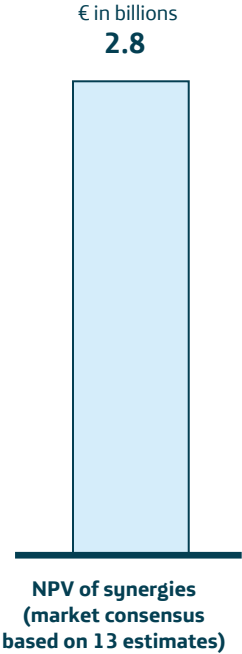


(1) According to Bloomberg data

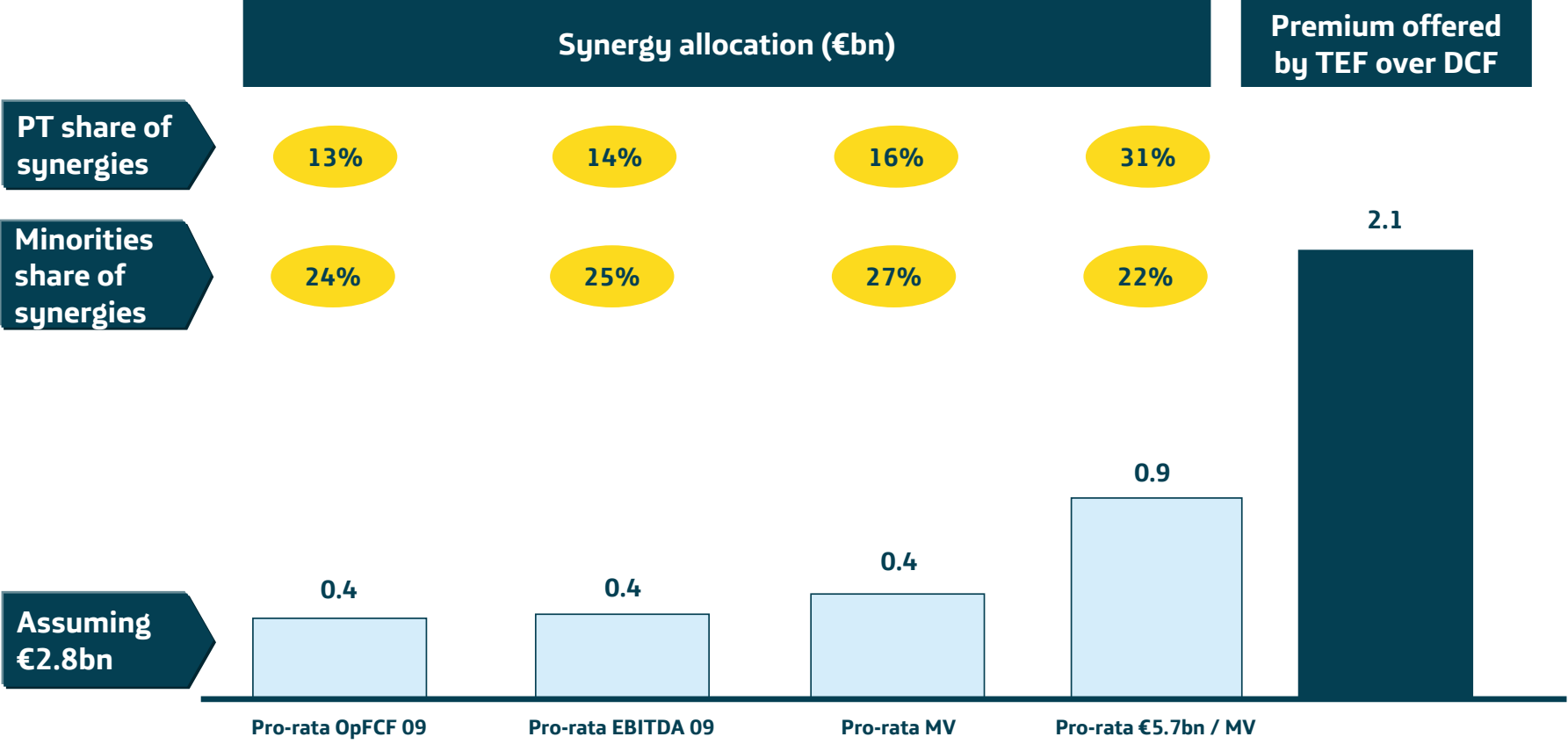


# Our assessment of synergies is consistent with market views

- Revenue**
  - Improved churn
  - Cross selling/Bundle offer
- Network & IT**
  - Network management integration
  - IT system unification
  - Data centers
- SG&A**
  - Customer care
  - Marketing
- CapEx**
  - Common infrastructure construction
  - IP Net and Metroethernet
- Other**
  - Synergies from national backbone and operation outside of Sao Paulo
  - Potential financial and tax benefits



# A Vivo-TSP combination would imply PT shareholders get at best ~30% of synergies



**By including a very significant part of the potential synergies in the price, the offer unlocks value for PT shareholders that cannot be achieved by PT standalone**

### 3. Value creation for PT shareholders

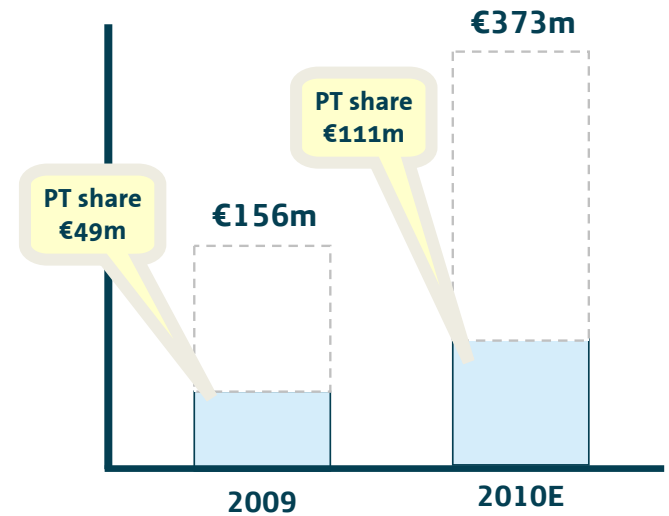
- **“Strategic asset” versus strategic flexibility**
- **PT’s arguments are misleading**
- **Growth can’t be dissociated from price offered**

# Despite proportionate consolidation, PT only has access to Vivo's cash flow through Brasilcel dividends

## 2009 PT Financials (€m)

	PT ex-Vivo	50% Vivo	PT consolidated	Vivo as a % of PT consolidated
Revenue	3,647	3,138	6,785	46%
EBITDA	1,555	947	2,502	38%
EBITDA – Capex	708	526	1,234	43%

## Vivo dividend<sup>1</sup> (€m)



- PT does not have access to Vivo's cash flow
- Dividends from Brasilcel are subject to TEF agreement

Source: PT and Vivo 2009 reports and Bloomberg

Note:

1. Vivo dividend in 2009 of BRL402.6m converted at 2.5868 BRL/€ rate as of 2-Dec-2009 (payment date); Vivo dividend declared in 2010 of BRL818.9m converted at 2.1971 forecast BRL/€ rate for Q4 2010 (broker consensus)

# PT ex-Vivo remains an attractive investment proposition...

## PT ex-Vivo pro-forma financials (assuming €3.6bn capital return post Vivo sale)<sup>1</sup>

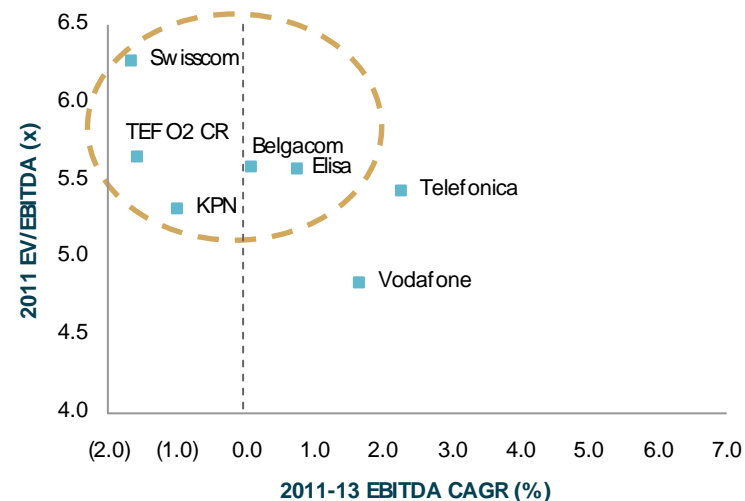
€m	2011	2012	2013	PT today	
				11-13 CAGR	11-13 CAGR
Revenue	3,585	3,626	3,655	+1.0%	+1.4%
EBITDA	1,486	1,503	1,500	+0.5%	+1.9%
EBITDA – Capex	784	916	922	+8.4%	+6.9%
EBITDA margin	41.5%	41.4%	41.0%	(average) 41.3%	(average) 36.3%
Net Debt/EBITDA	2.2x	2.1x	2.1x	nm	2.3x

Source:

All metrics are based on brokers' consensus

1. Illustrative – Assuming a capital return can be effected
2. CY2011

## PT ex-Vivo comparables are trading at healthy levels



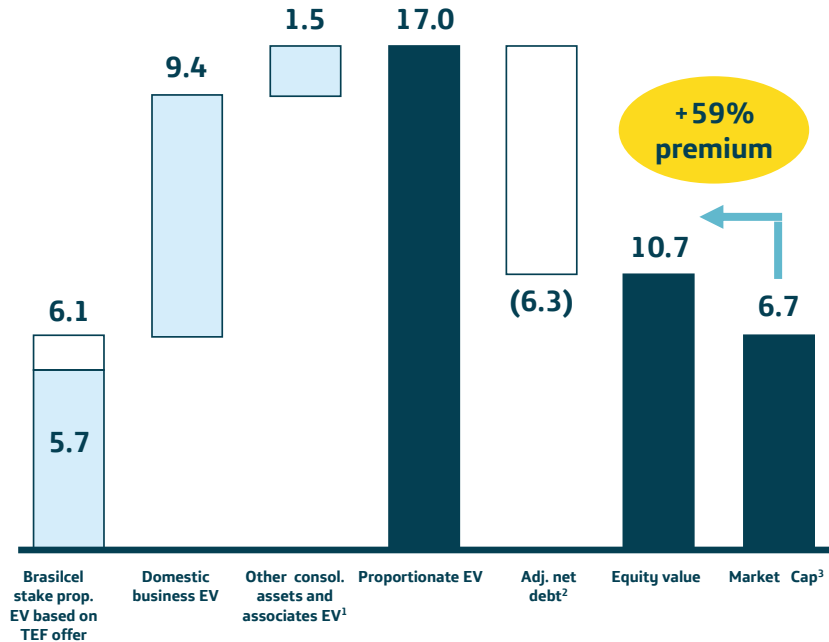
	PT ex-Vivo	Belgacom	Swisscom
EV (€bn)	10.8	9.8	19.7
Revenue	1.0%	0.4%	(0.1%)
EBITDA – Capex	8.4%	(6.7%)	0.0%
EBITDA margin <sup>2</sup>	41.5%	30.5%	38.9%

Source:

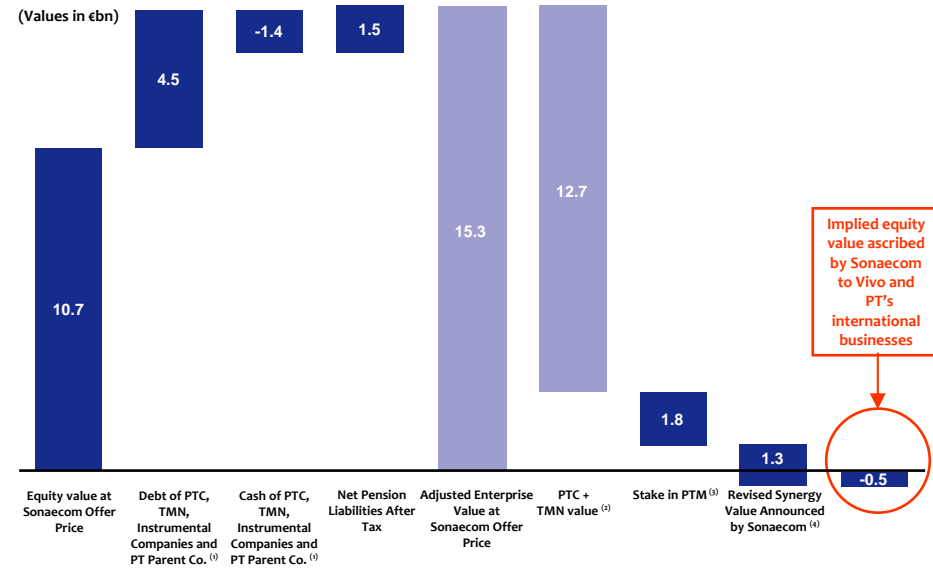
All metrics are based on brokers' consensus

# ...as recognised in current analysts' valuations

## Implied PT value (€bn)



## PT defence document (12 Jan 07)



## Analysts' value of PT domestic (pre-offer)

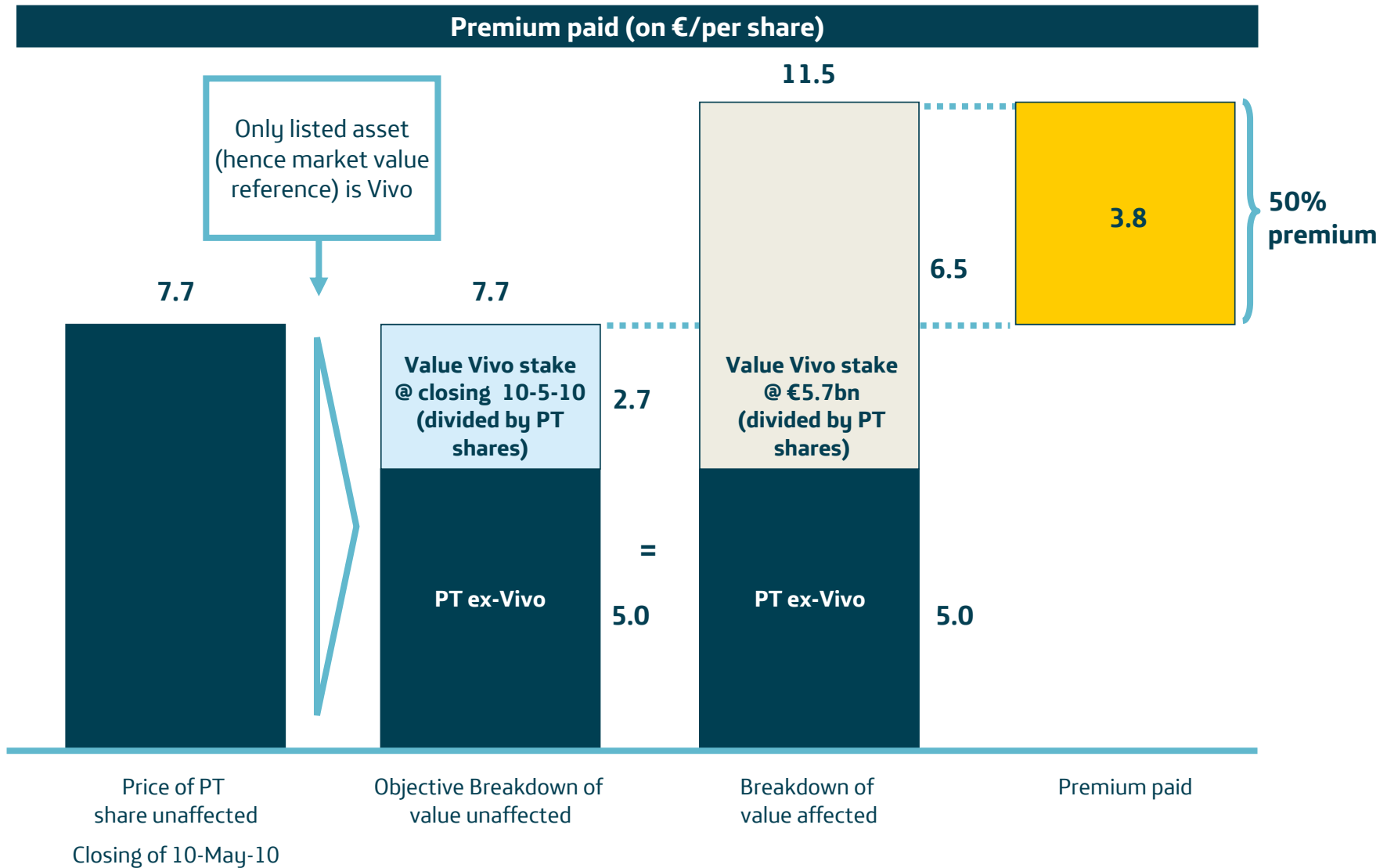
Broker	Date	EV domestic (€m)	EV/2010EBITDA
MILLENIUM	26-Apr-10	10,581	
MS	20-Apr-10	9,066	
DB	09-Apr-10	9,149	
JPM	22-Mar-10	8,897	
ML	12-Mar-10	9,526	
BARCLAYS	08-Mar-10	9,142	
BEREMBERG	25-Jan-10	9,642	
SAN	15-Dec-09	8,026	
EXANE	18-Nov-09	9,226	
ING	13-Oct-09	10,484	
<b>Mean</b>		<b>9,374</b>	<b>6.6</b>
<b>Median</b>		<b>9,188</b>	<b>6.5</b>

- (1) Q3 06 debt, cash, cash equivalents and short term investments of PTC, TMN, Instrumental Companies and PT parent company (i.e. does not include PTM and Vivo).
- (2) Based on LTM upon announcement average EV/EBITDA multiple for TDC/NTC (6.8x), Weather/Wind (7.7x), Cesky Telecom/Telefónica (6.4x) and the blended multiple for France Telecom/Amena and ONO/Auna transactions (9.3x).
- (3) At market value as of 10 January 2007.
- (4) Initially €2.0bn, then revised downwards to €1.5bn and subsequently revised on 2nd January 2007 downwards to €1.3bn (Sonaecom's COO interview with Jornal de Negócios).

Source: Broker consensus, PT Notes:

1. Based on average brokers consensus
2. Net debt as of Q409 adjusted for pensions
3. Share price as of 10 May 2010

# Telefónica's offer implies a healthy premium



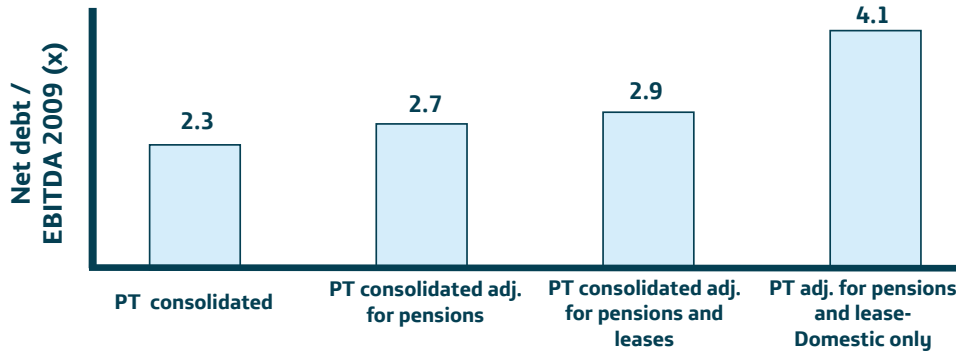
## 4. Significant downside risk if offer is rejected

- **Your investment could be at risk if the offer is not accepted**
- **PT's leverage is growing**
- **Your dividend relies on dividend from uncontrolled subsidiaries**
- **Telefónica's offer represents 11 years of dividend**

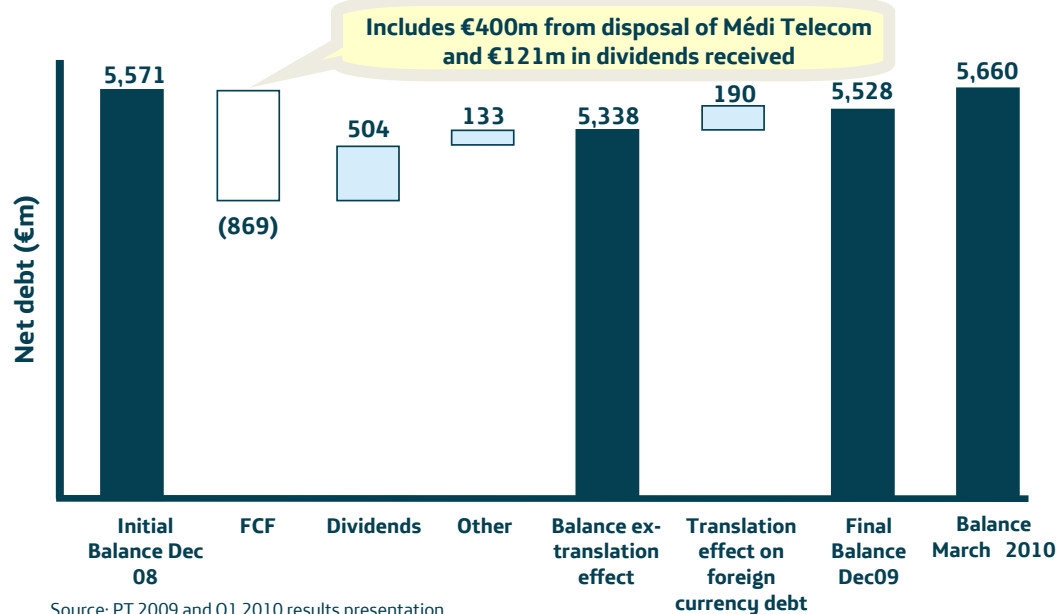


# High leverage could jeopardize dividends

## PT Leverage analysis



## Absence of deleverage despite asset sale



- PT will have to deconsolidate Brasilcel<sup>1</sup>
  - Actual leverage will become transparent
- PT relies on dividend from uncontrolled subsidiaries and asset sales to pay its own dividend
  - Brasilcel dividend is subject to TEF agreement
  - Dividend cover could be at risk
- Significant capex requirement for domestic market – scaling back would have business consequences
- *“The CreditWatch placement reflects the uncertainty over how much PT will deleverage this year*
- *PT has not achieved material debt deleverage in 2009 or so far in 2010, despite the fact that the group's fiscal 2009 performance benefited from substantial proceeds from asset disposals” – S&P 13 May 2010*
- Should TEF sell its stake in PT, it would represent 29 days of ADTV<sup>2</sup> (2009)

Source: PT 2009 and Q1 2010 results presentation

Note:

1. According to the draft of the new IFRS - Joint Arrangements
2. Average daily trading volume

# PT's rejection rationale is substantially different

## PT's rejection of Soneacom offer (excerpts)

16% premium

- Soneacom's offer is inadequate and significantly undervalues PT
- PT's cash flow belongs to you. Why should you finance Soneacom's offer?
- Soneacom's offer does not provide PT's shareholders with fair value, any control premium or share of the synergy value
- PT proposes a new attractive shareholder remuneration package
- PT is committed to returning significant value to its shareholders while allowing them to retain full ownership of the company
- PT will continue to deliver superior services to Portuguese consumers and value creation to all its shareholders

Source: Portugal Telecom Roadshow Presentations (2006 and 2007)

## PT's rejection of TEF's offer

145% premium

- "Vivo is core to PT's strategy and the sale of its stake would be against the long term growth prospects of PT"

**No mention to shareholder value and fiduciary duties**

# PT's Board may not be fully aligned towards shareholder value creation

## PT and TEF's board holdings

### PT

Members (date of first appointment)	Position	No. of shares	Market value of the shares (€)
Henrique Granadeiro	Chairman	150	1,086
Zeinal Bava	CEO	63,161	457,286
Luís Pacheco de Melo	ED	45	326
Carlos Alves Duarte	ED	40	290
Rui Pedro Soares <sup>1</sup>	ED	50	362
Manuel Rosa da Silva	ED	90	652
Fernando Soares Carneiro <sup>1</sup>	ED	-	-
Shakhaf Wine	ED	-	-
João de Mello Franco	NED	13,308	96,350
José Xavier de Basto	NED	-	-
Mário João de Matos Gomes	NED	-	-
José Maria Alvarez-Pallete (2008)	NED	100	724
Francisco Bandeira	NED	483	3,497
Santiago Fernandez Valbuena	NED	100	724
Joaquim Goes	NED	2,437	17,644
Gerald S. McGowan	NED	-	-
Rafael Mora Funes	NED	-	-
Maria Helena Nazaré	NED	-	-
Amílcar de Morais Pires	NED	2,146	15,537
António Palma Ramalho	NED	474	3,432
Francisco Soares	NED	-	-
Jorge Tomé	NED	-	-
Paulo Varela	NED	7,134	51,650
Milton Silva Vargas	NED	-	-
Nuno de Almeida e Vasconcellos	NED	11,190	81,016
<b>TOTAL</b>		<b>100,908</b>	<b>730,574</b>

Source: PT Corporate Governance Report 2009. Market value of shares as of 20 May 2010

Note

<sup>1</sup> Rui Pedro Soares and Fernando Soares Carneiro have recently left the Executive Committee of PT

### TEF

Name or corporate name of director	Position	No. of shares	Market value of the shares (€)
César Allerta	Chairman	4,044,186	62,482,674
Alfonso Ferrari Herrero	External	590,363	9,121,108
Gonzalo Hinojosa Fernández de Angulo	External	521,476	8,056,804
Isidro Fainé Casas	Vice Chairman	434,021	6,705,624
Julio Linares	ED	253,234	3,912,465
José María Álvarez-Pallete	ED	197,871	3,057,107
Peter Erskine	External	69,259	1,070,052
Carlos Colomer Casellas	External	63,754	984,999
Eva Castillo Sanz	External	58,450	903,053
Fco. Javier de Paz Mancho	External	26,115	403,477
José Fernando Almansa Moreno-Barreda	External	19,349	298,942
José María Abril Pérez	External	18,702	288,946
Manuel Vitalino Nafria Aznar	Vice Chairman	11,300	174,585
Thomas David Guy Arkulus	External	10,500	162,225
Pablo Isla Alvarez de Tejera	External	8,601	132,885
Luiz Fernando Furlán	External	4,100	63,345
Antonio Massanell Lavilla	External	2,286	35,319
<b>TOTAL</b>		<b>6,333,567</b>	<b>97,853,610</b>

Source: Telefónica. Market value of shares as of 20 May 2010

- Market value of stake owned by TEF's board is more than 100x superior to PT's one
- The two TEF directors at PT's Board own more shares than the members of PT's management (with the exception of the CEO)

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