

PORTUGAL TELECOM

Convertible bonds

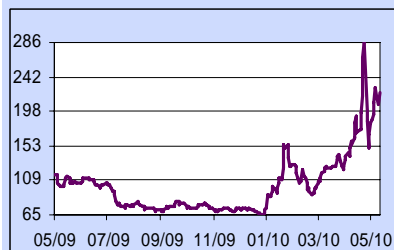
CB characteristics

Isin	XS0309600848
Name	Portugal Telecom 4,125% 2014
Maturity	28/08/14
Outstanding (€M)	750
Call	
date	11/09/10
trigger/price	130%/100%
Put	-
CB Curncy	EUR
Currency Underl.	EUR

Issuer

Rating Baa2/BBB *-

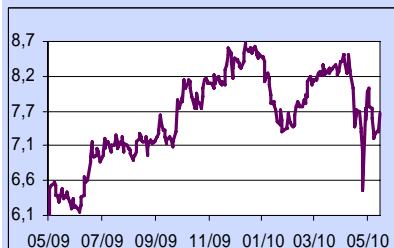
CDS5Y over 1Y



Underlying

Ticker	PTC PL
Name	PORTUGAL TELECOM INT FIN
Capi (€Bn)	6,58
Share price	7,63
Reco Natixis	Neutral
TP	EU7,50

Share price over 1Y



CB research

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Portugal Telecom 4.125% 2014

What's happen if Telefonica makes an offer on PTC?

Telefonica has not ruled out a hostile bid for PTC, following the rejection of Vivo offer.

Announced on May 11, 2010, Telefonica offered EU5.7Bn for PT 50% share of Brasilcel, the holding company that controls Vivo Participacoes SA.

- o Portugal Telecom immediately rejected the offer.
- o Even if Telefonica said "Full bid on PT is not what we would like to do", the CFO, in an interview to the FT today, said company has not ruled out a hostile bid for PT as an alternative to Vivo.
- o The Portuguese securities regulator (CMVM) asked TEF for clarification.
- o Natixis doesn't see TEF sweetening its bid for Brasilcel.
- o TEF has already lined up financing for its unsolicited bid.

The offering circular states that, in the event of a change of control, the bearers will have 60 days to convert their CBs and benefit from a lower conversion price.

Initial calendar clause:

Conversion Date	Exchange Price (EUR)
On or before 28 August 2008	10.17
Thereafter, but on or before 28 August 2009	10.72
Thereafter, but on or before 28 August 2010	11.26
Thereafter, but on or before 28 August 2011	11.81
Thereafter, but on or before 28 August 2012	12.35
Thereafter, but on or before 28 August 2013	12.90
Thereafter and until the Final Maturity Date	13.44

The initial exchange price was EU13.9859.

Due to some adjustments it was down to EU11.60 in October 2007.

So the preceding table is adjusted at the same time by the same proportion:

Conversion Date	Exchange Price (EUR)
On or before 28 August 2008	8,44
Thereafter, but on or before 28 August 2009	8,89
Thereafter, but on or before 28 August 2010	9,34
Thereafter, but on or before 28 August 2011	9,80
Thereafter, but on or before 28 August 2012	10,24
Thereafter, but on or before 28 August 2013	10,70
Thereafter and until the Final Maturity Date	11,15

Characteristics of the CB:

- CB price 98.50%, 99.55% accrued included.
- Nominal EU50 000
- underlying share price EU7.687
- delta 11
- premium 48%

Simulation (1): the best case.

Takeover soon and exchange **on the 28 August 2010** (min. exchange price and coupon received).

You will receive the 2.0625% coupon on the 28 August.

Takeover Premium	Conversion ratio before offer	Conversion price before offer	New CP	New share ratio	CB after offer	Loss of Δ /CB (ccy)	Pos. gain long CB (ccy)	Total arbitrage gain	Outright profit
20%	4 310	11.60	9.34	5 353	98.77	750	642	-0.2% *	1.3% *
30%					107	1 125	4 757	7.5%	9.8%
40%					115.23	1 500	8 873	15.1%	18.2%

* If you exercise your change of control put at par, the gain for arbitrage is 1% and 2.6% for outright.

Simulation (2): before the coupon payment.

You will **not** receive the 2.0625% coupon on the 28 August.

Takeover Premium	Conversion ratio before offer	Conversion price before offer	New CP	New share ratio	CB after offer	Loss of Δ /CB (ccy)	Pos. gain long CB (ccy)	Total arbitrage gain	Outright profit
20%	4 310	11.60	9.34	5 353	98.77	750	-389	-2.3% *	-0.8%*
30%					107	1 125	3 726	5.2%	7.5%
40%					115.23	1 500	7 842	12.7%	15.8%

* If you exercise your change of control put at par, the gain for arbitrage and outright is merely the same than the previous case (+1% and +2.6%), because of the accrued interests.

Simulation (3): the worst case, after the coupon payment.

You will receive the 2.0625% coupon on the 28 August, but new exchange price on 29 August 2010.

Takeover Premium	Conversion ratio before offer	Conversion price before offer	New CP	New share ratio	CB after offer	Loss of Δ /CB (ccy)	Pos. gain long CB (ccy)	Total arbitrage gain	Outright profit
20%	4 310	11.60	9.80	5 104	94.17	750	- 1 658	-4.9% *	-3.4% *
30%					102	1 125	2 266	2.3%	4.6%
40%					109.9	1 500	6 189	9.6%	12.7%

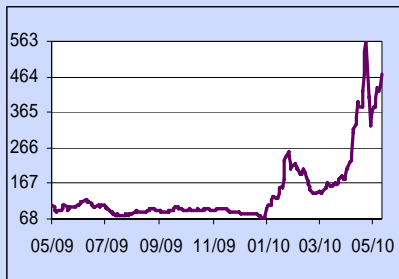
* If you exercise your change of control put at par, the day following the coupon payment, the gain will be the same as the case 1, and on the top of it you will add the accrued interests.

CB characteristics

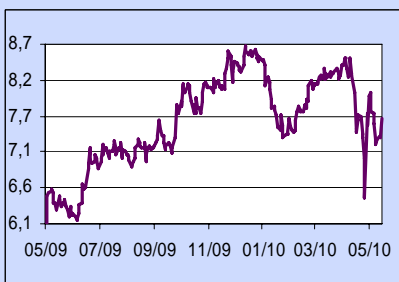
Isin	XS0481400173
Name	Portugal Telecom (BCP) 3% 2015
Maturity	28/01/15
Outstanding (€M)	224
Call	
date	aucun
trigger/price	
Put	-
CB Curncy	EUR
Currency Underl.	EUR

Issuer

Rating A1 *-/BBB+

CDS5Y over 1Y

Underlying

Ticker	PTC PL
Name	Portugal Telecom
Capi (€bn)	6,58
Share price	7,72
Reco Natixis	Neutral
TP	EU7,50

Share price over 1Y


BCP / Portugal Telecom 3% 2015

Prospectus abstract

"If the Issuer accepts such Offer and the Offer is or becomes unconditional in all respects, then, with effect from the Offer Consideration Date (as defined below), the Exchange Property will consist, in whole or in part, of the Offer Consideration, or the consideration received pursuant to such compulsory acquisition."

If the Offer Consideration in respect of any Relevant Securities consists of cash only, the Issuer will apply the relevant amount of cash in purchasing Eligible Shares.

"Eligible Shares" means ordinary shares of Deutsche Telekom AG, France Telecom S.A. or Telefonica S.A. being the ordinary shares of that entity in respect of which the arithmetic average of the 250-day historical volatility as published on Bloomberg page HVG ending on the fifth Trading Day preceding the Offer Consideration Date most closely matches the arithmetic average of the three 250-day historical volatilities of the ordinary shares of DTE, FTE and TEF ending on the fifth Trading Day preceding the Offer Consideration Date.

 ⇒ **250d historical volatility:**

FTE 19.61%
DTE 22.11%
TEF 25.02%

Arithmetic average: 22.24%, so today the winner is **Deutsche Telekom AG**.

Current valuation of the CB:

CB price	Underlying (EUR)	Premium	Delta	Elasticity	YTM	IV	Credit spread
90.6%	7.687	29%	19%	14.7%	5.32%	30%	470bp

Simulation with a new underlying (DTE):

DTE: EU8.90
IV: 22%
New repo: 30bp

Takeover premium	Theoretical price
20%	88.7%
30%	90%
40%	91.6%

Conclusion: avoid using exchangeable bonds to play takeover offers!

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