PORTUGAL TELECOM SGPS SA
Form SC14D9C
March 07, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14D-9C

Solicitation/Recommendation Statement Under Section 14(d)(4) of the Securities Exchange Act of 1934

PORTUGAL TELECOM, SGPS, S.A.

(Name of Subject Company)

PORTUGAL TELECOM, SGPS, S.A.

(Name of Person(s) Filing Statement)

Ordinary shares, nominal value €1 each
American Depositary Shares, each representing one ordinary share, nominal value €1 per share

(Title of Class of Securities)

Ordinary Shares (ISIN: PTPTC0AM0009)
American Depositary Shares (CUSIP: 737273102)

(CUSIP Number of Class of Securities)

Nuno Prego
Investor Relations Director
Portugal Telecom, SGPS, S.A.
Av. Fontes Pereira de Melo, 40
1069-300 Lisboa
Portugal
+351 21 500 1701

(Name, Address and Telephone Number of Person Authorized to Receive Notice and Communications on Behalf of the Person(s) Filing Statement)

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Check the box if the filing relates solely to preliminary communications made before commencement of a tender offer.

Table of Contents

1. Letter to Shareholders of Portugal Telecom, SGPS, S.A. ("PT") dated March 6, 2006 and Report of the Board of Directors of PT dated March 6, 2006

2. Letter to Shareholders of PT Multimédia-Serviços de Telecomunicações e Multimédia, SGPS, S.A. ("PTM") dated March 6, 2006 and Report of the Board of Directors of PTM dated March 6, 2006

IMPORTANT NOTICE

The attached communications have been made public by Portugal Telecom, SGPS, S.A. (the "Company") and PT Multimédia-Serviços de Telecomunicações e Multimédia, SGPS, S.A., one of the Company's subsidiaries. Investors are urged to read the Company's Solicitation/Recommendation Statement on Schedule 14D-9 when it is filed by the Company with the U.S. Securities and Exchange Commission (the "SEC"), as it will contain important information. The Solicitation/Recommendation Statement and other public filings made from time to time by the Company with the SEC are available without charge from the SEC's website at www.sec.gov and at the Company's principal executive offices in Lisbon, Portugal.

Letter to the shareholders of Portugal Telecom

6 March 2006

Dear Shareholder,

Sonaecom-SGPS, S.A. and Sonaecom, B.V. (hereinafter named jointly as "Sonaecom") preliminarily announced an unsolicited cash offer (the "Offer") for Portugal Telecom, SGPS, S.A. ("PT" or the "Company"), on 6 February 2006. The Board of Directors (the "Board") having carefully reviewed the draft offer announcement and the draft prospectus provided by Sonaecom on 27 February 2006 (the "Offer Documents"), believes that the Offer significantly undervalues the Company and is, therefore, not in the best interest of PT's shareholders. Accordingly, this letter and the accompanying presentation provide the basis on which the Board **recommends the shareholders to reject the Offer**.

WHY YOU SHOULD REJECT THE OFFER

Sonaecom's Offer Significantly Undervalues PT

Sonaecom's Offer significantly understates the full value of PT and Sonaecom's arguments on value are disingenuous. This is demonstrated by the following valuation methodologies:

1. Public Premia Analysis

The Offer price of €9.50 represents only a 16% premium to PT's pre-announcement closing price. The Offer price further reflects (assuming the removal of the restrictions in the by-laws) a modest 5% premium to PT's share price four weeks prior to the Offer when France Telecom's profit warning caused the share prices of Europe's publicly traded telecommunications companies to fall sharply.

The premium implied by the Offer is less than one half of levels achieved in: (i) precedent comparable public takeovers in the European telecommunications sector; (ii) large unsolicited transactions in the broader European market; and (iii) substantial unsolicited transactions in Portugal. The modest premium represented by the Offer relative to precedent premia results in an undervaluation of PT of up to €2.6 billion. This is value Sonaecom wants to take from PT's owners.

	Premia Paid in Precedent Transactions	Premium Offered by Sonaecom
European Telecom	40%	16%
Europe >$10 billion Unsolicited	40%	16%
Portugal >$500 million Unsolicited	45%	16%

In the United States, PT will file a Solicitation/Recommendation Statement on Schedule 14D-9 with the U.S. Securities and Exchange Commission (the "SEC") following commencement of a tender offer within the meaning of Rule 14d-2 under the Securities Exchange Act of 1934, as amended. Investors are urged to read the Company's Solicitation/Recommendation Statement on Schedule 14D-9 when it becomes available, as it will contain important information. The Solicitation/Recommendation Statement and other public filings made from time to time by the Company with the SEC are available without charge from the SEC's website at www.sec.gov and at the Company's principal executive offices in Lisbon, Portugal.

2. *Precedent Transaction Multiples Analysis*

Sonaecom's Offer values PT at 6.3x 2005 EBITDA, which represents a significant discount to valuations achieved in other change of control transactions which have occurred recently in the European telecommunications sector.

	Average EBITDA Multiple	**EBITDA Multiple Offered by Sonaecom**
European Precedents	7.5x	6.3x

PT's Cash Flow Belongs to You. Why Should You Finance Sonaecom's Offer?

Sonaecom's Offer will borrow heavily off PT's balance sheet to finance a €16.3 billion (including PT's net debt) Offer for PT's assets. Sonaecom has stated that it will undertake a rights issue of up to €1.5 billion to fund the Offer. How will the remaining €14.8 billion or more than 90% of the transaction value be funded? By mortgaging PT's assets and cash flows? This cash flow belongs to the PT shareholders, and by accepting the Offer you would be giving away value that can be realised by PT independently with lower execution risk.

Sonaecom B.V., the vehicle that Sonaecom proposes to acquire PT, has a share capital of €100,000 and will be highly levered with significant financing requirements (in particular a need to repay 50% of the Offer's financing at the end of the second year following a transaction) which endanger the Company's future ability to: (i) invest in the growth of its business; (ii) undertake capital expenditures relating to the modernisation of the Portuguese information society (e.g. broadband, 3G, digitalisation of pay-TV offering, etc.); (iii) continue to proactively fund its pension fund obligations; and (iv) maintain attractive and competitive tariffs going forward to benefit consumers. The Offer's minimum acceptance condition of 50.01% may be a further indication that Sonaecom is seeking to gain control of PT for a modest cash outlay, thereby reflecting the significant financial constraints Sonaecom faces going forward.

Sonaecom's Offer is Conditional on Regulatory Approval of Unprecedented Concentration

The Board has received legal opinions indicating that the regulator may be unable to approve Sonaecom's proposed transaction given that the Offer is predicated on permitting an unprecedented level of market concentration.

Wireless Concentration is Untenable for a Coherent Regulatory Policy

Sonaecom's management has publicly announced that the value creation opportunity contemplated by the Offer is based upon merging Sonaecom's Optimus and PT's TMN mobile operations. The combination of Optimus and TMN would create a very large wireless operator in a duopolistic market with an estimated pro forma subscriber market share of over 65%.

A TMN-Optimus combination would result in unprecedented levels of wireless market concentration. We do not believe that such a combination, when compared to other European precedent in-market mobile consolidation transactions, would satisfy the minimum conditions for a competitive mobile market:

Impact of Transactions After Consolidation

	European Precedents	**Portugal (as Implied by the Offer)**
Median No. of Remaining Operators	4	2
Resulting Market Share of Subscribers for Acquiror	22%-50%	66%

Having reviewed previous European wireless in-country consolidation transactions, we believe that the likelihood of such a transaction being approved is low and implies significant risks to the credibility of the Offer.

The Resulting Concentration is Also Unprecedented From a Combined Voice Market Share Perspective

The Portuguese voice market is split between mobile (58% of total) and fixed line (42%) services, with PT holding the leading position in both segments. As Sonaecom also has a relevant position in both the mobile and fixed line voice markets, the combination of PT and Sonaecom would produce a pro forma market

share of 77% of the Portuguese voice market. This transaction would ultimately leave Vodafone, which offers only mobile services, as the only substantial competitor to a combined Sonaecom-PT in the carriage of voice minutes.

In conclusion, we believe that despite Sonaecom's stated intention to divest one of the fixed networks that would be combined as a result of the transaction, the regulatory hurdles are such that an approval would be without precedent. This conclusion is particularly apparent given the fact that the regulator (according to Portuguese competition law) needs to look at each market segment individually (fixed and mobile) when ruling on the transaction.

While the cost (as measured by household bills in Portugal) of most basic services such as water, electricity, gas, transportation, food and healthcare has increased meaningfully over the past five years, PT has actually driven down the cost of telecommunication services in Portugal as a result of our initiatives to provide services at attractive and competitive prices. Concerns about whether such a substantial concentration in the telecommunications sector could jeopardise consumer gains are naturally a consideration that will need to be taken into account by the regulator.

WHY YOU SHOULD REMAIN WITH PT

PT Has Been a Substantial Contributor to the Development of Portuguese Society

PT has an extensive history of developing innovative products and services which have made telecommunication services more accessible to Portuguese consumers, including: (i) being the first prepaid mobile operator in Europe; (ii) introducing the low-cost UZO mobile brand; (iii) establishing flat-rate voice pricing plans; and (iv) current initiatives to offer VoIP and HDTV services.

Consumers in the Portuguese market further enjoy attractive pricing relative to others in Europe for leading telecommunication services, such as broadband, pay-TV and mobile services, which has resulted in above-European average penetration levels in each of those areas.

At the same time, PT has been a positive contributor to the establishment of a fully competitive environment in Portugal, by offering lower-than-average European wholesale prices for ULL services and leased lines, thereby facilitating an attractive market opportunity for new entrants.

However, Sonaecom has failed to take advantage of this opportunity, having achieved inferior results to date in mobile services compared to other European third entrants and having failed to establish a position as the #1 alternative operator in Portugal in any of the fixed line market segments: direct access, indirect access and broadband. How Sonaecom will reverse its history of underperformance in telecommunications as a result of an acquisition of PT has not been made clear to date since Sonaecom has not disclosed its strategy for a combined PT-Sonaecom and has never previously managed an operation of PT's magnitude. Similarly, Sonaecom has not disclosed key information regarding its plans for PT in terms of transaction financing, future investments, asset disposals and international partnerships. It is also unclear to what extent France Telecom will be a key driver of a pro-forma PT-Sonaecom strategy going forward. Finally, Sonaecom's Offer is conditioned on the removal of the restrictions in the by-laws and, consequently, it will be important to understand if Sonaecom expects preferential treatment in relation to these restrictions.

PT Has a Strong Track Record of Operational and Financial Performance . . .

PT has demonstrated outstanding operational and financial performance over the last five years, while also playing a key role in promoting innovation, launching technologically advanced products and services, and developing the Portuguese debt and equity markets.

PT's historical track record speaks for itself. PT has consistently delivered strong cash flow growth, achieving a 17% total increase over the 2001-2005 period in EBITDA and a 92% expansion in operating cash flow. PT has just released its 2005 results, which again confirmed its execution ability in challenging market conditions.

. . . And Has Built a Solid Portfolio of International Assets

PT has historically sought to leverage its proven operating capabilities and natural advantages by expanding its footprint internationally in search of enhanced growth and value creation opportunities. As a result, PT has succeeded in establishing a portfolio of high quality international investments in a variety of markets that we believe feature superior growth potential to the Portuguese telecom sector. This portfolio of international assets today represents significant value for PT and offers significant potential to create shareholder value. PT has previously demonstrated its commitment to monetise its international investments appropriately through sales of Mascom, Primseys and UOL (stake monetised in IPO).

PT Has Delivered Attractive Shareholder Value So Far . . .

PT's strong operational performance and financial flexibility has been reflected in its share price appreciation and has allowed the Company to deliver significant amounts of cash to its shareholders via highly attractive dividend and share buyback policies, while continuing to invest in its core businesses in Portugal and abroad.

Even without taking into account the impact of the Offer announcement, on a trailing 3-year basis, PT's share price has increased by approximately 25%. Additionally, PT has returned considerable cash to shareholders over this period in the form of: (i) dividends of approximately €863 million; and (ii) share buybacks of approximately €944 million. As a result, PT has returned over €1.8 billion (or 22% of its market capitalisation at the beginning of the three-year period) to shareholders over the last three years. Total shareholder return has been approximately 36% during this same period.

. . . And Has a Plan To Deliver Even More Through Sharp Focus on Execution

PT's management team has established an operating plan which will create substantial value for shareholders going forward. The key elements of this plan include: (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 wireline access, which potentially represents the first step towards monetisation and regulatory relief; (iii) seeking to promote a model of shared utilisation 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 crystallise the value of selected assets in Africa. This plan will be efficiently implemented by PT's management team, which features a proven value creation ability.

PT's 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 optimisation to be implemented progressively 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).

In combination with an optimisation of its capital structure position while still maintaining an investment grade rating, this translates into a commitment of total shareholder remuneration in excess of €3.0 billion between 2006 and 2008 (equivalent to approximately €2.66 per share). This will take the form of: (i) an ordinary dividend per share of €0.475 for 2005; (ii) a continuation of our progressive dividend policy going forward; and (iii) an extraordinary return of capital via share buybacks, dividends or a combination thereof undertaken within 12 months following the rejection of the Offer.

Recommendation

As demonstrated herein, Sonaecom's Offer significantly undervalues the Company. The Board is committed to maximising shareholder value and believes that the PT management team's plan will continue to deliver superior value to shareholders going forward.

PT's board is firmly of the view that the Offer is inadequate and strongly recommends that you reject the Offer.

Yours Sincerely,

Ernâni Rodrigues Lopes	Miguel Horta e Costa
Chairman of the Board of Directors	Chief Executive Officer

In the United States, Portugal Telecom, SGPS, S.A. (the "Company" or "PT") will file a Solicitation/Recommendation Statement on Schedule 14D-9 with the U.S. Securities and Exchange Commission (the "SEC") following commencement of a tender offer within the meaning of Rule 14d-2 under the Securities Exchange Act of 1934, as amended. Investors are urged to read the Company's Solicitation/Recommendation Statement on Schedule 14D-9 when it becomes available, as it will contain important information. The Solicitation/Recommendation Statement and other public filings made from time to time by the Company with the SEC are available without charge from the SEC's website at www.sec.gov and at the Company's principal executive offices in Lisbon, Portugal.

This communication includes statements that constitute "forward-looking statements." These statements are based on the beliefs and assumptions of our management and on information available to management at the time such statements were made. Forward-looking statements include, but are not limited to: (a) information concerning possible or assumed future results of our operations, earnings and industry conditions; (b) information or statements concerning potential disadvantages of the tender offer; and (c) statements that are preceded by, followed by or include the words "believes," "expects," "anticipates," "intends," "is confident," "plans," "estimates," "may," "might," "could," "would," the negatives of such terms or similar expressions.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations. Many of the factors that will determine these results are beyond our ability to control or predict. We do not intend to review or revise any particular forward-looking statements referenced in this communication in light of future events or to provide reasons why actual results may differ. Investors are cautioned not to put undue reliance on any forward-looking statements.

Any of the following important factors, and any of those important factors described in our Annual Report on Form 20-F for the year ended December 31, 2004 or in other of our SEC filings, among other things, could cause our results to differ from any results that might be projected, forecast or estimated by us in any such forward-looking statements:

- material adverse changes in economic conditions in Portugal or Brazil;
- exchange rate fluctuations in the Brazilian Real and the U.S. dollar;
- risks and uncertainties related to national and supranational regulation;
- increased competition resulting from the liberalization of the telecommunications sector in Portugal and Brazil;
- the development and marketing of new products and services and market acceptance of such products and services; and
- the adverse determination of disputes under litigation.

This communication is not for publication, release or distribution in any jurisdiction where it would otherwise be prohibited.

APPENDIX 1: BASES OF CALCULATION AND SOURCES OF INFORMATION

1. General

1.1 Unless otherwise stated in this document:

1.1.1 Closing prices and consensus earnings estimates are as at the close of market on 3 March 2006;

1.1.2 Share price data is sourced from Datastream or Bloomberg;

1.1.3 Consensus earnings estimates are sourced from Bloomberg or Reuters and are adjusted for exceptional items and goodwill amortisation where applicable;

1.1.4 Premia analysis references are sourced from company presentations, press releases, SDC and MergerMarket; and

1.1.5 Calculations are prepared on the basis of 1,128,856,500 PT Shares after the cancellation of treasury stock.

1.2. Unless otherwise stated, the financial information concerning Portugal Telecom has been extracted from the 2005 results, other published interim and annual reports and accounts of Portugal Telecom for the relevant periods and other information made publicly available by Portugal Telecom.

1.3. Unless otherwise stated, all references to PT's financial targets, cost savings and future shareholder returns are based on PT's Board of Directors' strategic plan.

1.4. Unless otherwise stated, information contained in this document regarding market position, sector, division and product analysis, comparable companies and precedent transactions is based on PT's management estimates and calculations sourced from publicly available information including ANACOM, Bloomberg, Reuters, Datastream, SDC and Factiva.

1.5. Unless otherwise stated, information regarding Sonaecom's offer is sourced from the Offer Documents and other material made publicly available by Sonaecom or any other person mentioned in the Offer Documents.

2. Page references

The relevant bases of calculation and sources of information are provided below in the order in which the relevant information appears in this document and by reference to page numbers in this document. Where such information is repeated in this document, the underlying bases and sources are not.

Page 1

(a)

The implied undervaluation as per precedent transactions premia is calculated as the difference between the Offer Price and the implied share price for PT applying the selected premia and multiplying by PT Shares.

(b)

For details regarding precedents for European telecommunications transactions, European unsolicited takeovers and Portuguese unsolicited takeovers, see notes (a), (b) and (c) to page v.

Page 2

(a)

For details on European precedent transaction multiples, see note (d) to page v.

(b)

Concentration in the mobile sector as per European precedents is based on selected transactions chosen based on the comparability of the transaction including Deutsche Telekom/Tele.ring, KPN/Telfort, TeliaSonera/Orange Denmark and TIM Hellas/Q-Telecom. Deutsche Telekom/Tele.ring is still in-progress.

(c)

The median number of operators is the median number of operators remaining post consolidation in each of the markets indicated in (b).

(d)

Resulting market shares for European precedents are based on company reports and Merrill Lynch Research, European Wireless Matrix as of the date of completion or announcement (if deal is in-progress) of the transaction.

Page v

(a)

The premium for the European telecommunications sector transactions are calculated as the average of premia offered in selected transactions since 1995. The premia is calculated relative to an estimated pre-bid speculation date (i.e. leak to the market date and initial offer date in improved deals). The sample of precedent transactions is comprised of the following:

Date	Target	Acquiror
31/11/2005	TDC	Nordic Telephone Company
31/10/2005	O2	Telefonica
18/07/2005	Versatel	Tele2
07/07/2005	Saunalahti	Elisa Communications
08/11/2004	Infonet	BT Group
14/09/2004	Song Networks	TDC
01/04/2003	Sense Comm Intl	Reitangruppen
02/07/2001	Eircom	Valentia Group
21/03/2001	Soon Communications	Elisa Communications
24/07/2000	SEC	Netcom
23/06/2000	NetCom	Telia
17/04/2000	Detron Group	Landis Group
11/01/2000	Esat Telecom	BT
14/11/1999	Mannesmann	Vodafone AirTouch
20/10/1999	Orange	Mannesmann
09/07/1999	Debitel	Swisscom
20/02/1999	Telecom Italia	Ing C Olivetti & Co

(b)

The premium for European unsolicited transactions is calculated as the average premia paid in selected unsolicited successful takeover bids in Europe with a transaction value above $10 billion since 1995. The premia is calculated relative to an estimated pre-bid speculation date (i.e. leak to the market date and initial offer date in improved deals). The sample of precedent transactions is selected based on comparability and is comprised of the following:

Date	Target	Acquiror
26/01/2004	Aventis	Sanofi-Synthelabo
29/11/1999	National Westminster Bank	Royal Bank of Scotland Group
14/11/1999	Mannesmann	Vodafone AirTouch
14/09/1999	INA	Assicurazioni Generali
05/07/1999	Elf Aquitaine	Totalfina
09/03/1999	Paribas	BNP
20/02/1999	Telecom Italia	Ing C Olivetti & Co
20/01/1995	Wellcome	Glaxo Holdings

(c)

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 1995. The premia is calculated relative to an estimated pre-bid speculation date (i.e. leak to the market date and initial offer date in improved deals). The sample of precedent transactions includes the following:

Date	Target	Acquiror
06/15/2000	Cimpor	Investor Group

Date	Target	Acquiror
07/19/1999	BPSM	BCP
06/18/1999	Mundial Confiança	BCP

(d)

The reference to precedent transaction Firm Value to last twelve months EBITDA multiples is based on the average for the following transactions: NTC/TDC (6.8x), Weather/Wind (7.7x), Telefonica/Cesky Telecom (6.4x), and the blended multiple for France Telecom/Amena and ONO/Auna transactions (9.3x).

(e)

Sonaecom's Offer implied 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.

Page vi

(a) Sonaecom's market capitalisation as of 3 March 2006.

(b) Sonaecom's free cash flow generation is sourced from Sonaecom's 2004 annual report.

(c) The reference to Sonaecom's equity contribution to the Offer is based on the Offer Documents.

(d) The reference to €14.8 billion funding requirement is calculated as the difference between Sonaecom's Offer implied value of €16.3 billion and the announced equity contribution of up to €1.5 billion. The €16.3 billion implied value is calculated as the sum of Sonaecom's Offer Price multiplied by PT Shares, plus net debt of €5,583 million (including €1,911 million of post-tax pension liabilities).

Page vii

(a) The pro-forma market share for TMN and Optimus is calculated as the sum of the reported market shares in Q3 2005 by PT, Sonaecom and ANACOM.

(b) The average of #1 European mobile operators is calculated as the simple average of Austria, Belgium, Denmark, France, Finland, Germany, Greece, Italy, Netherlands, Spain, Sweden and United Kingdom. Information based on Merrill Lynch Research from the individual country charts in the European Wireless Matrix as of Q3 2005.

(c) The "Portuguese voice market" refers to the combined fixed line and mobile voice markets.

(d) Voice market shares in minutes based on information from ANACOM and company filings for the 9 months ended September 30, 2005. Optimus' minutes based on PT's estimates.

Page viii

(a) The reference to household bills is based on the Statistical Yearbook of Portugal 2004.

Page ix

(a) Unless otherwise stated, the European average is based on the average of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Netherlands, Spain, Sweden and United Kingdom.

(b) Broadband price is the simple average of the monthly fee for 2Mbps or equivalent broadband offer of the incumbents in the above-mentioned countries as of February 2006.

(c) Broadband penetration is the total number of broadband subscribers divided by the total number of PC households in the country as of H1 2005. Source of information is Merrill Lynch Research, European Broadband Matrix as of Q3 2005.

(d) Mobile prices based on the simple average of mobile revenue per minute of the incumbents in the above mentioned countries as of Q3 2005. Source of information is Merrill Lynch Research, European Wireless Matrix as of Q3 2005.

(e)

Mobile penetration is defined as the total number of SIM cards divided by the total number of inhabitants in the country as of Q3 2005. Source of information is Merrill Lynch Research, European Wireless Matrix as of Q3 2005.

(f)

Pay-TV ARPU and penetration for PT is based on ANACOM and INE. European average is based on 2005 Screen Digest estimates for Austria, France, Germany, Greece, Italy, Spain and United Kingdom.

Page x

(a)

Unless otherwise stated, the European average is based on the average of incumbents of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Spain, Sweden and United Kingdom.

(b) Source of leased lines price information is Teligen as of December 2005. Information not available for Sweden.

(c) Termination fees information based on Cullen and company websites as of January 2006.

(d) ULL installation fees, ULL monthly fees and ULL retail margin for competitors are based on Cullen and company websites.

(e) Wholesale line rental monthly fees European average is based on the average of Ireland, Norway, Sweden and United Kingdom. Source of information is Cullen and company websites as of March 2006.

Page xi

(a) The table showing market shares of leading alternative operators in Portugal relates to the share of accesses of the total alternative telecommunication market excluding Portugal Telecom, and is based on ANACOM, company filings and PT estimates. All market shares as of September 2005 except for Indirect Access also as of December 2005. For direct access Sonaecom figures include Optimus Home and ULL. For Indirect access, Tele2's market share of greater than 50% and Sonaecom's 19% based on public announcement, Anacom, company information and PT estimates.

(b) The chart showing 3rd entrants market shares and EBITDA margins is based on Merrill Lynch Research, European Wireless Matrix as of Q3 2005. Wind is based on January 2006 Investor Presentation.

(c) The referenced mobile spectrum fees and fixed to mobile termination rates are based on ANACOM. Fixed-to-mobile termination rates as of February 2006. In contrast with other European countries where mobile operators pay a fixed spectrum fee, Portuguese operators pay a variable spectrum fee proportionate to their number of subscribers thereby allowing smaller operators to pay an overall lower fee. The calculation for Optimus is based on PT estimates by implying an average fee per subscriber and multiplying by Sonaecom's average subscriber base.

Page xiv

(a) Data shown in all charts from PT reported financials.

(b) Broadband subscribers including wireline retail accesses and PTM.

(c) Wireless subscribers include TMN and 50% proportional consolidation of Vivo.

(d) Pay-TV subscribers include cable and DTH.

Page xv

(a) Information for Vivo, Meditelecom, Unitel, CTM and Cabo Verde is based on company information as of December 2005.

(b) Margin refers to EBITDA margin.

Page xvi

(a) Share price appreciation calculated as PT's closing share price increase between 6 February 2003 (3 years prior to the Offer) and 6 February 2006 (pre Sonaecom's Offer announcement).

(b)

The reference to total shareholder return of 36% is based on the closing price for PT as at 6 February 2003 (3 years prior to the Offer) and the ordinary dividends distributed by PT between 6 February 2003 and 6 February 2006. The calculation assumes that all ordinary dividends distributed to PT's shareholders are reinvested in PT's shares from the payment date to 6 February 2006.

(c)

The reference to PT's capital returned as percentage of market capitalisation is based on the number of PT's Shares and the closing price for a PT Share as at 6 February 2003 (3 years prior to the Offer). Share buyback and dividend information from PT's filings.

Page xix

(a)

EBITDA growth at the current exchange rate of €1.00 = R$2.55 (Brazilian reais).

APPENDIX 2: DEFINITIONS

€	The lawful currency of the European Economic Union
$	The lawful currency of the United States
Average Revenue Per User ("ARPU")	Average monthly revenue per customer. Monthly average service revenues per average number of users in the period
Capex	Total amount of contracted acquisitions of goods and services that will be accounted as tangible or intangible assets
Carrier Pre-Selection ("CPS")	CPS allows telephony subscribers who are directly connected to the network of a telecommunications provider to access another telecommunication provider's voice telephony services, directly or by dialing a prefix
Direct-to-Home ("DTH")	Direct-to-Home satellite television. Technology used to provide pay-TV services in areas not covered by Hybrid Fibre Coaxial (HFC) networks
EBITDA of PT	Income before Financial Results and Taxes + Depreciation and Amortisation + Impairment Losses + Work Force Reduction Programme Costs +/ Losses and Gains on Disposals of Fixed Assets + Other Non-Recurring Items
EPS	Earnings per share
Firm Value or FV	Used to indicate the value of a company by multiplying the number of shares outstanding by the current share price less proceeds from options, warrants, convertible preferred and convertible debt, plus interest bearing debt and minority interests, less investment in unconsolidated affiliates, tax assets and cash and marketable securities
Market Capitalisation	Used to indicate the value of a company by multiplying the number of shares in issue by the current share price
Firm Value to EBITDA (or FV/EBITDA)	A measurement of a company's value, calculated by dividing the Firm Value by the annual EBITDA
Pension Liabilities	NPV of PT's pension liabilities as reported by the Company
Offer Documents	The documents filed on 27 February 2006 by Sonaecom containing the terms and conditions of Sonaecom's offer
Offer Price	The price offered for Portugal Telecom shares as set forth in the Offer Documents
Operating Cash Flow ("OCF")	EBITDA minus Capex
Portugal Telecom or PT or Company	Portugal Telecom, SGPS, S.A.
Portugal Telecom Shares	The ordinary shares of Portugal Telecom
Shareholder	A registered holder of Portugal Telecom shares
Tax Assets	Book value of tax assets as reported in company filings
Unbundled Local Loop ("ULL")	Ability to access the "last mile" network infrastructure owned by the incumbent telecommunications operator for a fee by competitors

PT-Multimédia - Serviços de Telecomunicações e Multimédia, SGPS, S.A.
Public Company
Registered Office: Av. 5 de Outubro, no. 208, Lisbon
Legal Entity: 504 453 513
Share Capital: 77.274.207 Euros
Registered with: Lisbon Commercial Registry Office under no. 8357

Letter to the owners of PT Multimedia

6 March 2006

Dear Shareholder,

On 7 February 2006, Sonaecom SGPS, S.A. and Sonaecom, BV (hereinafter named jointly as "Sonaecom") made a preliminary announcement of an unsolicited tender offer (the "Offer") for your company. Having carefully reviewed the draft offer announcement and the draft prospectus (the "Offer Documents"), the Board of Directors (the "Board") of PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS, S.A. ("PTM" or the "Company") believes that the Offer undervalues the Company and is, therefore, not in your best interest as a shareholder of PTM. Accordingly, this letter and the accompanying presentation provide the principal arguments setting out the basis on which your **Board recommends that you reject the Offer**, notably:

1) Sonaecom's Offer undervalues PTM and does not attempt to offer shareholders a fair price;

2) Sonaecom characterises the Offer as mandatory, but is avoiding the minimum offer price required under the Portuguese Securities Code, which is expected to be higher than the price of the Offer; and

3) Sonaecom does not present a strategy or plan for PTM in the Offer Documents.

Sonaecom's Offer does not reflect PTM's current strong strategic position and attractive future prospects.

In the United States, Portugal Telecom, SGPS, S.A. ("Portugal Telecom" or "PT"), the parent company of PTM will file a *Solicitation/Recommendation Statement on Schedule 14D-9* with the *U.S. Securities and Exchange Commission* (the "SEC") following commencement of a tender offer within the meaning of *Rule 14d-2* under the Securities Exchange Act of 1934, as amended. Investors are urged to read PT's *Solicitation/Recommendation Statement on Schedule 14D-9* when it becomes available, as it will contain important information. The Solicitation/Recommendation Statement and other public filings made from time to time by PT with the SEC are available without charge from the SEC's website at www.sec.gov and at PT's principal executive offices in Lisbon, Portugal.

WHY YOU SHOULD REJECT THE OFFER

<u>Sonaecom's Offer undervalues PTM and does not attempt to offer shareholders a fair price</u>

1) The Offer price represents a 6% discount to the pre-announcement price:

Sonaecom's Offer versus PTM share price performance over the last six months

2) The Offer is significantly below the average of the price targets for PTM published by equity analysts prior to the Offer, which do not include any control premium:

Sonaecom's Offer versus equity analyst price targets

3) Sonaecom characterises the Offer as mandatory, and is therefore stating that the Offer price has been determined on the basis of a six month historical weighted average price for PTM rather than on a fair assessment of the value of the Company. This is clearly inconsistent with the valuation methodology Sonaecom used in its offer for Portugal Telecom, which suggests that Sonaecom is not extending the same treatment to the PTM minority shareholders as to the Portugal Telecom shareholders.

Sonaecom is not offering a control premium for your shares. This is inconsistent with market practice, where bidders acquiring control of public companies offer a premium to the target's trading price in order to reflect strategic benefits of control. When assessing Sonaecom's Offer price, shareholders should compare the Offer premium with the premia paid in relevant precedent transactions as set out below:

Premia paid on relevant transactions compared to the Offer premium

<u>Sonaecom characterises the Offer as mandatory, but is avoiding the minimum offer price required under the Portuguese Securities Code, which is expected to be higher than the price of the Offer</u>

The Board of Directors has received a legal opinion confirming that Sonaecom's Offer for PTM does not follow the minimum offer price rule under the Portuguese Securities Code. Sonaecom incorrectly argues that the six month reference period for the minimum offer price has been triggered by the preliminary announcement of the Offer. The mandatory offer, and hence the minimum offer price reference period, is only triggered upon the completion of the acquisition by Sonaecom of over one third or one half of PTM's voting rights under Article 20 of the Portuguese Securities Code, as explained below:

1) Under the Portuguese Securities Code, the legal obligation to launch a mandatory offer arises only when an acquirer, directly or indirectly, passes one of the above mentioned legal thresholds. Sonaecom, which currently does not hold any voting rights for PTM or Portugal Telecom, has not exceeded any of the legal thresholds and therefore has not at this time legally triggered a mandatory offer requirement;

2) Sonaecom has stated that the launch of the Offer for PTM is conditional upon Sonaecom's owning at least 50.01% of PTM's voting rights, i.e., only if Sonaecom is able to complete the takeover offer for Portugal Telecom;

3) Thus, the announced Offer for PTM does not currently fall under the rules for a mandatory takeover under the Portuguese Securities Code and a mandatory offer will only be triggered upon the completion of the takeover offer for Portugal Telecom, if achieved;

4) In a mandatory offer, the offeror is required to offer the higher of: (i) the highest price paid by the offeror in the six months prior to the legal requirement to launch the mandatory offer, and (ii) the weighted average share price in that same period;

5) The minimum price legally required to be offered by Sonaecom should therefore be the weighted average price of the shares for the six months immediately prior to the completion of the acquisition of at least 50.01% of the voting rights of PTM (i.e. following completion of the takeover of Portugal Telecom), and not prior to the date of the announcement of the possible

offer. Sonaecom should not be allowed to unlawfully offer a price below the minimum legal requirement;

6) For example, if the PTM share price of €10.35 as at close on 3 March 2006 were to remain at the same level for six months and Sonaecom launched the mandatory offer six months from this date, the minimum legally acceptable offer price would be €10.35.

In addition, in the event that Sonaecom is able to acquire over 90% of PTM's voting rights and uses the squeeze-out mechanism under the Portuguese Securities Code to acquire the remaining PTM minority shares, Sonaecom would be legally required to pay the higher of: (i) the highest price paid by Sonaecom in the six months prior to the squeeze-out, and (ii) the weighted average price of PTM shares in the six months prior to the squeeze-out being undertaken.

Furthermore, by pre-empting the mandatory offer requirements at a moment when it is not under a legal duty to launch a mandatory offer, Sonaecom is attempting to impose limitations on PTM's management for an unjustifiably long period.

Sonaecom does not present a strategy or plan for PTM in its Offer Documents

Sonaecom in its Offer Documents does not outline any coherent strategy for PTM. The Offer Documents provide minimal information on how it will refinance this acquisition. Any financial constraints are likely to impair PTM's ability to invest in the network and in the roll-out of innovative services for its customers.

PTM IS A STRATEGIC ASSET WITH A CLEARLY DEFINED GROWTH STRATEGY

PTM has a leading position in the Portuguese Pay-TV and is number two in the broadband access market

Through CATVP Televisão por Cabo, S.A., PTM is the leading Pay-TV operator with 1,479 thousand Pay-TV customers and 83% market share in subscriber terms. Through its brand "Netcabo', PTM is the number two broadband internet access provider in Portugal with 348 thousand broadband customers, and a 29% market share.

PTM is well positioned to seize a substantial share of the continuing growth in the Portuguese Pay-TV market

Portugal still has significant upside in Pay-TV penetration. PTM has several key advantages that makes it best positioned to seize a substantial share of the additional growth in the market. Its cable network coverage should increase from the current 70%+ of homes passed to as much as 85%+ by the end of 2007. Additionally, PTM also owns a DTH platform in Portugal. Through these two platforms, PTM covers 100% of Portuguese households. Furthermore, PTM has a strong advantage given its scale, well established brands and high density of distribution networks.

PTM has further potential to increase revenues per subscriber

PTM's current ARPU is lower than in a number of other European markets. PTM has further room to increase ARPU through the migration of its subscriber base to higher tier packages. Additionally, take-up of premium channels by PTM cable customers is low relative to other European markets, thus providing significant room for growth.

PTM has the opportunity to increase its broadband subscriber base

Although broadband penetration over PC households in Portugal is one of the highest in Europe, expansion of PC penetration, one of the lowest in Europe, should provide room for future growth. In addition, leading cable operators in European countries and the US show penetration rates over their total customer base of up to 53%, suggesting significant upside potential for PTM, which stands at a 32% penetration level.

PTM has yet to tap the voice opportunity

PTM is planning the commercial launch of VoIP in late Q3 2006, subject to regulatory approval. There is significant potential for growth in additional voice revenues, as well as for improving Pay-TV and broadband penetration and reducing churn.

PTM's infrastructure will support continuous introduction of additional innovative services with better quality and at competitive prices

Continued investment in its network and information systems, which over the last three years amounted to €286 million, has enabled PTM to offer high speed broadband and digital Pay-TV services to more than 2.6 million homes. During the course of 2006 and 2007, the network will be expanded further to cover 3.2 million homes whilst the implementation of fibre to the hub architecture will enable the improvement in the quality of service and the roll out of new interactive services.

PTM is well positioned to continue growing EBITDA

PTM has delivered consistent revenue, EBITDA and cash flow growth over the past four years. PTM is well positioned to continue to deliver growth given the revenue opportunities outlined above. Top line growth would result in higher absorption of fixed costs. Moreover, a number of incremental revenue opportunities such as Pay-TV ARPU increases, further broadband penetration and the impact of triple play, including voice revenues and reduction of churn rates, carry relatively low marginal costs and thus should lead to margin expansion in the future.

PTM is committed to maintaining high levels of shareholder remuneration

PTM has invested over €300 million in its business over the last three years in order to develop a strong platform for growth in number of customers and quality of service. In parallel, PTM has been increasing its cash flow generation and has consistently demonstrated strong commitment to shareholder remuneration.

In 2005, PTM paid a dividend of €77.3 million (compared to €12.6 million in 2004) and undertook a €91.5 million share buy-back, providing total shareholder remuneration for 2005 of €168.8 million. In 2006, the proposed dividend to be paid in relation to fiscal year 2005 earnings will amount to €85.0 million (€0.275 per share, a 10% increase over dividends per share paid in 2004). This is equivalent to a 2.8% dividend yield based on PTM's market capitalisation as of 31 December 2005.

Furthermore, in its last meeting, and in light of 2005 results and the existing distributable reserves, the Board agreed to submit to the next annual general shareholders meeting a proposal for a capital increase through the incorporation of reserves followed by a capital reduction. Upon completion of these transactions, distributable reserves are expected to increase by €220 million, resulting in total distributable reserves of approximately €300 million after the payment of the proposed 2005 dividend. PTM continues to be committed to returning cash to shareholders, and aligning management and employee compensation with shareholder interests and returns.

Recommendation

Your Board believes that Sonaecom's Offer undervalues the Company. In addition, the Offer does not present a strategy or plan for the future development of PTM.

Your Board is committed to maximising shareholder value and believes that PTM's clearly defined business strategy, prospects and sharp focus on execution will continue to deliver superior shareholder value.

Your Board firmly believes that the Offer is inadequate and strongly recommends that you reject the Offer.

Yours Sincerely,

Miguel Horta e Costa	Zeinal Bava
Chairman of the Board	Chief Executive Officer

This communication includes statements that constitute "forward-looking statements." These statements are based on the beliefs and assumptions of our management and on information available to management at the time such statements were made. Forward-looking statements include, but are not limited to: (a) information concerning possible or assumed future results of our operations, earnings and industry conditions; (b) information or statements concerning potential disadvantages of the tender offer; and (c) statements that are preceded by, followed by or include the words "believes," "expects," "anticipates," "intends," "is confident," "plans," "estimates," "may," "might," "could," "would," the negatives of such terms or similar expressions.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations. Many of the factors that will determine these results are beyond our ability to control or predict. We do not intend to review or revise any particular forward-looking statements referenced in this communication in light of future events or to provide reasons why actual results may differ. Investors are cautioned not to put undue reliance on any forward-looking statements.

Any of the following important factors, and any of those important factors described in PT's Annual Report on Form 20-F for the year ended December 31, 2004 or in other of PT's SEC filings, among other things, could cause our results to differ from any results that might be projected, forecast or estimated by us in any such forward-looking statements:

- material adverse changes in economic conditions in Portugal;
- risks and uncertainties related to regulation;
- actions of our competitors;
- the development and marketing of new products and services and market acceptance of such products and services; and
- the adverse determination of disputes under litigation.

This communication is not for publication, release or distribution in any jurisdiction where it would otherwise be prohibited.

Appendix: Sources and Bases

1. General

1.1
Unless otherwise stated in this document, share price data is sourced from FactSet, Datastream or Bloomberg.

1.2.
Unless otherwise stated, the financial information concerning PTM has been extracted from the Q4 Press Release, other published interim and annual reports and accounts of PTM for the relevant periods and other information made publicly available by PTM.

1.3.
Unless otherwise stated, information contained in this document regarding market position, sector, division and product analysis, comparable companies and precedent transactions is based on PTM's management estimates and calculations sourced from publicly available information.

2. Page references

The relevant bases of calculation and sources of information are provided below in the order in which the relevant information appears in this document and by reference to page numbers in this document. Where such information is repeated in any of the documents, the underlying bases and sources are not repeated.

Page 2

The sources for equity analyst price targets are equity research reports, Bloomberg and Datastream.

Page 3

The premium for Portuguese transactions is calculated as the average premia paid in selected unsolicited takeover bids in Portugal with a transaction value above €500 million. The sample of precedent transactions has been chosen based on the comparability of the transaction and includes the following:

Date	Target	Acquiror
06/15/00	Cimpor	Investor Group
07/19/99	BPSM	BCP
07/19/99	Mundial Confiança	BCP

Precedent European cable, telecoms and Pay-TV transactions include those since 1 January 2004 with a deal value larger than €500 million. The sample of precedent transactions has been chosen based on the comparability of the transaction and includes the following:

Date	Target	Acquiror
31/10/05	O2	Telefónica
30/11/05	TDC	Nordic Telephone
03/10/05	Telewest Global	NTL
05/12/05	Virgin Mobile Holdings(UK)	NTL
04/04/05	TIM Hellas Telecommunications	Troy GAC Telecom
17/07/05	Versatel Telecom International	Tele2
14/09/04	Song Networks Holding	TDC
02/11/05	Sogecable	PRISA

Page 5

PTM's Pay TV market share calculation is based on 1,479 thousand TV Cabo subscribers compared with estimated total subscribers of 300 thousand for the remaining competition. PTM's broadband market share is based on 348 thousand broadband customers compared with an estimated total of 860 thousand for the remaining competition. Netcabo is the number 2 broadband supplier based on subscriber numbers. All these estimates were produced by the PTM management team.

The network coverage of PTM's cable network is based on an estimated 3,655 thousand total TV households and 2,666 thousand homes passed and an expansion of coverage as per PTM expansion plan.

PTM currently generates an ARPU level of €20.6 and €26.7 on its cable and satellite businesses, respectively. The relative ARPU level of PTM has been reviewed against selected comparable companies across Europe. The following sources form the basis of this comparison:

- Premiere: €22.4 (Oppenheimer Equity Research as of 17 February 2006, page 10)
- NTL: £18.92 (UBS Equity Research as of 30 January 2006, page 13)
- Sky: £32 (2005 Annual Report, page 13)
- ONO: €24.2 (2004 Annual Report, page 43)
- Digital+: €46.8 (Deutsche Bank Equity Research as of 16 February 2006, page 6)

Take up rates for premium channels as per PTM's company information and market estimates.

Broadband penetration calculated for Portugal based on an estimated 3,655 thousand total households and an estimated 1,207 thousand broadband subscribers. Average for Western Europe is sourced from the following research report by Merrill Lynch: "The risks of a low market share in broadband", 11 January 2006.

The market data on penetration of PC households in Portugal and Europe, as well as the data relating to the expansion of PC penetration, are sourced from the following research report by Merrill Lynch: "The risks of a low market share in broadband", 11 January 2006.

Comparison with other leading cable operators in Europe and the United States with respect to the broadband penetration over total customers is sourced and/or calculated as follows:

- PTM: 32% (broadband subscribers of 348 thousand divided by cable customers of 1,090 thousand)
- NTL: 52% (broadband subscribers of 1720.6 thousand divided by total customers of 3,315.4 thousand; Q3/2005 report, page 54)
- Telenet: 32% (broadband subscribers of 576 thousand divided by total customers of 1,810 thousand; Q3/2005 report, page 31)
- Liberty Global Western Europe: 22% (Morgan Stanley Equity Research on Liberty Global 7/2/2006, page 33)
- Comcast: 38% (Morgan Stanley Equity Research Note 6/2/2006 on Comcast, page 21)
- Cablevision: 53%, (Morgan Stanley Equity Research Note 13/1/2006 on Cablevision, page 39)

9

Definitions:

DTH *Direct-to-Home*

ARPU *Average Revenue per User*

PVR *Personal Video Recorder*

HDTV *High Definition Television*

VoD *Video on Demand*

VoIP *Voice over Internet Protocol*

QuickLinks

Table of Contents
IMPORTANT NOTICE
APPENDIX 1: BASES OF CALCULATION AND SOURCES OF INFORMATION
APPENDIX 2: DEFINITIONS
Appendix: Sources and Bases