

TELEFONICA BRASIL S.A.  
Form 20-F  
February 21, 2018

As filed with the Securities and Exchange Commission on February 21, 2018

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 20-F**

(Mark One)

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2017**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission file number: 001-14475**

**TELEFÔNICA BRASIL S.A.**  
(Exact name of Registrant as specified in its charter)

**TELEFÔNICA BRAZIL S.A.**  
(Translation of Registrant's name into English)

**Federative Republic of Brazil**  
(Jurisdiction of incorporation or organization)

**Avenida Engenheiro Luis Carlos Berrini, 1376, 28º andar**  
**04571-936 São Paulo, SP, Brazil**  
(Address of principal executive offices)

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(Name, Telephone, Email and/or Facsimile and Address of Company Contact Person)

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
<b>Preferred Shares, without par value</b>	<b>New York Stock Exchange*</b>
<b>American Depositary Shares (as evidenced by American Depositary Receipts), each representing one share of Preferred Stock</b>	<b>New York Stock Exchange</b>

\* **Not for trading purposes, but only in connection with the registration on the New York Stock Exchange of American Depositary Shares representing those Preferred Shares.**

**Securities registered or to be registered pursuant to Section 12(g) of the Act: None**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

The number of outstanding shares of each class (excluding treasury shares) as of December 31, 2017 was:

<b>Title of Class</b>	<b>Number of Shares Outstanding (excluding treasury shares)</b>
Shares of Common Stock.....	569,354,053
Shares of Preferred Stock.....	1,119,339,723

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

x Yes    No

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If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  Yes  No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards<sup>†</sup> provided pursuant to Section 13(a) of the Exchange Act.

<sup>†</sup> The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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## INTRODUCTION

References in this annual report to “Telefônica Brasil,” “we,” “our,” “us,” “our company” and “the company” are to Telefônica Brasil S.A. and its consolidated subsidiaries (unless the context otherwise requires). All references in this annual report to:

- “ADRs” are to the American Depositary Receipts evidencing our ADSs;
- “ADSs” are to our American Depositary Shares, each representing one share of our non-voting preferred stock;
- “ANATEL” are to *Agência Nacional de Telecomunicações – ANATEL*, the Brazilian telecommunications regulatory agency;
- “B3” are to *B3 S.A. – Brasil, Bolsa, Balcão*, the São Paulo stock exchange and a Brazil-based financial market infrastructure provider;
- “BNDES” are to *Banco Nacional de Desenvolvimento Econômico e Social*, the Brazilian Development Bank;
- “Brazil” are to the Federative Republic of Brazil;
- “Brazilian Corporate Law” are to Law No. 6,404 of December 15, 1976, as amended;
- “CADE” are to *Conselho Administrativo de Defesa Econômica*, the Brazilian competition authority;
- “CDI” are to *Certificado de Depósito Interbancário*, the Certificate for Interbank Deposits;
- “Celular CRT” are to Celular CRT Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
- “Central Bank” are to the *Banco Central do Brasil*, the Brazilian Central Bank;
- “CMN” are to the *Conselho Monetário Nacional*, the Brazilian Monetary Council;
- “CTBC Telecom” are to *Companhia de Telecomunicações do Brasil Central*;
- “CVM” are to the *Comissão de Valores Mobiliários*, the Brazilian Securities Commission;
- “Federal District” are to *Distrito Federal*, the federal district where Brasília, the capital of Brazil, is located;
- “FGV” are to the *Fundação Getúlio Vargas*, an economic private organization;
- “General Telecommunications Law” are to *Lei Geral de Telecomunicações*, as amended, the law which regulates the telecommunications industry in Brazil;
- “Global Telecom” are to Global Telecom S.A., formerly a Vivo subsidiary before Vivo’s corporate restructuring;
- “GVT” are to Operating GVT and GVTPar, collectively, formerly wholly owned subsidiaries of Telefônica Brasil prior to our 2016 corporate restructuring;

- “GVTPar” are to GVT Participações S.A., a formerly wholly owned subsidiary of Telefônica Brasil prior to our 2016 corporate restructuring;
- “IASB” are to International Accounting Standards Board;

- “IBGE” are to *Instituto Brasileiro de Geografia e Estatística*, the Brazilian Institute of Geography and Statistics;
- “IFRS” are to International Financial Reporting Standards, as issued by the IASB;
- “IGP-DI” are to the *Índice Geral de Preços - Disponibilidade Interna*, an inflation index developed by the FGV used by fixed broadband and mobile service providers to adjust their prices;
- “IGP-M” are to the *Índice Geral de Preços ao Mercado*, an inflation index developed by the FGV used by TV and cable service providers to adjust their prices;
- “IOF Tax” are to *Imposto sobre Operações de Crédito, Câmbio e Seguros*, a tax on credit, exchange and insurance transactions;
- “IPCA” are to *Índice Nacional de Preços ao Consumidor Amplo*, the consumer price index, published by the IBGE;
- “IST” are to *Índice de Serviços de Telecomunicações*, the inflation index of the telecommunications sector;
- “NYSE” are to the New York Stock Exchange;
- “Oi” are to Oi S.A., the mobile operator branch of Telemar;
- “Operating GVT” are to Global Village Telecom S.A., a formerly wholly owned subsidiary of Telefônica Brasil prior to our 2016 corporate restructuring;
- “Real,” “reais” or R\$ are to the Brazilian *real*, the official currency of Brazil;
- “SEC” are to the U.S. Securities and Exchange Commission;
- “Telebrás” are to *Telecomunicações Brasileiras S.A.–Telebrás*;
- “Telefonica” or are to *Telefonica S.A.*, our parent company;
- “Terra Networks” are to *Terra Networks Brasil S.A.*, a formerly wholly owned subsidiary of SP Telecomunicações Participações S.A. (one of our controlling shareholders); Terra Networks provides digital services and advertising;
- “TJLP” are to *Taxa de Juros de Longo Prazo*, or long-term interest rate;
- “UMBNDDES” are to a monetary unit of the BNDES, consisting of a currency basket of BNDES debt obligations in foreign currencies, which are mostly denominated in U.S. dollars;
- “U.S. dollar,” “U.S. dollars” or “US\$” are to U.S. dollars, the official currency of the United States;
- “Vivo” are to *Vivo S.A.*, a formerly wholly owned subsidiary of Telefônica Brasil, which conducted cellular operations including SMP (as defined in the Glossary of Telecommunication Terms), nationwide; and
- “Vivo Participações” are to *Vivo Participações S.A.* (formerly *TELESP Celular Participações S.A.*) and its consolidated subsidiaries (unless the context otherwise requires).



Unless otherwise specified, data relating to the Brazilian telecommunications industry included in this annual report was obtained from ANATEL.

The “Glossary of Telecommunications Terms” that begins on page 155 provides the definition of certain technical terms used in this annual report.

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this Annual Report can be identified, in some instances, by the use of words such as “will,” “expect,” “aim,” “hope,” “anticipate,” “intend,” “believe” and similar language or the negative thereof or by the forward-looking nature of discussions of strategy, plans or intentions. These statements appear in a number of places in this Annual Report including, without limitation, certain statements made in “Item 3. Key Information—D. Risk Factors,” “Item 4. Information on the Company,” “Item 5. Operating and Financial Review and Prospects” and “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and include statements regarding our intent, belief or current expectations with respect to, among other things:

- the size and growth rate of the Brazilian telecommunications market;
- the accuracy of our estimated demand forecasts;
- our ability to successfully execute our strategic initiatives and capital expenditure plans;
- our ability to secure and maintain telecommunications spectrum and infrastructure licenses, rights-of-way and other regulatory approvals;
- our ability to comply with the terms of our concession agreements;
- decisions by applicable regulatory authorities to terminate, modify or renew our concession agreements or the terms thereof;
- new telecommunications regulations or changes to existing regulations;
- technological advancements in our industry and our ability to successfully implement them in a timely manner;
- network completion and product development schedules;
- the level of success of competing networks, products and services;
- the possible requirement to record impairment charges relating to goodwill and long-lived assets;
- increased competition in the Brazilian telecommunications sector;
- the cost and availability of financing;
- uncertainties relating to political and economic conditions in Brazil as well as those of other emerging markets;
- inflation, interest rate and exchange rate risks;
- the Brazilian government’s policies regarding the telecommunications industry;
- the Brazilian government’s tax policy;

- the Brazilian government’s political instability;
- adverse decisions in ongoing litigation;
- regulatory and legal developments affecting the telecommunications industry in Brazil; and
- other risk factors discussed under “Item 3. Key Information—D. Risk Factors.”

We undertake no obligation to publicly update or revise any forward-looking statements as a result of new information, future events or otherwise. Because of these risks and uncertainties, the forward-looking information, events and circumstances discussed in this annual report might not occur. Our actual results and performance could differ substantially from those anticipated in our forward-looking statements.

## PRESENTATION OF FINANCIAL INFORMATION

We maintain our books and records in *reais*. We prepared our consolidated financial statements included in this annual report in accordance with IFRS as issued by the IASB (“IFRS”).

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our accounting policies. Those areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3 to our consolidated financial statements.

Our financial statements prepared in accordance with IFRS as of December 31, 2017 and December 31, 2016 and for the years ended December 31, 2017, December 31, 2016 and December 31, 2015 have also been filed with the CVM, the local securities regulator in Brazil and made publicly available. Our selected financial information included in “Item 3. Key Information—A. Selected Financial Data” should be read in conjunction with, and is qualified in its entirety by, our financial statements and “Item 5. Operating and Financial Review and Prospects” appearing elsewhere in this annual report.

The consolidated financial statements as of December 31, 2017 and 2016 and for each of the three years in the period ended December 31, 2017 are in compliance with IFRS, as issued by the IASB and also with the pronouncements, interpretations and guidance issued by the IASB and the IFRS Interpretations Committee, or the IFRIC, which entered into force as of January 1, 2017.

We have made rounding adjustments to reach some of the figures included in this annual report. Accordingly, numerical figures shown as totals in some tables may not be an arithmetic aggregation of the figures that preceded them.

**PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION****A. Selected Financial Data**

The selected financial data presented below should be read in conjunction with our consolidated financial statements, including the notes thereto included elsewhere in this annual report. Our consolidated financial statements included herein as of December 31, 2017 and for the year ended December 31, 2017 have been audited by PricewaterhouseCoopers Auditores Independentes. The report of PricewaterhouseCoopers Auditores Independentes on the consolidated financial statements appears elsewhere in this annual report. Our consolidated financial statements included herein as of December 31, 2016 and for the years ended December 31, 2016 and 2015 have been audited by Ernst & Young Auditores Independentes S.S. The report of Ernst & Young Auditores Independentes S.S. on the consolidated financial statements appears elsewhere in this annual report.

Results of Terra Networks S.A. are consolidated into our financial statements as from July 3, 2017.

Results of GVT are consolidated into our financial statements as from May 1, 2015. Consequently, our results of operations for the years ended December 31, 2017 and 2016 are not comparable with our results of operations for the years ended December 31, 2015, 2014 and 2013. For further information, see “Item 4.A.—Historical Background—Acquisition of GVT.”

The following tables present a summary of our selected financial data at the dates and for each of the periods indicated. You should read the following information together with our audited consolidated financial statements and the notes thereto included elsewhere in this annual report and with “Item 5. Operating and Financial Review and Prospects.”

<b>Income Statement Data:</b>	<b>Year ended December 31,</b>					
	<b>2017</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	<b>(in millions of U.S. dollars)(1)</b>					
	<b>(except for share and per share data)</b>					
Net operating revenue	13,061	43,207	42,508	40,287	35,000	34,722
Cost of sales	(6,128)	(20,272)	(20,823)	(20,345)	(17,223)	(17,542)
Gross profit	6,933	22,935	21,685	19,942	17,777	17,180
Operating income (expenses), net	(4,928)	(16,302)	(15,317)	(14,702)	(12,668)	(12,248)
Operating income	2,005	6,634	6,369	5,242	5,116	4,877
Financial income (expenses), net	(273)	(903)	(1,234)	(848)	(362)	(215)
Equity pickup	—	1.5	1.2	2.0	6.9	(55.1)
Income before taxes	1,732	5,731	5,135	4,394	4,754	4,662

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Income and social contribution taxes	(339)	(1,122)	(1,050)	(974)	183	(946)
Net income for the year	1,393	4,609	4,085	3,420	4,937	3,716
Attributable to:						
Controlling shareholders	1,393	4,609	4,085	3,420	4,937	3,716
Non-controlling shareholders	—	—	—	—	—	—
Basic and diluted earnings per share:						
Common shares	0.77	2.56	2.27	2.15	4.12	3.10
Preferred shares	0.85	2.82	2.50	2.37	4.53	3.41
Cash dividends per share in <i>reais</i> , net of withholding tax:						
Common shares	0.52	1.73	1.65	2.04	2.04	1.86
Preferred shares	0.57	1.90	1.81	2.25	2.25	2.04

<b>Balance Sheet Data:</b>	<b>As of December 31,</b>					
	<b>2017</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	<b>(in millions of U.S. dollars)(1)</b>		<b>(in millions of reais)</b>			
	<b>(except for share and per share data)</b>					
Property, plant and equipment, net	10,043	33,222	31,925	30,477	20,454	18,442
Total assets	30,648	101,383	102,066	101,685	73,065	69,504
Loans and financing—current portion	490	1,621	2,543	2,222	1,509	1,237
Loans and financing—noncurrent portion	701	2,320	3,127	4,455	2,123	3,215
Debentures—current portion	427	1,413	2,120	121	755	287
Debentures—noncurrent portion	940	3,108	1,434	3,424	3,412	4,015
Shareholders' equity	20,998	69,461	69,244	68,567	44,950	42,894
Attributable to:						
Controlling shareholders	20,998	69,461	69,244	68,567	44,950	42,894
Non-controlling shareholders						
Capital stock	19,218	63,571	63,571	63,571	37,798	37,798
Number of shares outstanding (in thousands)(2)	n/a	1,688,694	1,688,694	1,688,694	1,123,269	1,123,269

<b>Cash Flow Data:</b>	<b>Year ended December 31,</b>					
	<b>2017</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	<b>(in millions of U.S. dollars)(1)</b>		<b>(in millions of reais)</b>			
<b>Operating activities:</b>						
Net cash (used in) generated by operating activities	3,821	12,641	11,440	9,897	9,384	9,576
<b>Investing activities:</b>						
Net cash (used in) generated by investing activities	(2,551)	(8,438)	(6,895)	(14,626)	(7,608)	(5,543)
<b>Financing activities:</b>						
Net cash (used in) generated by financing activities	(1,589)	(5,258)	(4,777)	5,373	(3,627)	(4,622)
Increase (decrease) in cash and cash equivalents	(319)	(1,055)	(232)	644	(1,851)	(589)
Cash and cash equivalents at beginning of year	1,543	5,105	5,337	4,693	6,544	7,133
Cash and cash equivalents at end of year	1,224	4,050	5,105	5,337	4,693	6,544

(1) Translated for convenience only using the commercial offer rate as reported by the Central Bank as of December 31, 2017 for *reais* into U.S. dollars of R\$3.3080 to US\$1.00. These translations should not be considered representations that any such amounts have been, could have been or could be converted into U.S. dollars at that or at any other exchange rate as of that or any other date. In addition, translations should not be construed as representations that the *real* amounts represent or have been or could be converted into U.S. dollars as of that or any

other date.

(2) As of the date of this annual report, we held 1,688,693,776 outstanding shares, composed of common and preferred shares, net of 2,291,147 treasury shares.

### ***Exchange Rates***

The Central Bank allows the *real*/U.S. dollar exchange rate to float freely and has intervened to control the exchange rate volatility. However, the exchange market may continue to be volatile, and the *real* may depreciate or appreciate substantially in relation to the U.S. dollar. The Central Bank or the Brazilian government may intervene in the exchange rate market.

Since 1999, the Central Bank has allowed the *real*/U.S. dollar exchange rate to float freely, and, since that time, the *real*/U.S. dollar exchange rate has fluctuated considerably. In 2013, 2014 and 2015, the *real* depreciated 14.6%, 13.4% and 47.0%, respectively, against the U.S. dollar. In 2016, the *real* appreciated 16.5% against the U.S. dollar. In 2017, the *real* depreciated 1.5% against the U.S. dollar, ending the year at an exchange rate of R\$3.3080 per US\$1.00.

The Brazilian government has implemented various economic plans and utilized a number of exchange rate policies, including sudden devaluations, periodic mini-devaluations (during which the frequency of adjustments ranged from a daily to a monthly basis), floating exchange rate systems, exchange controls and dual exchange rate markets. We cannot predict whether the Central Bank or the Brazilian government will continue to let the *real* float freely or intervene in the exchange rate market by returning to a currency band system or otherwise. The *real* may depreciate or appreciate substantially against the U.S. dollar.

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The following tables set forth the selling exchange rate, expressed in *reais* per U.S. dollar (R\$/US\$) for the periods indicated, as reported by the Central Bank.

	<b>Exchange Rates of R\$ per US\$1.00</b>			
	<b>Period-End</b>	<b>Average(1)</b>	<b>High</b>	<b>Low</b>
<b>Year ended December 31,</b>				
2013	2.3426	2.1605	2.4457	1.9528
2014	2.6562	2.3547	2.7403	2.1974
2015	3.9048	3.3387	4.1949	2.5754
2016	3.2591	3.4833	4.1558	3.1193
2017	3.3080	3.2031	3.3807	3.0510
<b>Month</b>				
August 2017	3.1471	3.1509	3.1976	3.1161
September 2017	3.1680	3.1348	3.1932	3.0852
October 2017	3.2769	3.1912	3.2801	3.1315
November 2017	3.2616	3.2592	3.2920	3.2136
December 2017	3.3080	3.2911	3.3332	3.2322
January 2018	3.1624	3.2140	3.2697	3.1450
February 2018 (through February 20)	3.2507	3.2393	3.2821	3.1730

Source: Brazilian Central Bank.

(1) Annually, represents the average of the exchange rates on the last day of each month during the periods presented; monthly, represents the average of the end-of-day exchange rates during the periods presented.

On February 20, 2018, the exchange rate was R\$ 3.25 to US\$1.00. The *real*/dollar exchange rate fluctuates and, therefore, this exchange rate may not be indicative of future exchange rates.

## **B. Capitalization and Indebtedness**

Not applicable.

## **C. Reasons for the Offer and Use of Proceeds**

Not applicable.

## **D. Risk Factors**

*This section is intended to be a summary of more detailed discussions contained elsewhere in this annual report. The risks described below are not the only ones we face. Additional risks that we do not presently consider material, or of which we are not currently aware, may also affect us. Our business, results of operations or financial condition could be impacted if any of these risks materializes and, as a result, the market price of our preferred shares and our ADSs could be affected.*

## **Risks Relating to Brazil**

***The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This influence, as well as Brazilian political and economic conditions, could adversely affect us and the trading price of our preferred shares and ADSs.***

The Brazilian federal government frequently exercises significant influence over the Brazilian economy and occasionally makes significant changes in policy and regulations. The Brazilian government's actions to control inflation and other policies and regulations have often involved, among other measures, changes in interest rates, changes in tax policies, wage and price controls, foreign exchange controls, currency devaluations, capital controls and limits on imports. Our business, financial condition, results of operations and the market price of our preferred shares and ADSs may be adversely affected by changes in government policies, especially those related to our sector, such as changes in telephone fees and competitive conditions, as well as general economic factors, including:

- exchange rates and currency fluctuations;
- exchange controls and restrictions on remittances abroad, (including with regards to the payment of dividends) such as those imposed in 1989 and early 1990;
- growth or downturn of the Brazilian economy;
- inflation;
- energy policy;
- interest rates and monetary policies;
- liquidity of domestic capital and lending markets;
- fiscal policies and changes in tax laws;
- economic, political or social instability;
- labor and social security policies, laws and regulations; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Uncertainty over whether the Brazilian federal government will implement changes to the policies, regulations or standards affecting these or other factors in the future may affect economic performance and contribute to economic uncertainty in Brazil, which may have an adverse effect on us and the trading price of our preferred shares and ADSs. Recent economic and political instability has led to a negative perception of the Brazilian economy and higher volatility in the Brazilian securities markets, which also may adversely affect us and the trading price of our preferred shares and ADSs.

***The ongoing economic uncertainty and political instability in Brazil may adversely affect the Brazilian economy, our business, and the market price of our preferred shares and ADSs.***

Brazil's political environment has historically influenced, and continues to influence, the performance of the country's economy. Political crises have affected and continue to affect the confidence of investors and the general public, which have historically resulted in economic deceleration and heightened volatility in the securities issued by Brazilian companies.

The recent economic instability in Brazil has contributed to a decline in market confidence in the Brazilian economy as well as to a deteriorating political environment. In addition, various ongoing investigations into allegations of money laundering and corruption being conducted by the Office of the Brazilian Federal Prosecutor, including the largest such investigation, known as "*Operação Lava Jato*," have negatively impacted the Brazilian economy and political environment. Certain members of the Brazilian federal government and of the legislative branch, as well as senior officers of large state-owned companies, are facing allegations of political corruption for officials allegedly accepting bribes by means of kickbacks on contracts granted by the government to several infrastructure, oil and gas and construction companies. A number of senior politicians, including members of Congress, and high-ranking executives officers of major corporations and state-owned companies in Brazil have been arrested, convicted of various charges relating to corruption, entered into plea agreements with federal prosecutors and/or have resigned or been removed from their positions. The potential outcome of *Operação Lava Jato* as well as other ongoing

corruption-related investigations is uncertain, but they have already hurt the image and reputation of those companies that have been implicated as well as the general market perception of the Brazilian economy, political environment and the Brazilian capital markets. We have no control over, and cannot predict, whether such investigations or allegations will lead to further political and economic instability or whether new allegations against government officials will arise in the future.

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Former President Dilma Rousseff was suspended from office on May 12, 2016, when the Brazilian Senate voted to hold a trial on impeachment charges against her. Ms. Rousseff was replaced by Vice-President Michel Temer, who served as acting President until Ms. Rousseff was permanently removed from office by the Senate on August 31, 2016 for infringing budgetary laws. Michel Temer then became President for the remainder of the presidential term, until the next general elections, scheduled for October of 2018. In June 2017, the Brazilian Higher Electoral Court (*Tribunal Superior Eleitoral*) cleared the electoral alliance formed by Ms. Rousseff and Mr. Temer of charges that it had violated campaign finance laws in the 2014 election. President Temer remains the subject of investigations by the Brazilian Federal Police and the Office of the Brazilian Federal Prosecutor relating to allegations of corruption, however, and may ultimately be subject to impeachment proceedings before his presidential term ends. We cannot predict whether these investigations and lawsuits will bring about further economic and political instability or if new allegations against high officers of the Brazilian federal Government will arise in the future. In addition, we cannot predict the results of any such investigations, including their effects over the Brazilian economy. The development of such cases may negatively affect us and the price of our preferred shares and ADSs.

Furthermore, uncertainty over whether the acting Brazilian government will implement changes in policy or regulation in the future may contribute to economic uncertainty in Brazil and to heightened volatility in the securities issued abroad by Brazilian companies. The Brazilian government may be subject to internal pressure to change its current macroeconomic policies, including its fiscal policy, in order to achieve higher rates of economic growth and/or meet its fiscal targets. We cannot foresee what policies or actions the Brazilian government may pursue or adopt. Moreover, uncertainty with respect to the upcoming presidential elections may increase the volatility in the financial markets.

Any of the above factors may create additional political uncertainty, adversely affect the Brazilian economy, our business, financial condition, results of operations and the market price of our preferred shares and ADSs.

***Inflation and government efforts to curb inflation may contribute to economic uncertainty in Brazil, adversely affecting our business and results of operations.***

In the past, Brazil has experienced extremely high rates of inflation. Inflation and some of the measures taken by the Brazilian government in an attempt to curb inflation have had significant negative effects on the Brazilian economy generally. Inflation, policies adopted to curb inflationary pressures and uncertainties regarding possible future governmental intervention have contributed to economic uncertainty and heightened volatility in the Brazilian capital markets.

According to the National Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*), or IPCA, Brazilian inflation rates were 6.3%, 10.7% and 6.4% in 2016, 2015 and 2014, respectively. In 2017, inflation as measured by the IPCA fell to 2.9%. Brazil may experience high levels of inflation in the future and inflationary pressures may lead to the Brazilian government's intervening in the economy and introducing policies that could harm our business and the price of our preferred shares and ADSs. In the past, the Brazilian government's interventions included the maintenance of a restrictive monetary policy with high interest rates that restricted credit availability and reduced economic growth, causing volatility in interest rates. For example, the SELIC (*Sistema Especial de Liquidação e de Custódia*), the Central Bank's overnight rate, as established by the Monetary Policy Committee of the Central Bank (*Comitê de Política Monetária do Banco Central do Brasil—COPOM*), increased from 10.00% at the beginning of 2014 to a high point of 14.25% in 2016 before a series of reductions in 2017, bringing the SELIC rate down to 6.75% as of February 7, 2018. Conversely, more lenient government and Central Bank policies and interest rate decreases have triggered and may continue to trigger increases in inflation, and, consequently, growth volatility and the need for sudden and significant interest rate increases, which could negatively affect us and increase our indebtedness.

Currently, fixed broadband and mobile service providers use the internal general price index (*Índice Geral de Preços - Disponibilidade Interna*), or IGP-DI, to adjust their prices and television and cable service providers use the market general price index (*Índice Geral de Preços ao Mercado*), or IGP-M. The IGP-DI and IGP-M are inflation indexes developed by the Fundação Getúlio Vargas, a private organization. Since 2006, telephone fees for fixed line services have been indexed to the telecommunication services index (*Índice de Serviços de Telecomunicações*), or IST, adjusted by a productivity factor, which is defined by ANATEL Resolution 507/2008. The IST is an index composed of other domestic price indexes (including the IPCA, IGP-DI and IGP-M, among others) that is intended to reflect the telecommunications industry's operating costs. As a result, this index serves to reduce potential discrepancies between our industry's revenue and costs, and thus reduce the apparent adverse effects of inflation on our operations. The productivity factor, pursuant to which ANATEL is authorized to adjust fee rates, is calculated based on a compensation index established by ANATEL to incentivize operational efficiency and to share related gains in earnings from fixed line services with customers through fee rate adjustments. The IST is calculated based on a 12-month period average. This may cause increases in our revenues above or below our costs (including salaries), with potentially adverse impacts on our profitability.

Inflation and government measures to combat inflation, along with speculation about possible future governmental measures, have had and are expected to continue to have significant negative effects on the Brazilian economy, including heightened volatility in the Brazilian securities market. On the other hand, these policies may be incapable of preventing increases in the inflation rate. In the event of an increase in inflation, we may not be able to adjust the prices we charge our customers to offset the effects of inflation on our cost structure, which may adversely affect us.

*Fluctuations in exchange rates may adversely affect our ability to meet liabilities denominated or linked to foreign currencies or reduce our income in foreign currency, and may have a material adverse effect on the market value of our preferred shares and ADSs.*

The Brazilian currency has been historically volatile and has been devalued frequently over the past three decades. Throughout this period, the Brazilian government has implemented various economic plans and used various exchange rate policies, including sudden devaluations, periodic mini-devaluations (during which the frequency of adjustments has ranged from daily to monthly), exchange controls, dual exchange rate markets and a floating exchange rate system. Although long-term depreciation of the real is generally linked to the rate of inflation in Brazil, depreciation of the real occurring over shorter periods of time has resulted in significant variations in the exchange rate between the real, the U.S. dollar and other currencies. The exchange rate between the U.S. dollar and the Brazilian *real* has experienced significant fluctuations in recent years. The *real* depreciated 14.6% against the U.S. dollar in 2013, 13.4% in 2014 and 47.0% in 2015. In 2016, the *real* appreciated 16.5% against the U.S. dollar and in 2017, the *real* depreciated 1.5%. There can be no assurance that the *real* will not again depreciate against the U.S. dollar or other currencies in the future.

As of December 31, 2017, 2.7% of our total indebtedness of R\$8.5 billion was denominated in foreign currency. As of December 31, 2017, we had currency hedges in place to cover all of our financial foreign currency-denominated indebtedness. Approximately 6.4% of our operating costs and expenses are payable or linked to payment by us in U.S. dollars or Euros. By contrast, 99.7% of our revenue is generated in *reais*, except income derived from hedging transactions, international long-distance interconnection fees and services to customers outside of Brazil.

To the extent that the value of the *real* decreases relative to the U.S. dollar or the Euro, our commitments payable or linked to payment by us in foreign currencies become more expensive. Although our accounts receivable denominated in foreign currencies would also appreciate, the net effect could adversely affect our revenue and expenses. In addition, the IST does not adequately reflect the true effect of exchange rate fluctuations. Thus, our revenue, when translated to U.S. dollars, does not adequately reflect the true effect of exchange rate fluctuations, which may affect our results of operations.

Nearly all of our transactions denominated in foreign currencies are covered by hedge transactions. Since May 2010, we have been using a “net balance coverage” strategy, pursuant to which we seek to hedge our net foreign exchange exposure arising from invoices issued or received in foreign currencies. Our corporate market risk department periodically reviews our foreign currency invoices and manages our commitments linked to foreign currencies to limit our overall foreign currency exposure. Though we believe this strategy has substantially reduced our exposure to fluctuations in exchange rates, we cannot guarantee that this strategy will be successful. There can be no assurance that we will continue in the future our practice of entering into hedge instruments to hedge against the volatility of the *real*. Additionally, the liquidity in the derivatives market may become scarce, making it more difficult to hedge our foreign exchange exposure under satisfactory conditions, which could negatively affect our overall financial performance in case of depreciation of the *real* against such foreign currencies.



***Political, economic and social developments and the perception of risk in other developed and emerging countries may adversely affect the Brazilian economy, our business, and the market price of Brazilian securities, including our preferred shares and ADSs.***

The market for securities issued by Brazilian companies may be influenced, to varying degrees, by economic conditions in both developing and developed economies. The reaction of investors to developments in other countries may have an adverse impact on the market value of securities of Brazilian companies. The prices of shares traded on the B3, for example, have historically been sensitive to fluctuations in interest rates in the United States, as well as variations of the main U.S. stock exchanges. Additionally, crises in other emerging countries or the economic policies of other countries may reduce investor demand for securities of Brazilian companies, including our preferred shares and ADSs. Any of the foregoing developments may adversely affect the market value of our preferred shares and ADSs and hinder our ability to access the capital markets and finance our operations in the future on acceptable terms and costs, or at all.

To the extent that economic problems in emerging market countries or elsewhere adversely affect Brazil, our business and the market value of our preferred shares and ADSs could be adversely affected. Furthermore, we cannot assure you that, in the event of adverse developments in emerging market economies, the international capital markets will remain open to Brazilian companies or that the resulting interest rates in such markets will be advantageous to us. Decreased foreign investment in Brazil may negatively affect growth and liquidity in the Brazilian economy, which in turn may have a negative impact on our business. Disruption or volatility in the global financial markets could further increase negative effects on the financial and economic environment in Brazil, which could have a material adverse effect on us.

***Any further downgrading of Brazil's credit rating could reduce the trading price of our preferred shares and ADSs.***

We may be harmed by investors' perceptions of risks related to Brazil's sovereign debt credit rating. Rating agencies regularly evaluate Brazil and its sovereign ratings, which are based on a number of factors including macroeconomic trends, fiscal and budgetary conditions, indebtedness metrics and the perspective of changes in any of these factors.

Brazil has lost its investment grade sovereign debt credit rating by the three main U.S. based credit rating agencies, S&P Global Ratings, Moody's and Fitch. S&P Global Ratings downgraded Brazil's sovereign debt credit rating from BBB- to BB+ in September 2015, subsequently reduced it to BB in February 2016 and further reduced it to BB- in January 2018 with a stable outlook. In December 2015, Moody's placed Brazil's Baa3 sovereign debt credit rating on review and downgraded Brazil's sovereign credit rating in February 2016 to Ba2 with a negative outlook, citing the prospect for further deterioration in Brazil's indebtedness figures amid a recession and challenging political environment. Fitch downgraded Brazil's sovereign credit rating to BB+ with a negative outlook in December 2015, citing the country's rapidly expanding budget deficit and worse-than-expected recession, and further downgraded Brazil's sovereign debt credit rating in May 2016 to BB with a negative outlook.

Brazil's sovereign credit rating is currently rated below investment grade by the three main credit rating agencies. Consequently, the prices of securities issued by Brazilian companies have been negatively affected. A prolongation or worsening of the current Brazilian recession and continued political uncertainty, among other factors, could lead to further ratings downgrades. Any further downgrade of Brazil's sovereign credit ratings could heighten investors' perception of risk and, as a result, cause the market price of our preferred shares and ADSs to decline.

## **Risks Relating to the Brazilian Telecommunications Industry and Us**

*Extensive government regulation of the telecommunications industry and our concession agreements may limit, in some cases, our flexibility in responding to market conditions, competition and changes in our cost structure or impact our fees.*

Our business is subject to extensive regulation, including any regulatory changes that may occur during the terms of our concession agreements and our authorizations to provide telecommunication services in Brazil. ANATEL, the main telecommunications industry regulator in the country, regulates, among other things:

- industry policies and regulations;
- licensing;
- fees and tariffs;
- competition, including our ability to grow by acquiring other telecommunications businesses;
- service, technical and quality standards;
- interconnection and settlement arrangements; and
- universal service obligations.

The Brazilian telecommunications regulatory framework is continuously evolving. The interpretation and enforcement of regulations, the assessment of compliance with regulations and the flexibility of regulatory authorities are all marked by uncertainty. We operate under authorizations and a concession from the Brazilian government, and our ability to maintain these authorizations and concession is a precondition to our success. However, because of the changing nature of our regulatory framework, we cannot provide assurances that ANATEL will not adversely modify the terms of our authorizations and/or licenses. According to our operating authorizations and licenses, we must meet specific requirements and maintain minimum quality, coverage and service standards. Our failure to comply with such requirements may result in the imposition of fines, penalties and/or other regulatory responses, including the termination of our operating authorizations and concession. Any partial or total termination of any of our operating authorizations and licenses or our concession would have a material adverse effect on our business, financial condition, revenues, results of operations and prospects.

In recent years, ANATEL has been reviewing and introducing regulatory changes, especially regarding asymmetric competition measures and interconnection fees charged among local providers of telecommunications services. Asymmetric competition measures can include regulations intended to rebalance markets in which a market participant has distinct market power over other competitors. The adoption of disproportionately asymmetric measures could have a material adverse effect on our business, financial condition, revenues, results of operations and prospects.

With respect to interconnection fees, these are an important part of our revenue and cost bases. Such fees are charged by telecommunications service providers to each other in order to allow interconnected use of each other's networks. To the extent that changes to the rules governing interconnection fees reduce the amount of fees we can receive, or our ability to collect such fees, our businesses, financial conditions, revenues, results of operations and prospects could be materially adversely affected.

Therefore, our business, results of operations, revenues and financial conditions could be negatively affected by the actions of the Brazilian authorities, including, in particular, the following:

- the introduction of new or stricter operational and/or service requirements;
- the granting of operating licenses in our areas;

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- limitations on interconnection fees we may charge to other telecommunications service providers;
- delays in the granting of, or the failure to grant, approvals for rate increases; and
- antitrust limitations imposed by ANATEL and CADE.

***Our concession may be terminated by the Brazilian government under certain circumstances.***

We operate our fixed line business in the state of São Paulo under a concession granted by the Brazilian government. According to the terms of the concession, we are obligated to meet certain universal service requirements and to maintain minimum quality and service standards. For example, ANATEL requires that we satisfy certain conditions with respect to, among other things, the expansion of our network to provide (i) public pay-phone service for all locations with a population over 100 inhabitants and (ii) private individual telephone service for all locations with a population over 300 inhabitants, as well as several quality of service targets. Our ability to satisfy these and other terms and conditions may be affected by factors beyond our control, and our failure to comply with the requirements of our concession may result in the imposition of fines up to R\$50 million per incident and/or other government actions, including the termination of our concession. Any partial or total termination of our concession or authorizations would have a material adverse effect on our financial condition and results of operations.

Furthermore, the concession agreements establish that all assets owned by us, and which are indispensable to the provision of the services described in such agreements, are considered “reversible assets” (*bens reversíveis*) and are deemed to be part of the concession assets. According to ANATEL’s interpretations of current regulations, reversible assets will be automatically returned to ANATEL’s possession upon expiration of the concession agreements in accordance with regulations in force at the time of such expiration, and would not be available to creditors in the event of insolvency, bankruptcy or similar events.

As of December 31, 2017, the net book value of our reversible assets, calculated in accordance with ANATEL’s interpretation of current regulations, is estimated at R\$8.7 billion. These assets are comprised of switching and transmission equipment, public use terminals, external network equipment, energy equipment and systems and operations support equipment.

***Review of our concession agreements and/or the implementation of a new regulatory framework in Brazil could have a materially adverse effect on our operations.***

The expiration date of our fixed line concession agreements is December 31, 2025. These agreements contain a provision allowing ANATEL to review the concession agreements every five years, and include revisions to terms and conditions that relate to network expansion, modernization and quality of service targets in response to changes in technology, competition in the marketplace and domestic and international economic conditions.

On June 24, 2014, ANATEL opened a public review and comment period for the revisions of the terms of fixed line concession agreements with respect to the 2016-2020 period. However, when the agency released the new version of the agreements in June 2017, operators disagreed with the inclusion by ANATEL of certain provisions, and decided against executing new agreements with the agency. As a result, the agreements with respect to the 2011-2015 period remain in force.

Changes to our concession agreements or to the current regulatory framework may entail the imposition of new requirements, including obligations to make specific investments and/or capital expenditures. ANATEL may also impose new service targets on us with values that we are not able to predict. The conditions, terms and criteria being considered with respect to any such changes in the regulatory framework are still uncertain, and will only be defined

by ANATEL after the approval of a law amending the General Telecommunications Act (*Lei Geral de Telecomunicações*). Any such changes to laws, rules or regulations could have a material adverse effect on our operations and financial condition.

***Telefônica Brasil is exposed to risks in relation to compliance with anti-corruption laws and regulations.***

Telefônica Brasil is required to comply with Brazilian anti-corruption laws and regulations, as well as laws and regulations on the same subject in jurisdictions where it has its securities traded. In particular, the Company is subject, in Brazil, to Law nº 12,846/2013 and, in the United States, to the U.S. Foreign Corrupt Practices Act of 1977.

Although we have internal policies and procedures designed to ensure compliance with the aforementioned anti-corruption laws and regulations, there can be no assurance that such policies and procedures will be sufficient or that our employees, directors, officers, partners, agents and service providers will not take actions in violation of our policies and procedures (or otherwise in violation of the relevant anti-corruption laws and regulations) for which we or they may be ultimately held responsible. Violations of anti-corruption laws and regulations could lead to financial penalties, damage to our reputation or other legal consequences that could have a material adverse effect on our business, results of operations and financial condition.

In connection with the above-mentioned policies, Telefônica Brasil is currently conducting an internal investigation - which is part of a broader investigation being conducted by the controlling shareholder of the Company (Telefônica, S.A.) - regarding possible violations of the abovementioned laws and regulations. Telefônica Brasil is in contact with governmental authorities about this matter and intends to cooperate with those authorities as the investigation continues. It is not possible at this time to predict the scope or duration of this matter or its likely outcome.

***We are dependent on key personnel and the ability to hire and retain additional personnel.***

We believe that our success will depend on the continued services of our senior management team and other key personnel. Our management team is comprised of highly qualified professionals, with extensive experience in the telecommunications industry. The loss of the services of any of our senior management team or other key employees could adversely affect our business, financial condition and results of operations. We also depend on the ability of our senior management and key personnel to work effectively as a team.

Our future success also depends on our ability to identify, attract, hire, train, retain and motivate highly skilled technical, managerial, sales and marketing personnel. Competition for such personnel is intense, and we cannot guarantee that we will successfully attract, assimilate or retain a sufficient number of qualified personnel. Failure to retain and attract the necessary technical, managerial, sales and marketing and administrative personnel could adversely affect our business, financial condition and results of operations.

***We depend on key suppliers to obtain necessary equipment and services for our business.***

We depend on certain key suppliers of equipment and services, especially telecommunications network equipment and handsets, for the execution and development of our business. These suppliers may delay delivery, alter prices and limit supply as a result of problems related to their own businesses, over which we have no control. If these suppliers are not able to deliver equipment and services regularly, we may face problems with the continuity of our business activities, which may have an adverse effect on our business and results of operations.

***We are subject to liabilities relating to third party contractors, which may have a material adverse effect on our business and results of operations.***

We are exposed to contingent liabilities resulting from our contracting structure, which includes third party service providers. Such potential liabilities may involve labor claims by third party providers that are treated as direct employees as well as joint liability claims relating to wage or overtime pay complaints and workplace injury claims. If a significant portion of these contingent liabilities are decided against us and for which we have not made adequate

provisions, our financial condition and results of operation may be adversely affected.

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Furthermore, if the contracting of third party service are considered to involve the main activities of the company, it may be characterized as a direct employment, which would significantly increase our costs and as a result we may be subject to administrative proceedings by the relevant labor regulators and may be required to pay fines to the third party service providers.

***Certain key inputs are subject to risks related to importation, and we acquire other key inputs from a limited number of domestic suppliers, which may further limit our ability to acquire such inputs in a timely and cost effective manner.***

The high growth in data markets in general and broadband in particular may result in a limited supply of equipment essential for the provision of such services, such as data transmission equipment and modems. The restrictions on the number of manufacturers imposed by the Brazilian government for certain inputs, mainly data transmission equipment and modems, and the geographical locations of non-Brazilian manufacturers of these inputs, pose certain risks, including:

- vulnerability to currency fluctuations in cases where inputs are imported and paid for with U.S. dollars, Euros or other non-Brazilian currency;
- difficulties in managing inventory due to an inability to accurately forecast the domestic availability of certain inputs; and
- the imposition of customs or other duties on key inputs that are imported.

If any of these risks materialize, they may result in our inability to provide services to our customers in a timely manner or may affect the prices of our services, which may have an adverse effect on our business, financial condition and results of operations.

***We make investments based on demand forecasts that may become inaccurate due to economic volatility and may result in revenues that lower than expected.***

We make certain investments, such as the procurement of materials and the development of physical sites, based on our forecasts of the amount of demand that customers will have for our services at a later date (generally several months later). However, any major changes in the Brazilian economic scenario may affect this demand and therefore our forecasts may turn out to be inaccurate. For example, economic crises may restrict credit to the population, and uncertainties relating to employment may result in a delay in the decision to acquire new products or services (such as broadband or Pay TV). As a result, it is possible that we may make larger investments based on demand forecasts than were necessary given actual demand at the relevant time, which may directly affect our cash flow.

Furthermore, improvements in economic conditions may have the opposite effect. For example, an increase in demand not accompanied by our investment in improved infrastructure may result in a possible loss of opportunity to increase our revenue or result in the degradation of the quality of our services.

***Consolidation in the telecommunications market may increase competition in the near future and may change Brazilian market dynamics.***

Mergers and acquisitions may change market dynamics, create competitive pressures, force small competitors to find partners and impact our financial condition; and may require us to adjust our operations, marketing strategies (including promotions), and product portfolio.



The entry of a new market participant with significant financial resources or potential changes in strategy by existing telecommunications service providers can change the competitive environment in the Brazilian market. We may be unable to keep pace with these changes, which could affect our ability to compete effectively and have a material adverse effect on our business, financial condition and results of operations.

Additional joint ventures, mergers and acquisitions among telecommunications service providers are possible in the future. If such consolidation occurs, it may result in increased competition within our market. We may be unable to adequately respond to pricing pressures resulting from consolidation in our market, adversely affecting our business, financial condition and results of operations. We may also consider engaging in merger or acquisition activity in response to changes in the competitive environment, which could divert resources away from other aspects of our business.

***We face significant competition in the Brazilian market.***

In 2017, competition in the Brazilian telecommunications sector remained fierce, with operators focusing on improving their base of accesses by attracting customers to higher-value products to increase overall ARPUs and profitability.

In turn, customers are demanding higher quality and more data availability, which require investments in development, modernization, expansion and continuous improvement in service quality and customers' experience, pressing companies' results.

As a result, we have faced significant competition, mainly driven by the following factors: (1) commercial and pricing pressures from new mobile portfolios launched by competitors; (2) competitors increasing 3G and 4G coverage, improving the quality of service provided by them; and (3) low-cost alternative services, such as voice and text services provided over IP and Video on Demand, may affect our competitive position in the market.

We continuously monitor the market progress in order to anticipate future challenges and opportunities and how to address them. Nevertheless, our operational results, market position, competitiveness in the market and margins may be negatively affected if we are unable to keep the same pace as our competitors.

***Our results of operations may be negatively affected by the application of the Fixed Commuted Telephone Service (Serviço de Telefonia Fixa Comutada), or STFC, rules relating to fixed telephone service and the Personal Mobile Service (Serviço Móvel Pessoal), or SMP, rules relating to mobile services.***

We receive payments for the termination of calls in our fixed network. On May 18, 2014, ANATEL established a gradual decrease in termination rates for the STFC concessionaries, including TU-RL (Urban Usage Rate), TU-RIU1 (Interurban Usage Rate Level 1) and TU-RU2 (Interurban Usage Rate Level 2). In the same year, ANATEL also established gradual decreases in mobile interconnection fees, also known as mobile termination rates, or MTR, based on a cost model. The related rates established by ANATEL are set forth in the following table:

	2015	2016	2017	2018	2019
<b>Sector 31 (fixed)</b>					
TU-RL	N/A	0.011390	0.005740	0.002890	0.00146
TU-RU1	N/A	0.053390	0.021910	0.008990	0.00369
TU-RU2	N/A	0.061290	0.02348	0.009	0.00345
<b>Mobile</b>					
Region I	0.167510	0.093170	0.049280	0.026060	0.01379
Region II	0.162370	0.103090	0.053870	0.028150	0.01471
Region III	0.147760	0.112180	0.068160	0.041410	0.02517

We cannot assure you that new mobile service plans will not be suspended by ANATEL, that the mobile interconnection fees we negotiated will not be changed, nor that future negotiations regarding mobile termination rates will be as favorable as those that were previously set by the agency. If the readjustments to mobile interconnection fees that we negotiated are cancelled or if negotiated mobile interconnection fees in the future are less favorable to us, our business, financial condition, revenues, results of operations and prospects may be adversely affected.

***ANATEL has the authority to issue new regulations affecting many of our areas of operations.***

ANATEL has the authority to issue new regulations affecting many of our areas of operations. Such new regulations could have an adverse effect on our operating results because: (1) ANATEL could significantly reduce the interconnection fees we are able to charge, thereby reducing our revenues (see “—Our results of operations may be negatively affected by the application of the Personal Mobile Service (Serviço Móvel Pessoal – SMP) rules relating to mobile services”); (2) ANATEL may allow more favorable conditions for economic groups without significant market power; (3) the granting of new licenses may increase competition in our area from other operators, which could adversely affect our prices and/or market share, thereby reducing our revenues; (4) ANATEL may require that revenue received for the usage of the SMP network must be included in the calculation of operating revenue, which will increase the cost of renewing licenses; and (5) ANATEL’s general plan of updating the regulations targets several areas of vital importance for the mobile business, such as regulations (i) to improve the quality of services, which may cause an increase in operating costs, (ii) of virtual mobile operations, or MVNO, which may cause an increase in competitive pressure, (iii) against SMP providers exercising market power to negotiate lower mobile termination rate fees, which could cause a decrease in our revenues from the mobile termination rate fees we are able to charge to SMP providers, and (iv) relating to multimedia communication.

For a detailed description of the regulations issued by ANATEL and their impact on our business, see “—Item 4. Information on the Company—Business Overview—Regulation of the Brazilian Telecommunications Industry.”

***The industry in which we conduct our business is continually changing and evolving technologically, which demands adequate changes in the regulatory environment.***

The telecommunications industry is subject to rapid and significant technological changes. Our future success depends on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will be further developed.

The advent of new products and technologies could have a variety of consequences. These new products and technologies may reduce the price of our services by providing lower-cost alternatives and the creation of new digital services, such as the example of over-the-top (OTT) players that provide voice and messages over IP. Also, new product and technologies may become superior to, and render obsolete, the products and services we offer and the technologies we use, thus requiring our constant investment in new technology and innovation.

Such new technologies will demand changes in the regulatory environment, challenging both governmental agencies and telecommunication companies. Companies that provide OTT services, which have characteristics similar to telecommunications services, are currently not subject to the same rules as the telecommunications operators. This gap can bring additional challenges to the telecommunications industry, as current developments in the regulatory framework for OTTs are inconsistent and still unclear.

***We are subject to certain risks related to conditions and obligations imposed by ANATEL for the use of the spectrum needed for the LTE services we offer.***

In 2012, Telefonica acquired 40MHz on the 2.5GHz to 2.69GHz frequencies for the amount of R\$ 1.05 billion. In order to meet the coverage requirements we had the obligation of implementing 4G coverage in 1,094 cities by December 31, 2017. By that date, we had made 4G services available in 2,600 municipalities. To achieve these targets, Telefonica has deployed and continues to deploy 4G coverage by serving its customers through the use of its own network or by established agreements of RAN-sharing approved by ANATEL. The remaining coverage commitments in cities with less than 30,000 inhabitants may be fulfilled with other frequency bands, according to the following schedule:

- by December 31, 2018: 117 cities; and
- by December 31, 2019: 156 more cities.

To complete the 450 MHz frequency requirements we had the obligation to meet voice and data demand in remote rural areas. As a commitment, we are required to provide infrastructure and service in rural areas in the states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, Sergipe, and in the countryside of São Paulo, for a total of 2,556 municipalities.

Regarding the 700MHz spectrum, ANATEL has allocated the band for the provision of fixed, mobile and broadband services. On September 30, 2014 we acquired 20 MHz (10+10 MHz) with nationwide coverage, for R\$1.92 billion, at the minimum price, plus R\$904 million for the band cleaning (migration of broadcasters that currently occupy the band and interference management). According to the auction rules, the winning bidders are responsible for financing and managing the band cleaning process.

In January 2016, the Ministry of Communications (presently, the Ministry of Science, Technology, Innovation and Communications) published a new schedule for the analog TV Switch Off, postponing the usage of the 700 MHz frequency for telecommunications in some major Brazilian cities. According to the schedule and further revisions, 11 cities had its analog TV services turned off in 2016, including Rio Verde (GO) and Brasília (DF). In 2017 the switch off was completed in over 404 cities. In 2018 the analog switch off is expected to be completed in 1124 cities distributed in 24 states. The switch off for the remaining 4244 cities is set for 2023, though the activation of LTE in these cities does not require the switch off schedule to be completed.

In December 2015, ANATEL auctioned the remaining spectrum lots in the 1800 MHz, 1900 MHz and 2500 MHz bands. Telefônica acquired seven lots of 2.5 GHz frequency band for a total of R\$185.4 million. These lots are associated to five capital cities located in the States of São Paulo, Rio de Janeiro, Porto Alegre, Florianópolis, and Palmas and one countryside city in the State of Mato Grosso do Sul. Such frequencies are already being used for the provision of mobile broadband service on 4G.

The targets established by ANATEL for the fast-paced implementation of networks could be impacted by (1) our ability to obtain licenses for the construction of new sites at the speed necessary to achieve the coverage targets, (2) the capacity of our suppliers to deliver the equipment necessary for this expansion, which may increase the price of such equipment, and (3) lack of qualified resources to meet the expected implementation pace.

If we are not able to meet targets and obligations set forth in the bid documents, ANATEL may use our bank guarantees, we may be subject to fines and/or have our licenses to operate these frequencies revoked, negatively affecting our business and results of operations. Additionally, the inefficient use of any frequency may lead to the loss of the usage license.

***Our sales could be suspended as a result of issues with the quality of our services.***

ANATEL and other judiciary and administrative agencies have the authority to suspend our sales in an attempt to improve the overall quality of telecommunications services. Sales suspensions are generally applied to the services for which there have been complaints by consumers and the consumer protection agencies. When applied, the suspension is temporary and usually lifted once the company presents an action plan for improvement. In July 2012, ANATEL suspended mobile service sales from three of our main competitors, Oi, Claro and Tim, as result of a considerable increase in consumer complaints. The suspensions lasted about 20 days and ANATEL requested that all telecommunications companies, including us, present an action and investment plan to improve the mobile network. Although our action plan was approved by ANATEL in September 2012, if a similar increase in customer complaints occurs in the future we may face suspension of one or more of our services until a new plan can be presented to and approved by ANATEL, which may materially affect our business and results of operations.

***Internet regulation in Brazil is recent and still limited and several legal issues related to the Internet are uncertain.***

In 2014, Brazil enacted a law, which we refer to as the Civil Rights Framework for the Internet, setting forth principles, guarantees, rights and duties for the use of the internet in Brazil, including provisions about internet service provider liability, internet user privacy and network neutrality. In May 2016, further regulations were passed relating to the privacy and network provisions set forth in Civil Rights Framework for the Internet. However, unlike in the United States, few legal precedents relating to the Internet Act exist and existing jurisprudence has not been consistent, especially with respect to the application of the network neutrality principle. Legal uncertainty arising from the limited guidance provided by current laws in force allows for different judges or courts to decide very similar claims in different ways and establish contradictory jurisprudence. This legal uncertainty allows for rulings against us and could set adverse precedents, which individually or in the aggregate could seriously harm our business, results of operations and financial condition. In addition, legal uncertainty may harm our customers' perception and use of our service.

***Certain of our debt agreements contain financial covenants, and any default under such debt agreements may have a material adverse effect on our financial condition and cash flows.***

Certain of our existing debt agreements contain restrictions and covenants and require the maintenance or satisfaction of specified financial ratios and tests. Failure to meet or satisfy any of these covenants, financial ratios or financial tests could result in an event of default under these agreements.

***We are subject to environmental laws and regulations. Failure to comply with governmental laws and regulations could subject us to penalties that could have an adverse effect on our business.***

Our operations and properties are subject to a variety of environmental laws and regulations governing, among other things, environmental licensing and registries, protection of flora and fauna, air emissions, waste management and remediation of contaminated areas, among others. Our failure to comply with present and future requirements, or the management of existing and identification of new contamination, could cause us to incur substantial costs, including cleanup costs, indemnification, compensation, fines, suspension of activities and other penalties, investments to upgrade our facilities or change our processes, or curtailment of operations. The identification of presently unidentified environmental conditions, more vigorous enforcement by regulatory agencies, enactment of more stringent laws and regulations or other unanticipated events may arise in the future and give rise to material environmental liabilities and related costs. The occurrence of any of the foregoing could have a material adverse effect on our business, results of operations and financial condition.

***Companies in the telecommunication industry, including us, may be harmed by restrictions regarding the installation of new antennas for mobile services.***

Currently, there are approximately 250 municipal laws in Brazil that limit the installation of new antennas for mobile service. This scenario has been a barrier to the expansion of mobile networks. Those laws are meant to regulate issues related to zoning and the alleged effects of the radiation and radiofrequencies of the antennas. Despite the existence of a federal law approved in 2015, that addresses this issue by establishing new guidelines to create a consolidated plan for the installation of antennas, as long as the municipal laws remain unchanged, the risk of noncompliance with regulations and of having services of limited quality in certain areas continues to exist.

Additional antenna installation is also limited as a result of concerns that radio frequency emissions from base stations may cause health problems and other environmental impacts. These concerns could have an adverse effect on the wireless communications industry and, possibly, expose wireless providers, including us, to litigation. Based on information from the World Health Organization (WHO) we are not aware of any evidence in the latest medical research that conclusively establishes any relationship between radio frequency emissions of base stations and health concerns. Perceived risks may, however, delay expansion of our network if we experience problems in finding new sites, which in turn may delay expansion and affect the quality of our services.

For instance, in May 2009, the Brazilian government published Law No. 11934/2009 that limits the exposure for fields with frequencies up to 300 GHz. The new law uses the exposure limits determined by the International Commission on Non-Ionizing Radiation Protection and recommended by the WHO and restricts the installation of new antennas.

New laws may create additional transmission regulations, which in turn, could have an adverse effect on our business. Health concerns regarding the effects of radio frequency emissions may also discourage the use of mobile telephones and may result in the adoption of new measures by governments or any other regulatory interventions, any of which

could materially and adversely affect our business, results of operations and financial condition.

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*We face risks associated with litigation.*

We are party to a number of lawsuits and other proceedings. An adverse outcome in, or any settlement of, these or other lawsuits could result in significant costs to us. In addition, our senior management may be required to devote substantial time to these lawsuits, which they could otherwise devote to our business. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings.”

**Risks Relating to the Preferred Shares and the ADSs**

*Holders of our ADSs may face difficulties in serving process on or enforcing judgments against us and other persons.*

We are organized under the laws of Brazil, and all of our executive officers and our independent public accountants reside or are based in Brazil. Also, six of our twelve directors reside or are based in Brazil. Substantially all of our assets and those of these other persons are located in Brazil. As a result, it may not be possible for holders of the ADSs to effect service of process upon us or these other persons within the United States or other jurisdictions outside Brazil or to enforce against us or these other persons judgments obtained in the United States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain conditions are met, holders may face greater difficulties in protecting their interests due to actions by us, our directors or executive officers than would shareholders of a U.S. corporation.

***Holders of our preferred shares and ADSs generally do not have voting rights.***

In accordance with Brazilian Corporate Law and our bylaws, holders of our preferred shares, and therefore of our ADSs, are not entitled to vote at meetings of our shareholders, except in limited circumstances set forth in “Item 10. Additional Information—B. Memorandum and Articles of Association.”

***Holders of our preferred shares might be unable to exercise preemptive rights with respect to the preferred shares unless there is a current registration statement in effect which covers those rights or unless an exemption from registration applies.***

Holders of our preferred shares will not be able to exercise the preemptive rights relating to the preferred shares underlying their ADSs unless a registration statement under the U.S. Securities Act of 1933, as amended, or the Securities Act, is effective with respect to the shares underlying those rights, or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement. Unless we file a registration statement or an exemption from registration applies, holders of our preferred shares may receive only the net proceeds from the sale of their preemptive rights by the depositary, or if the preemptive rights cannot be sold, they will lapse and they will not receive any value for them. For more information on the exercise of these rights, see “Item 10. Additional Information—B. Memorandum and Articles of Association—Description of our Bylaws—Preemptive Rights.”

***An exchange of ADSs for preferred shares risks the loss of certain foreign currency remittance and Brazilian tax advantages.***

Beginning on March 30, 2015, the different forms of foreign portfolio investments in Brazil, including investments via Depositary Receipts, have been regulated by CMN Resolution 4,373, of September 29, 2014 (or “Resolution No. 4,373”), which revoked the former rule (CMN Resolution 2,689, of January 26, 2000) that had been in effect for the previous 15 years. Resolution No. 4,373 provides for the issuance of Depositary Receipts in foreign markets in respect of shares of Brazilian issuers, and, pursuant to this regulation, the ADSs benefit from the certificate of foreign capital registration, which permits Citibank N.A., as depositary, to convert dividends and other distributions with respect to preferred shares into foreign currency, and to remit the proceeds abroad. Holders of ADSs who exchange their ADSs for preferred shares will then be entitled to rely on the depositary’s certificate of foreign capital registration for five business days from the date of exchange. Thereafter, they will not be able to remit non-Brazilian currency abroad unless they obtain their own certificate of foreign capital registration, or unless they qualify under CMN Resolution No. 4,373, which entitles certain investors to buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration. CMN Resolution No. 4,373 replaced both CMN Resolution No. 1,927 and CMN Resolution No. 2,689 as of March 30, 2015. Further rules will be issued by CVM and by the Central Bank to regulate foreign investments in ADSs, including with regard to the exchange of ADSs for preferred shares and the remittance of funds arising from the sale of these preferred shares.

If holders of ADSs do not qualify under Resolution No. 4,373, they will generally be subject to less favorable tax treatment with respect to our preferred shares. There can be no assurance that the depositary's certificate of registration or any certificate of foreign capital registration obtained by holders of ADSs will not be affected by future legislative or regulatory changes, or that additional Brazilian law restrictions applicable to their investment in the ADSs may not be imposed in the future.

***Holders of our preferred shares will be subject to, and holders of our ADSs could be subject to, Brazilian income tax on capital gains from sales of preferred shares or ADSs.***

Brazilian Law No. 10,833 provides that gains on the disposition of assets located in Brazil by nonresidents of Brazil, whether to other nonresidents or to Brazilian residents, will be subject to Brazilian taxation. The preferred shares are expected to be treated as assets located in Brazil for purposes of the law, and gains on the disposition of preferred shares, even by nonresidents of Brazil, are expected to be subject to Brazilian taxation.

Based on the fact that the ADSs are issued and registered abroad, we believe that gains on the disposition of ADSs made outside of Brazil by nonresidents of Brazil to another non-Brazilian resident would not be subject to Brazilian taxation, since they would not fall within the definition of assets located in Brazil for purposes of Law 10,833. However, considering the general and unclear scope of Law No. 10,833 and the absence of judicial/administrative court rulings in respect thereto, we cannot be assured that such an interpretation of this law will prevail in the courts of Brazil.

In case of any assessment by the Brazilian tax authorities, the gains arising from the disposal of ADSs made as of January 1, 2017 could be subject to capital gain tax in Brazil at (i) progressive rates ranging from 15% to 22.5% (for transactions executed after January 1, 2017) or at a flat rate of 15% (for transactions executed before January 1, 2017), or (ii) 25% if the non-Brazilian holder is located in a tax haven jurisdiction, whether the transaction was executed before or after January 1, 2017. See "Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations."

#### **Certain Factors Relating to Our Controlling Shareholder**

***Our controlling shareholder has power over the direction of our business.***

Telefónica S.A., or Telefónica, our controlling shareholder, and its affiliates currently own directly and indirectly approximately 94.47% of our voting shares and 73.58 % of our total capital stock. See "Item 7. Major Shareholders and Related Party Transactions—A. Major Shareholders" and "Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions." As a result of its share ownership, Telefónica has the power to control us and our subsidiaries, including the power to elect our directors and officers and to determine the outcome of any action requiring shareholder approval, including corporate reorganizations and the timing and payment of our dividends. Given this degree of control over our company, circumstances could arise under which the interests of Telefónica could be deemed to be in conflict with the interests of our other shareholders.

## ITEM 4. INFORMATION ON THE COMPANY

### A. History and Development of the Company

#### General

We were incorporated on May 22, 1998, as a corporation (*sociedade anônima*) organized under the laws of the Federative Republic of Brazil, as a result of the restructuring and privatization of Telecomunicações Brasileiras S.A. and its operating subsidiaries, or the Telebrás System, which monopolized the provision of public telecommunications services in virtually all areas of Brazil prior to 1998. We were incorporated under the name Telesp Participações S.A. and after subsequent reorganizations we were named Telecomunicações de São Paulo S.A. – TELESP. After our merger with Vivo Participações in October 2011, we changed our corporate name to Telefônica Brasil S.A.

On September 18, 2014, we entered into a stock purchase agreement with Vivendi S.A. to acquire all of the shares of GVT Participações S.A., or GVT, the controlling shareholder of Global Village Telecom S.A., or Operating GVT, which was approved by our board of directors on the same date.

According to Brazilian Law, the transaction must be approved by both ANATEL and CADE. On December 22, 2014, ANATEL approved the transaction and imposed certain obligations, that include (1) the maintenance of current GVT services and plans within the same geographic scope in which GVT previously operated, requiring, in addition, that the successor company expand its operations to at least ten new municipalities within three years beginning on January 26, 2015; and (2) the waiver of the STFC license held by GVT within 18 months of ANATEL's decisions, since the same economic group cannot hold more than one STFC license in the same geographic area. Telefônica has satisfied both obligations.

On March 25, 2015, CADE provisionally approved the GVT acquisition, subject to a series of obligations imposed to prevent any undesired concentration effects of the merger. Such obligations require that we:

- Maintain, for at least three years, the current geographical coverage for STFC, SCM and SeAC services;
- Maintain, for at least three years, the current average broadband speed for GVT's customers on a nationwide basis. The reference as of December, 2014 is 15.1 Mbps;
- Maintain, for at least three years, the current average broadband speed for GVT's customers in São Paulo. The reference as of December, 2014 is 18.25 Mbps; and
- Do not exchange, directly or indirectly, classified information, strategic or competitively sensitive information with any other company or between management and representative responsible for subsidiaries of Vivendi Group, Telefónica Group and Telecom Italia Group related to its operations in the Brazilian market.

In November 2015, ANATEL consented to our corporate reorganization involving Telefônica Brasil S.A., GVT Participações S.A. and its subsidiaries. The approval was subject to certain conditions such as the end of overlap licenses of STFC, SCM and SeAC within 18 months and the obligation to present a list of all assets from the companies incorporated in our STFC (Sector 31, Region III) concession area, confirming the absence of reversible assets burdened judicially (by means of a negative certificate), or in case of attachment, present the appropriate requests for replacement.

On March 14, 2016, the corporate reorganization was approved by our Board of Directors, and was completed on April 1, 2016, after the approval by an extraordinary shareholders meeting of the relevant companies.

On July 3, 2017, Telefônica Data S.A., a wholly owned subsidiary of the Company, acquired all the shares of capital stock of Terra Networks Brasil S.A. from SP Telecomunicações Participações S.A., one of the controlling shareholders of the Company. The purpose of the Terra Networks Transaction is to expand and integrate our offering of digital services, in order to provide additional value to our customer base and TData's.

We are registered with the CVM as a publicly held company and our stock is traded on the B3 – Brasil, Bolsa, Balcão under the symbol “VIVT3” (formerly “TLPP3”) for common shares and “VIVT4” (formerly “TLPP4”) for preferred shares. We are also registered with the SEC in the United States and our ADSs are traded on the NYSE, under the symbol “VIV” (formerly “TSP”). Our headquarters are located at Avenida Engenheiro Luis Carlos Berrini, 1376, 04571-936, São Paulo, SP, Brazil. Our telephone number is 55-11-3430-3687 and our website is [www.telefonica.com.br/ir](http://www.telefonica.com.br/ir). The information on our website is not part of this annual report on Form 20-F.

As of December 31, 2017, we had 569,354,053 outstanding common shares (excluding treasury shares), with no par value per share, and 1,119,339,723 outstanding preferred shares (excluding treasury shares), with no par value per share. Our shareholders’ equity amounted to R\$69.5 billion as presented in our audited financial statements prepared in accordance with IFRS.

## Historical Background

### *Corporate Restructuring Involving Telefônica Brasil and Vivo Participações*

On July 28, 2010, our controlling shareholder, Telefónica, reached an initial agreement with Portugal Telecom for the acquisition of 50% of the capital stock of Brasilcel, N.V., or Brasilcel. As a result of this transaction, Telefónica held 100% of the capital stock of Brasilcel. At that time, Brasilcel held approximately 60% of the capital stock of Vivo Participações. On December 21, 2010, Brasilcel was merged into Telefónica.

Due to the acquisition of control of Vivo Participações, on February 16, 2011, Telefónica, through its subsidiary SP Telecomunicações Ltda., or SP Telecom, launched a public tender offer for the common shares of Vivo Participações (the only shares with voting rights) held by minority shareholders. As a result of the public tender offer, on March 18, 2011, SP Telecom acquired 10,634,722 common shares of Vivo Participações, representing 2.66% of its shares, resulting in the Telefónica group’s ownership of 62.1% of Vivo Participações.

On December 27, 2010, the boards of directors of Vivo Participações and Telefônica Brasil approved the terms and conditions of a corporate restructuring, which provided for the merger of shares issued by Vivo Participações into Telefônica Brasil. The corporate restructuring was approved by ANATEL on March 24, 2011, and on April 27, 2011, the shareholders of Vivo Participações and Telefônica Brasil approved the merger of shares issued by Vivo Participações into Telefônica. On June 14, 2011, the board of directors of both companies approved a second corporate restructuring, pursuant to which Vivo Participações became our wholly owned subsidiary. The terms and conditions of the second corporate restructuring were approved unanimously by the shareholders of both companies on October 3, 2011. Vivo Participações was merged into us, and the holders of the merged shares of Vivo Participações received new shares in the company.

Due to the merger of Vivo Participações into us, our capital was increased by R\$31.2 billion, reflecting the economic value of the shares issued as a result of the merger. The merger did not change the identity of the controlling shareholders of the companies.

Additionally, as a consequence of this merger, on July 6, 2011, Vivo Participações filed a statement with the SEC in order to cancel the registration of its American Depositary Shares, or ADS, program since all of its ADSs were converted into ADSs of Telefônica Brasil. The SEC approved the deregistration on July 7, 2011.

A third stage of the corporate restructuring was approved by ANATEL on August 16, 2011. On October 3, 2011, our shareholders approved the merger of Vivo Participações into us and Telefônica Brasil absorbed Vivo Participações’ equity, extinguishing Vivo Participações, which further simplified and rationalized our cost structures. On the same date, we changed our name from Telecomunicações de São Paulo S.A. – TELESP to Telefônica Brasil S.A., to reflect

our nationwide operations. On October 18, 2011, ANATEL approved transfer of the authorization for the provision of SMP services in the state of Minas Gerais from Vivo Participações to Vivo.

As a result of this name change, the ticker symbols for our shares were also changed as of October 6, 2011 (inclusive), from TLPP3, for the common shares, and TLPP4, for the preferred shares, to VIVT3 and VIVT4, respectively, with the subsequent change of our trading name to TELEF BRAZIL. Our ticker symbol for the ADRs on the NYSE was changed to VIV, from TSP.



### ***Telefónica and Telecom Italia Agreement***

Through a series of transactions from 2007 to 2009, Telefónica acquired an indirect holding in the voting shares of Telecom Italia through its holdings in the Italian company TELCO S.p.A. Telecom Italia holds an indirect interest in TIM Participações S.A., or TIM, a Brazilian telecommunications company. None of Telefónica, Telefônica Brasil or any other affiliate of Telefónica was involved with or had decision-making powers over TIM's operations in Brazil, although Telefónica held an indirect interest with respect to TIM's operations in Brazil. They were also legally and contractually forbidden from exercising any voting rights in TIM's operations in Brazil.

On June 16, 2014, TELCO, S.p.A.'s Italian shareholders exercised their right to a spin-off, in accordance with the shareholders' agreement. The implementation of the spin-off was approved by the shareholders on July 9, 2014 and was subject to approval from ANATEL and CADE. When approved by ANATEL and CADE, the spin-off consisted of the shares held by Telecom Italia being spun-off to four new companies, each of which would be wholly owned by one of TELCO, S.p.A.'s shareholders and each of which would hold shares of Telecom Italia, S.p.A. proportional to their holding in TELCO, S.p.A.

As a result of the spin-off, Telefónica S.A. would indirectly hold 14.77% of Telecom Italia S.p.A. of which 8.3% would be exchanged with Vivendi as consideration in the GVT acquisition and 6.47% would be tied to debentures issued by Telefónica S.A. in July 2014 convertible into shares of Telecom Italia upon maturity.

On December 22, 2014, ANATEL authorized the spin-off of TELCO, S.p.A. conditional on the suspension of all control rights of Telefónica S.A. in Telecom Italia, S.p.A. and its subsidiaries. In addition, ANATEL authorized the GVT acquisition, subject to certain regulatory obligations. On March 25, 2015, CADE approved the spin-off of TELCO S.p.A. and the GVT acquisition, subject to certain regulatory obligations.

On April 7, 2015, ANATEL approved the swap transaction to exchange 12% of our common shares and 0.7% of our preferred shares owned by Vivendi for 8.3% Telecom Italia's common shares with voting rights, previously held by Telefónica, S.A..

On July 29, 2015, Telefónica, S.A. entered into an agreement with Vivendi, S.A. through which Telefónica, S.A. committed to transfer its treasury shares representing approximately 0.95% of its capital stock in exchange for Telefônica Brasil S.A. preferred shares (received by Vivendi, S.A. in the GVT acquisition) representing approximately 3.5% of our capital stock. Pursuant to this agreement, Vivendi, S.A. has committed to, among other obligations: (i) refrain from selling the Telefónica shares during specified periods (lock up), and (ii) comply with certain restrictions that, in case of sale, and once the lock up periods have lapsed, would ensure an orderly sale of such shares.

On July 30, 2015, Vivendi S.A. announced after the closing of the New York Stock Exchange trading session of July 30, 2015, that they sold 67.9 million preferred shares of Telefônica Brasil S.A. (representing 4.0% of our capital stock).

As a result, Telefónica no longer held, directly or indirectly, any economic interest in Telecom Italia by the end of 2015.

### ***Restructuring Involving the Subsidiaries of Telefônica Brasil***

On March 15, 2012, our board of directors approved a corporate restructuring of our wholly owned subsidiaries to align the services provided by each such subsidiary and to concentrate all telecommunication services in one company. The restructuring was finalized on July 1, 2013.

The restructuring was implemented by means of a spin-off and mergers involving only our wholly owned subsidiaries, A. TELECOM S.A., or A. TELECOM, Telefonica Data S.A., or TData, Telefônica Sistema de Televisão S.A. and Vivo. The mergers did not result in an increase in our capital stock or in the issuance of new shares by us, and the corporate restructuring did not give rise to a change in the equity interests held by our shareholders. As a result of the restructuring, value added services and innovative services provided by several wholly owned subsidiaries of the company were consolidated under TData and other telecommunications services were consolidated under Telefônica Brasil, which, as a final step to the corporate restructuring, merged these subsidiaries.

Since the completion of the merger, all services which are exclusively telecommunications services have been provided by us, Telefônica Brasil. Other services, including value added services, have been performed by our wholly owned subsidiary, TData. We were required to separate our services into separate companies because the telecommunications laws in Brazil and our concession agreement require that we only perform telecommunications services. ANATEL approved the corporate restructuring in May 2013.

### *Acquisition of GVT*

On September 18, 2014, we entered into a stock purchase agreement with Vivendi and certain of its controlled companies, or collectively, Vivendi, and with GVTPar, Telefónica, S.A. and Operating GVT, pursuant to which we agreed to purchase all of the shares of GVTPar, the controlling shareholder of Operating GVT. This acquisition was approved by our board of directors on September 18, 2014.

As consideration for the acquisition, we agreed to pay a portion of the price in cash and a portion in kind, in the form of our common and preferred shares, as follows: (1) €4,663,000,000 to be paid in cash on the closing date, as adjusted pursuant to the stock purchase agreement, and (2) our common and preferred shares amounting to 12% of our total share capital following the capital increase contemplated in the stock purchase agreement and the merger of shares of GVTPar, which must be in the same proportion as our existing common shares and preferred shares. The total consideration was paid after the conclusion of (A) a capital increase, the proceeds of which were used to pay the cash consideration described in (1) above, and (B) the merger of shares of GVTPar into us.

On December 22, 2014, ANATEL approved the transaction and imposed certain obligations, which include (1) the maintenance of current GVT services and plans within the same geographic scope in which GVT operates today, requiring, in addition, that the successor company expand its operations to at least ten new municipalities within three years beginning on January 26, 2015; and (2) the waiver of the FSTS license held by GVT within 18 months of ANATEL's decisions, because regulations establish that the same economic group cannot hold more than one FSTS license in the same geographic area. We understand that obligations imposed do not compromise the terms of the GVT acquisition or its value.

On March, 25 2015, CADE's administrative tribunal approved the transaction on the basis of certain confidential commitments offered by us and Vivendi S.A. The commitments include the execution of two merger control agreements: the first between CADE and us and the second between CADE and Vivendi S.A.

On March 25, 2015, our board of directors approved the public offering of shares, including shares in the form of ADSs, pursuant to a capital increase in the amount of R\$15,812,000,038.03, through issuance of 121,711,240 common shares, at a price of R\$38.47 and 236,803,588 preferred shares, at a price of R\$47.00 as well as an additional 6,282,660 preferred shares pursuant to the exercise of the over-allotment option.

On May 28, 2015, our shareholders approved the ratification of the Stock Purchase Agreement and Other Covenants, entered into by the Company, as Buyer, and Vivendi S.A. and its subsidiaries, Société d'Investissements et de Gestion 108 SAS and Société d'Investissements et de Gestion 72 S.A., as Sellers, whereby all the shares issued by GVTPar, the controlling shareholder of Global Village Telecom S.A., were acquired by us.

Therefore, as provided for in the stock purchase agreement, we paid a portion of the GVT acquisition price in cash, receiving shares of GVTPar and GVT Operator, and another portion in shares, to FrHolding108 as a result of the merger of GVTPar's shares into us, representing 12% of our capital stock after the merger.

After the merger and as a result of the acquisition, our corporate structure was as follows:

On June 24, 2015, the transaction for the exchange of shares between Telefónica and Société d'Investissements et de Gestion 108 SAS, a company controlled by Vivendi S.A. was completed, through which FrHolding108 transferred to Telefónica 76,656,559 shares representing 4.5% of our capital stock, including 68,597,306 common shares representing 12% of such class of shares and 8,059,253 preferred shares representing 0.72% such class of shares, in exchange for 1,110,000,000 shares representing 8.2% of the common shares of Telecom Italia, S.p.A., previously held by Telco TE, S.p.A., a subsidiary of Telefónica.

On July 29, 2015, Vivendi S.A. sold 67.9 million preferred shares, representing 4% of our capital stock. On the same day, Telefónica S.A. announced that it entered into an agreement with Vivendi's subsidiary Société d'Investissements et de Gestion 108 SAS, through which Telefónica committed to deliver 46.0 million of its treasury shares, representing 0.95% of its share capital, in exchange for 58.4 million preferred shares of Telefonica Brasil, S.A., (received by Société d'Investissements et de Gestion 108 SAS. in the context of the acquisition of GVT Participações, S.A.). On September 16, 2015, the exchange of shares was concluded. Consequently, Telefónica S.A.'s interest in the Company was increased by 5.2% in relation to the total preferred shares of the Company, and by 3.5% in relation to the total capital stock of the Company. Conversely, SIG108 shareholding interest in the Company was reduced by the same proportion. Therefore, from that date on, SIG108 does not hold any interest at the Company.

On March 14, 2016, our board of directors approved a corporate restructuring in order to simplify our organizational structure. In the previous corporate structure, GVT Participações S.A. ("GVTPart") was 100% owned by Telefonica Brasil, as shown below:

On the date of the merger, GVT was split and its net assets were transferred in part to GVTPart and in part to POP. The portion of the spun-off net assets of GVT concerning the goods, rights and obligations related to telecommunications activities were transferred to GVTPart and the remaining portion, concerning the assets, rights and obligations related to the other activities of non-telecommunications were transferred to POP. GVTPart was subsequently merged into Telefônica Brasil, resulting in the following corporate structure:

The corporate restructuring did not result in a capital increase or change in ownership of the Company's shareholders and was ratified by an extraordinary shareholders' meeting on April 1, 2016.

***Acquisition of Telefônica Transporte e Logística Ltda. (TGLOG) by TData***

On October, 28, 2015, TData, as buyer, and Telefónica Gestión de Servicios Compartidos España S.A., as seller, entered into a Stock Purchase agreement that resulted in the acquisition of Telefônica Transporte e Logística Ltda., a company headquartered in Brazil that provides logistics services.

***Acquisition of Terra Networks by TData***

On July 3, 2017, we announced that our wholly-owned subsidiary, Telefônica Data S.A. ("TData"), acquired all the shares of capital stock of Terra Networks Brasil S.A. ("Terra Networks") from SP Telecomunicações Participações S.A. ("SPTE"), one of our controlling shareholders (the "Terra Networks Transaction").

Terra Networks is a provider of digital services (own and third-party value-added services ("VAS") and carrier billing, as well as mobile channels for sales and relationships) and advertising. TData is a company dedicated to the exploration of VAS, as well as integrated business solutions in telecommunications, technical assistance of telecommunications equipment and networks, maintenance of equipment and networks and development of projects. The purpose of the Terra Networks Transaction was to expand and integrate our offering of digital services, in order to provide additional value to our customer base and TData's, as well as to provide TData's offering of services to Terra Networks' customer base and subscribers. In addition, the Terra Networks Transaction was intended to amplify TData's advertising business as a result of Terra Networks' nationwide operations and expertise.

By combining the Company's skills in creating new digital media products for mobile and advertising and Terra Networks' know-how in sales, customer service and operating digital services for specific customers, we believe the acquisition by TData will facilitate the exchange of know-how between the companies involved, and increase the consistency of commercial terms among the companies and their suppliers.

The total price paid by TData as consideration for the acquisition of shares issued by Terra Networks was R\$250 million, paid in a single installment using TData's cash on hand, with no need for financing. Such value was calculated based on our estimated valuation of the company, using a discounted cash flow model, based on an appraisal report commissioned by TData's board of directors.

The Terra Networks Transaction is subject to conditions usually applicable to this type of deal, and was preceded by legal and financial diligence in relation to Terra Networks and valuation by an independent company. In addition, the respective sale and purchase agreement contains terms and provisions common to this type of transaction. The Terra Networks Transaction is not subject to obtaining any regulatory authorizations or approvals by the Company's regulators and was structured in a way that does not change our shareholding structure or cause any dilution to our shareholders, seeking to generate value through an accelerated growth of digital services and increased operational efficiency. There are no significant costs related to the Terra Networks Transaction.

## Capital Expenditures

### *Year Ended December 31, 2017*

In 2017, we invested R\$7,998.3 million, a 2.3% decrease over the amount we invested in 2016 (R\$8,189.1 million), primarily due to the fact that we had no spectrum licensing costs in 2017, compared to R\$185 million in spectrum licensing costs in 2016. Investments in projects were strongly focused on network investments (which accounted for 85% of investments in 2017) and included expenditures on items such as radio access network (Node-Bs, eNode-Bs and WCDMA carriers), transmission backhaul and backbone, FTTH and copper network. The investments helped sustain our commercial and revenue growth while maintaining the quality of the services provided and are also designed to prepare us for medium-term growth.

To meet the needs of an increasingly data driven and connected society, significant investments were made to support the strong growth of data usage in our residential fiber network, mobile 4G/3G network and dedicated corporate networks. We continue to invest in expanding our national data transmission backbone to meet the increase in data traffic throughout Brazil.

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2017.

<b>Telefônica Brasil</b>	<b>Year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<b>(in millions of reais)</b>		
Network	6,783.5	6,743.9	6,557.6
Technology / Information Systems	883.3	929.5	870.3
Others(1)	331.5	515.6	239.6
Total capital expenditures	7,998.3	8,189.1	7,667.5

(1) Consists primarily of handset sales made to corporate customers for the length of their contracts, furniture and fixtures, office equipment and store layouts and spectrum licensing costs. The spectrum licensing costs amounted to R\$0.1 million in 2015, relating to the acquisition of the new 700MHz frequency spectrum and R\$185 million in 2016, relating to the acquisition of the remainder of the 2,500 MHz spectrum for 4G usage. We had no spectrum licensing costs in 2017.

### *Year Ended December 31, 2016*

In 2016, we invested R\$8,189.1 million, a 6.8% increase over the amount we invested in 2015, primarily due to the cost of acquiring the remains of the 2,500MHz 4G spectrum (R\$185 million) and also because GVT's capital expenditures from January 1, 2015 to April 30, 2015, which totaled R\$582.9 million, were not consolidated in our 2015 financial statements. Investments in projects were strongly focused on network (which accounted for 84% of investments in 2016, excluding licenses) and included expenditures on items such as radio access network (Node-Bs, eNode-Bs and WCDMA carriers), transmission backhaul and backbone, FTTH and copper network. The investments helped sustain our commercial and revenue growth while maintaining the quality of the services provided and are also designed to prepare us for medium-term growth. To meet the needs of an increasingly data driven and connected society, significant investments were made to support the strong growth of data usage in our residential fiber network, mobile 4G/3G and dedicated corporate networks.

### *Year Ended December 31, 2015*

In 2015, considering the consolidation effect of GVT from May 1, 2015, we invested R\$7,667.5 million, a 16% decrease over the amount we invested in 2014, primarily due to the cost of acquiring the new 700 MHz frequency spectrum, in an amount of R\$2,770 million. However, the consolidation of GVT's investment partially compensated for the decrease in investments with spectrum licenses (20% increase in capital expenditures, excluding licenses). Investments in projects were strongly focused on network (which accounted for 86% of investments in 2015, excluding licenses) and included expenditures on items such as radio access network (Node-Bs, eNode-Bs and WCDMA carriers), transmission backhaul and backbone, FTTH and copper network. The investments helped sustain our commercial and revenue growth while maintaining the quality of the services provided and are also designed to prepare us for medium-term growth.

## **B. Business Overview**

We are the leading mobile telecommunications company in Brazil (31.7% market share as of December 31, 2017, based on accesses), with a particularly strong position in postpaid mobile services (41.8% market share as of December 31, 2017, based on accesses). We are also the leading fixed telecommunications company in the state of São Paulo where we began our business as a fixed telephone service provider pursuant to our concession agreement. In the same period, we reached almost 44.8% of market share in ultra-fast broadband accesses with speeds higher than 34 Mbps in the state of São Paulo.

According to ANATEL's customer service performance index, we are and have been the highest-quality mobile operator in Brazil. Our Vivo brand, under which we market our mobile services, is among the most recognized brands in Brazil. The quality of our services and strength of our brand recognition enable us to, on average, achieve higher prices relative to our competition and, as a result, generally earn higher margins. As of December 31, 2017, our average revenue per mobile user, or ARPU, of R\$29.20 represented a significant premium relative to the market average of R\$17.30 (considering the average Mobile ARPU of Claro, TIM and Oi for the third quarter of 2017). In 2017, we captured 39.3% of the 8.6 million net additions in the postpaid mobile segment. We offer our clients a complete portfolio of products, including mobile and fixed voice, mobile data, fixed broadband, ultra-fast broadband, or UBB (based on our Fiber to the Home, or FTTH and Fiber to the Curb, or FTTC infrastructure), Pay TV, information technology and digital services (such as entertainment, cloud and financial services). We also have one of the most extensive distribution networks of the sector, where our clients can obtain certain services, such as purchasing credit for prepaid phones.

We seek to continue to increase our operating margins by focusing on developing and growing our product offerings so that they comprise an integrated portfolio of higher-margin services. As part of this strategy, we acquired GVT in 2015, a high-growth telecommunications company in Brazil that offers high-speed broadband, fixed telephone and Pay TV services to high income customers across its target market, primarily located outside the state of São Paulo.

### **Our Operations and Services**

Our operations consist of:

- local and long distance fixed telephone services;
- mobile services, including value-added services;
- data services, including broadband services and mobile data services;
- Pay TV services through DTH (a satellite technology), IPTV and cable;
- network services, including rental of facilities, as well as other services;
- wholesale services, including interconnection;
- digital services;
- services designed specifically for corporate customers;
- the sale of wireless devices and accessories.



***Fixed Voice Services***

Our fixed line services portfolio includes local, domestic long-distance and international long-distance calls provided both on the public and private regime.

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### *Local Service*

Fixed local services include activation, monthly subscription, public telephones and measured services. Measured services include all calls that originate and terminate within the same area code within our concession region, which we refer to as local calls.

### *Intraregional, Interregional and International Long-Distance Services*

Intraregional long-distance services consist of all calls that originate in one local area or municipality and terminate in another local area or municipality within our concession region. Interregional long-distance services consist of state-to-state calls within Brazil and international long-distance services consist of calls between a phone line in Brazil and a phone line outside Brazil. We were the first telecommunications company to be granted the authorization to develop local, intraregional, interregional and international services throughout Brazil, including outside our concession area.

### *Mobile Services*

According to data regarding market share published by ANATEL, we are among the leading providers of mobile telecommunications services in Brazil.

Our mobile portfolio includes voice and broadband internet access through 3G and 4G as well as value-added services, family plans, including voice mail, voice mail translation in speech-to-text, caller identification, voice minutes in unlimited bundles to other mobile phones of postpaid customers, ring tones, and innovative services such as multi-media backup, cloud based services to save texts, entertainment and music apps, advertising platforms, among others.

We also offer wireless roaming services through agreements with local mobile service providers throughout Brazil and other countries, allowing our subscribers to make and receive calls while outside of our concession areas. We provide reciprocal roaming rights to the customers of the mobile service providers with which we have such agreements.

### *Data Services*

We provide fixed broadband through xDSL technologies, coaxial cable and fiber (FTTH – fiber-to-the-home and FTTC – fiber-to-the-curb), with speeds ranging from 1Mbps to 300Mbps.

In 2017, we covered 100% of the municipalities in our concession area in the state of São Paulo, reaching more than 7.4 million fixed broadband customers, and we expanded our national fiber network to reach more than 18 million homes.

In 2010, we began offering the “Banda Larga Popular,” an initiative of the government of the state of São Paulo to provide broadband at affordable prices to the low-income population. This product currently has a top speed of 2Mbps.

Through the GVT acquisition in 2015, we were able to further expand our data services by providing high speed broadband to high income customers across our target markets. GVT provided services that were complementary to our own, with limited overlap with the services we already provided. Such complementary services included fiber broadband to locations in the state of São Paulo (outside of the city of São Paulo, where we already have a large presence) and nationwide.

In mobile broadband, we use a variety of technologies to provide wireless internet services to our customers. Our 3G network is currently available nationwide. In addition, we offer the HSPA+ technology, commercially known as 3G Plus. This technology allows customers with compatible terminals (including handsets) to reach up to three times the speed of traditional 3G. In December 2017, we covered 4,027 municipalities with our 3G network, reaching 92.7% of Brazil's population. We also offer the 4G LTE technology, which, by the end of 2017, was available in 2,600 municipalities, reaching 84.5% of Brazil's population, and also 4G+ LTE through carrier aggregation in 118 municipalities.

### ***Pay TV Services***

We began offering subscription-based television, or “Pay TV,” services via DTH (“direct to home,” a special type of service that uses satellites for the direct distribution of television and audio signals to subscribers) on August 12, 2007. We currently provide Pay TV services by means of DTH and IPTV (a type of service that offers video broadcast through the use of IP protocol) technologies and as of December 31, 2017, had 1.6 million Pay TV customers, including more than 381 thousand IPTV customers.

### ***Network Services***

Our network management technology ensures comprehensive management and supervision of all our network processes and network performance for our wholesale clients. We have two Network Management Centers, one located in São Paulo (with a remote team in Minas Gerais) and another located in Curitiba. These centers monitor all regions of the country, but each has a different function.

The Network Management Center in São Paulo monitors the critical network operational parameters of the countrywide transmission backbone, IP networks, broadband networks, packet/circuit core networks, VAS/Multimedia platform and global services. The remote team in Minas Gerais monitors the critical operational parameters of the radio access network, infrastructure and online services performance. The Network Management Center in Curitiba monitors the critical operational parameters of the countrywide transmission backbone, network interconnection and IPTV/DTH networks. These centers are able to identify abnormalities in both our network and in third-party networks, using failure and signaling monitoring systems. In addition, quality and service standards are constantly monitored. The Network Management Centers are integrated with maintenance and operations teams that maintain and operate cellular network elements, as well as cellular infrastructure and transmission, in addition to the radio network elements and computing bases, service platforms and communications backbones.

Our network provides for continuity of service to our customers in the event of network interruptions. We have developed contingency plans for potential catastrophes in our switchboard centers, power supply interruptions and security breaches.

We continuously aim to consolidate our network and increase its offerings, to deliver the best possible service to our customers and to meet their expectations. Some of the improvements we have made in recent years include advancements in the migration of time-division multiplex switches to next generation network switches, which offer new digital services to our clients and reduce our maintenance costs, including improvements in levels of security, power supply, battery and air conditioning infrastructure. The most significant implementation of technology has been a project to exchange optical cabinets, used for offering voice and data services for Multi-Service Access Nodes, which allows us to offer broadband service to a large number of clients who did not previously have this service.

### ***Network and Facilities***

We provide industrial exploration of dedicated lines or (*Exploração Industrial de Linha Dedicada*), EILD, pursuant to our concession agreement and our authorization agreements. The EILD consists of the rental of dedicated circuits and clear channel protocols for the provision of services to third parties.

In addition, we are able to offer a complete portfolio of wholesale products, including L2L, IP, ETHERNET, MPLS and GPON. All of these products are used to meet the demands of other network operators and regional internet providers. The circuits are requested with different service level agreements, and we are required to provide the facilities with contingency routes, sites and equipment to improve the service against points of failure.

Our network consists of an access layer that connects our clients through our copper or optical networks, which are connected to voice and data centers. These centers are interconnected locally or remotely through transmission equipment connected predominantly with fiber optics and occasionally through a microwave network, which together form a network layer that enables connectivity between the various central aggregate service platforms as well as interconnection with other carriers. Our network strategy is based on the expansion of the fiber optic access network to allow greater coverage and broadband services for our customers, as well as to develop an integrated multiservice network and multimedia applications. As a telecommunication service provider, we do not manufacture equipment for the construction of our networks and facilities. We buy the equipment from qualified suppliers in Brazil and abroad and through such equipment we implement our networks and facilities through which we supply our services.

***Wholesale Services (including Interconnection)***

We have continuously adapted and expanded our network topology aiming to develop new business opportunities throughout Brazil by offering services to other telecommunications companies. The result has been a significant increase in the number of providers that use our wholesale services.

As part of our wholesale services, we provide interconnection services to users of other network providers. We earn revenue from any call that originates from another mobile or fixed-line service provider network connecting to one of our customers. We charge the service provider from whose network the call originates an interconnection fee for every minute that our network is used in connection with the call. See “—Operating Agreements—Interconnection Agreements.”

At the end of 2017, we had 439 local and long-distance interconnection agreements and 124 agreements for provision of local traffic and long-distance.

The interconnection is a link between compatible telecommunications networks which permits that a fixed or mobile service user of one network can adequately communicate with the users of a network from another provider.

All providers of telecommunication services (fixed or mobile) are required to provide interconnection upon request to any other telecommunication collective service provider. The conditions for interconnection agreements may be freely negotiated among the parties. The agreements are required to be formalized by contract, whose effectiveness depends on ANATEL’s approval. If any given agreement is contrary to the principles of free competition or conflicts with other regulations, ANATEL may reject it. If the parties cannot reach an agreement on the terms of interconnection, including the interconnection fee, ANATEL may determine those terms and conditions by arbitration.

***Digital Services (including Value Added Services)***

In 2017, we accelerated the process of becoming a digital telecommunications company, launching relevant services, with high perceived value, in areas such as entertainment, education, advertising, e-health, security, financial services, insurance and machine-to-machine operations. In entertainment, for example, Vivo became the NBA official carrier in Brazil. Because of this exclusive partnership, Vivo customers can access exclusive content of the most important basketball league in the world. In addition, Vivo also offers NBA League Pass, a premium service with all NBA games, including regular season, playoffs and finals, for a special price. We have also partnered with Editora Abril, the leading magazine publisher in Brazil, to become the exclusive distributor in the telecommunication segment of GoRead app, Brazil’s largest digital magazine platform, with more than 190 titles available to the service subscribers.

In our education services, we launched the Vivo Educa app, a platform of courses in the following categories: preparatory courses, career development, school support, personal finance, cooking and gastronomy, children and technology. Courses can be accessed through video lessons, online books with complete content and exercises, and live sessions.

In our security services, we launched the Vivo Protege app, a solution that guarantees the security of information on mobile phones, tablets and notebooks, bringing together five complementary services – storage and synchronization of files with security and privacy in the cloud, antivirus and antitheft, parental control, Wi-Fi browsing protection and a 24x7 online technical support.

In our e-health services, we launched the Vivo Meditação app, a new digital service that helps customers to develop concentration and mindfulness. It is the best-in-class app in Portuguese, with more than 1,000 guided meditation exercises, including exercises designed for kids.



In our advertising services, Vivo Ads has become one of the main mobile media platforms in Brazil, offering solutions for video campaigns, email lists and lead generations, app installations and other media-related content. Of the ten largest advertisers in Brazil, eight already use our platform in a recurring way in their marketing strategies. Vivo Ads was also one of the three finalists of the Caboré Prize, the main prize of the advertising market of Brazil, in the category Communication Vehicle - Media Platform.

### ***Corporate***

We offer our corporate clients comprehensive telecommunications solutions and IT support designed to address specific needs and requirements of companies operating in all types of industries (retail, manufacturing, services, financial institutions, government, etc.).

Our clients are assisted by our highly qualified professionals who are capable of meeting the specific needs of each company with voice, data, broadband and computer services solutions, including hardware and software (for example, anti-virus software). We work to consistently achieve greater quality and efficiency in our services and increase our level of competitiveness in the market.

### ***Sale of Devices and Accessories***

In addition, we sell handsets and accessories at our physical stores, to customers who purchase our digital services. We sell WCDMA and LTE devices such as smartphones, broadband USB modems and devices that are certified to be compatible with our network and service. We have special offers on smartphones, USB modems and other data devices for customers of bundled packages. Our current device suppliers are Motorola, LG, Samsung, Alcatel, Apple, D-Link, ZTE, Flex (WNC) and our accessories suppliers are Harman (JBL), Alfacomex (SanDisk and Geonav), Comesp (SanDisk) and Easy Mobile.

### **Rates, Taxes and Billing**

#### ***Rates***

We generate revenue from (i) activation and monthly subscription charges, (ii) usage charges, which include measured service charges, (iii) interconnection fees that we charge to other telecommunications service providers, and (iv) other additional services. Rates for all telecommunications services are subject to extensive regulation by ANATEL. We set forth below the different methods used for calculating our rates.

#### ***Local Rates***

Our concession agreement sets forth three mandatory plans for local fixed service, and allows us to design alternative pricing plans. Customers have a choice among three plans that we are required to offer or any other alternative plan that we may choose to offer. ANATEL must be informed of any alternative plan and notified of its implementation. The three main mandatory plans are:

- Local Basic Plan: for clients that make mostly short-duration calls (up to three minutes), during regular hours;
- Mandatory Alternative Service Plan (*Plano Alternativo de Serviços de Oferta Obrigatória – PASOO*): for clients that make mostly long-duration calls (above three minutes), during regular hours and/or that use the line for dial-up service to the internet; and



- Special Class Individual Access (*Acesso Individual Classe Especial – AICE*): a plan created specifically for families enrolled in social programs from the Brazilian government.

The following table outlines the basic billing requirements and gross rates for the Local Basic Plan and the Mandatory Alternative Plan as of the date of this annual report:

<b>Characteristics of Plan</b>	<b>Local Basic Plan</b>	<b>Mandatory Alternative Service Plan</b>
<b>Monthly Basic Assignment</b>		
Allowance (minutes included in the residential assignment)	200 minutes	400 minutes
Commercial Assignment Allowance (minutes included in the commercial assignment)	150 minutes	360 minutes
<b>Local Call Charges</b>		
<b>Regular Hours</b>		
Completing the call (minutes deducted from the allotment)	–	4 minutes
Completing the call after the terms of the allotment Sector 31	–	R\$0.17750
Local Minutes–charges in excess use of the allotment Sector 31	R\$ 0.11425	R\$0.04436
Minimum time billing	30 seconds	–
<b>Reduced Hours</b>		
Charge per answered call (minutes deducted from allotment)	2 minutes	4 minutes
Charge per answered call after the allotted duration Sector 31	R\$0.22260	R\$0.22260

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As of the date of this annual report, the subscription to the AICE plan costs R\$7.81 and allows for 90 minutes of local fixed-line calls per month. Any additional fixed or mobile calls may be made only if the customer purchases prepaid credits. The prices of mobile and long-distance calls are determined pursuant to a standard plan.

Our concession agreement also sets forth criteria for annual fee adjustments for all of our plans for local fixed service. We derive a substantial portion of our revenue from services subject to this price adjustment. The method of price adjustment is an annual price index correction applied by ANATEL to our local and long-distance fees that reflects the inflation index for the period and a productivity factor, which is calculated based on a compensation index established by ANATEL to share earnings from fixed charge services with their users. Currently, the inflation index used by ANATEL is the IST, which reflects variations in telecommunications companies' costs and expenses. ANATEL has consistently complied with the fee range set by the concession agreements.

#### *Long-Distance Rates*

Rates for domestic long-distance calls are computed on the basis of the time of day, day of the week, duration and distance of the call, and also may vary depending on whether special services, including operator assistance, are used. We have several options of domestic long-distance calling plans for consumers using our carrier dial code (15). Customers of any local and long-distance operator may use Code 15 when dialing long-distance and will benefit from our rates. To readjust the long-distance local rates, ANATEL applies an annual price index correction that reflects inflation.

We also offer international long-distance rates, which are also available to all users using Code 15. International long-distance call charges are computed on the basis of the time of day, day of the week, duration and destination of the call, and also may vary depending on whether special services are used or not, including operator assistance. Our rates for international services are not subject to regulation and are not required to follow the annual rate adjustment described above for other services. We are free to negotiate our fees for international calls based on the international telecommunications market, to which our main competitor is Embratel.

With respect to long-distance calls, we have developed alternative rate plans for residential and corporate customers.

*Mobile Services Rates*

With respect to our Local Basic Plan, as described above, and certain roaming charges incurred in connection with alternative service plans, our authorizations provide for a mechanism to set and adjust rates on an annual basis. The maximum rate is calculated as the current rate *plus* the rate of inflation. The maximum rate is revised annually and the rate of inflation is measured by the IGP-DI index. The maximum rate is applicable to all service plans, but mobile operators are able to freely set the maximum rates for alternative service plans (other than with respect to certain roaming charges).

The initial price cap agreed by ANATEL and us in our authorizations was based on the previously existing or bidding prices, and has been adjusted annually on the basis of a formula contained in our authorizations. As of the date of this report, the most recent adjustment was approved in February 2017 and established the tariffs of R\$0.20981 for regular hours and R\$0.14686 for reduced hours.

Other telecommunications companies that interconnect with and use our network must pay certain fees, primarily an interconnection fee. The interconnection fee is a flat fee charged per minute of use that directly affects the mobile services rates. Since 2005, ANATEL has allowed free negotiations for mobile interconnection fees (MTR).

In December 2013, ANATEL established the reference values for MTR for 2014 and 2015, and in July 2014, for the years 2016, 2017, 2018 and 2019. The table below shows the ranges for these reference values:

<b>Year</b>	<b>Reduction in %</b>	<b>MTR in reais</b>
2014	25	0.22164 – 0.25126
2015	33	0.14776 – 0.16751
2016	37	0.09317 – 0.11218
2017	47	0.04928 – 0.06816
2018	47	0.02606 – 0.04141
2019	50	0.01379 – 0.02517

*Interconnection Fees*

We are paid interconnection fees by any fixed-line or mobile service provider that either originates or terminates a call within our network. We also pay interconnection fees to other service providers when we use their network to place or receive a call. The interconnection agreements are freely negotiated among the service providers, subject to a price cap and to compliance with the regulations established by ANATEL, which include not only the interconnection basic costs including commercial, technical and legal aspects, but also the traffic capacity and interconnection infrastructure that must be made available to requesting parties. If a service provider offers to any party an interconnection fee below the price cap, it must offer the same fee to any other requesting party on a non-discriminatory basis. If the parties cannot reach an agreement on the terms of interconnection, including the interconnection fee, ANATEL can establish the terms of the interconnection. For additional information about interconnection fees, see “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies—Interconnection.”

*Data Services Rates*

We receive revenue from charges for data transmission, which includes our fixed broadband, dedicated analog and digital lines for privately leased circuits to corporations and others services. Data transmission rates are not regulated by ANATEL, except for EILD. Multimedia services operators are able to freely set the rates for alternative service

plans.

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### *TV Rates*

Pay TV rates are not regulated. Service providers are able to freely set the rates for alternative service plans.

### *Taxes*

The cost of telecommunications services to each customer includes a variety of taxes. The main tax is a state value-added tax, the *Imposto sobre Circulação de Mercadorias e Serviços*, or ICMS, which the Brazilian states impose at rates ranging from 7% to 35% on certain revenues from the sale of goods and services, including telecommunication services.

Other taxes include: (1) Federal Social Contributions (*Contribuição para o Programa de Integração Social*), or PIS, and Social Security Financing Contributions (*Contribuição para o Financiamento da Seguridade Social*), or COFINS; (2) Fund for Universal Access to Telecommunications Services (*Fundo de Universalização dos Serviços de Telecomunicações*), or FUST; (3) the Telecommunications Technological Development Fund (*Fundo para o Desenvolvimento Tecnológico das Telecomunicações*), or FUNTTEL; and (4) Fund for Telecommunications Regulation (*Fundo de Fiscalização das Telecomunicações*), or FISTEL.

### *Billing*

We send each contract customer a monthly bill covering all of the services provided during the previous monthly period. Pursuant to Brazilian law, telephone service providers are required to offer their customers the choice of at least six different monthly payment dates.

We have a billing and collection system with respect to local, national and international long-distance voice, subscriptions, broadband, data, IT services, outsourcing, television and third-party services. For invoice payments, we have agreements with various banks. These agreements include options for customers to select their preferred payment type: direct debit, payment to a bank, Internet and other collection agencies (including lottery-playing facilities, drugstores and supermarkets). We aim to avoid losses in the implementation of new processes and the roll-out of new products through the monitoring of billing, collection and recovery controls. The billing process is audited by the Brazilian Association of Technical Standards (*Associação Brasileira de Normas Técnicas*), or ABNT. These practices are closely monitored by our revenue assurance team, which measures every risk of revenue loss detected along the billing and collection chain. These risks are managed to minimize revenue losses.

### *Co-billing*

In accordance with Brazilian telecommunications regulations, we use a billing method called “co-billing” for both fixed and mobile services. This method allows billing from other phone service providers to be included within our own invoice. Our customers can receive and subsequently pay all of their bills (including the fees for the use of services of another telephone service provider) on our invoice. To allow for this method of billing, we provide billing and collection services to other phone service companies. We have co-billing agreements with national and international long-distance phone service providers. Similarly, we use the same method of co-billing to bill our services to customers of other fixed and mobile providers. This service is charged to the long-distance operator, by means of a call record described in the invoice.

For customers who use our long-distance services through operators that have no joint billing agreement with us, we use direct billing through the national registry of clients.

### *Value Added Services*

Value added services such as entertainment, information and online interactivity services are available to mobile prepaid as well as postpaid customers through agreements with content suppliers. These agreements are based on a revenue-sharing model.

*Third-party Services*

We incorporate third party services in our billing, collection and transfer process. These services are later passed on to the third party contractor.

*Collection*

Our collection policies with respect to customers in default follow ANATEL regulations, as well as those of *Serviços de Telecomunicações*, or RACO, and the Foundation for Consumer Protection and Defense (*Fundação de Proteção e Defesa do Consumidor*), or PROCON. For mobile, fixed and Pay TV customers, as a general rule, if payment is more than 15 days overdue, service can be partially suspended by blocking out-going calls that generate costs to the customer. If payment is more than 30 days overdue after this partial suspension, the service can be fully suspended, disabling all services (out-going and incoming calls), until payment is received. We offer an installment payment plan for clients with overdue balances. However, if accounts are not paid after 30 days following the total suspension, the contract can be cancelled and reported to credit protection agencies.

The collection process for customers in default involves several steps, from an internal interactive voice response, SMS contact, email contact, followed by a late payment notice, and finally reporting customer information to an external credit bureau. Concurrently with our internal process, delinquent customers are also contacted by collection agencies. Customer risk profile, overdue debt and other quality issues are used to increase strategy efficiency and maximize debt recovery efforts. Amounts overdue by over 105 days, except for accounts receivables from interconnection fees and government and corporate customers (there is a specific rule for those exceptions), are considered provisions for doubtful accounts. In accordance with Brazilian regulations, bad debt write-offs are permitted for late payments of zero to R\$5,000 if they are over 180 days late or R\$5,001 to R\$30,000 if they are over 365 days late. Late payments of over R\$30,001 that are open for more than 365 days require the commencement of a lawsuit. This rule is applied for outstanding debt through October 8, 2014; after this period, amount ranges change as follows: zero to R\$15,000 if they are over 180 days late or R\$15,001 to R\$100,000 if they are over 365 days late. Lawsuits are demanded for debts over R\$100,000 open for more than 365 days.

In the year ended December 31, 2017, the monthly average of partial suspensions, for mobile and fixed services, was 4.3 million lines and the monthly average of total suspensions was 673,780 lines. For Pay TV services, the monthly average of partial and total suspension was 171,575 terminals and 21,650 terminals, respectively. Provisions for doubtful accounts in the year ended December 31, 2017 were 2.2% of the total gross revenue.

### **Our Markets of Operation**

Our concession agreement allows us to operate in the state of São Paulo, except for a small region that is still subject to an earlier concession. In addition, we offer fixed telephone, data and Pay TV services throughout Brazil pursuant to licenses and authorization. We also operate mobile voice and broadband services throughout Brazil, under the mobile service (SMP) authorization. The following table sets forth population, gross domestic product (GDP), and per capita GDP statistics for each state in our service regions at the dates and for the years indicated:



Area	Pop.(million)	Last Available IBGE Data from 2015 (1)		Per capita GDP (reais)(2)
		Percent of Brazil's pop.	Percent of Brazil's GDP	
		GDP (R\$ million)	GDP	
São Paulo State	44.4	21.7%	1,939,890	32.4%
Rio de Janeiro State	16.6	8.1%	659,137	11.0%
Minas Gerais State	20.9	10.2%	519,326	8.7%
Rio Grande do Sul State	11.2	5.5%	381,985	6.4%
Paraná State	11.2	5.5%	376,960	6.3%
Santa Catarina State	6.8	3.3%	249,073	4.2%
Federal District	2.9	1.4%	215,613	3.6%
Bahia State	15.2	7.4%	245,025	4.1%
Goiás State	6.6	3.2%	173,632	2.9%
Pernambuco State	9.3	4.6%	156,955	2.6%
Espírito Santo State	3.9	1.9%	120,363	2.0%
Pará State	8.2	4.0%	130,883	2.2%
Ceará State	8.9	4.4%	130,621	2.2%
Mato Grosso State	3.3	1.6%	107,418	1.8%
Amazonas State	3.9	1.9%	86,561	1.4%
Maranhão State	6.9	3.4%	78,475	1.3%
Mato Grosso do Sul State	2.7	1.3%	83,082	1.4%
Rio Grande do Norte State	3.4	1.7%	57,250	1.0%
Paraíba State	4.0	1.9%	56,140	0.9%
Alagoas State	3.3	1.6%	46,364	0.8%
Rondônia State	1.8	0.9%	36,563	0.6%
Sergipe State	2.2	1.1%	38,555	0.6%
Piauí State	3.2	1.6%	39,148	0.7%
Tocantins State	1.5	0.7%	28,930	0.5%
Amapá State	0.8	0.4%	13,861	0.2%
Acre State	0.8	0.4%	13,622	0.2%
Roraima State	0.5	0.2%	10,354	0.2%
<b>Total</b>	<b>204.5</b>	<b>100.0%</b>	<b>5,995,787</b>	<b>100.0%</b>

(1) According to IBGE data (2015) – subject to revision.

(2) Average per capita GDP for Brazil, weighted by percentage of population represented by each state.

### Seasonality

Our business and results of operations are not materially affected by seasonal fluctuations in the consumption of our services.

### Marketing and Sales

Our commercial distribution network (marketed under the Vivo brand), as of December 31, 2017, consisted of 295 own sales outlets throughout Brazil. In addition, we also have approximately 12,000 sales outlets run by authorized dealers (including exclusive dealers and retail channels), maintaining a solid capillarity strategy that contributed to our

leadership position in Brazilian telecommunications market.

In 2017, we had approximately 600,000 points of sale where prepaid mobile service customers could purchase credits. Prepaid phones can be credited remotely or by purchasing cards containing credits. Credits may also be purchased through credit and debit cards, call centers, Vivo PDV (M2M using a cell phone for transferring the credit), personal recharge (using the phone itself to recharge credits), as well as certain certified internet websites.

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We bring our solutions to our clients through the following physical sales channels:

- **Vivo stores:** located in strategic points, our own stores provide a complete portfolio of products and services through a highly trained team, built to guarantee the best sales experience for the customer. Following the massive and increasingly digital transformation in the global community and environments, we have been adapting the way to offer our services in Vivo stores to customers. These changes include self-service terminals to offer after-sales services, as well as the convenience of scheduled appointments via the internet, delivery of SMS passwords and online queue tracking, all to minimize time spent waiting in lines. In addition, to improve customer experience, we launched the new iconic store at Barra Shopping Rio de Janeiro that transforms the traditional POS (Point of Sale) into a PDX (Point of Experience).
- **Exclusive dealers:** this channel is composed of select companies that have been certified to provide our full product portfolio. These dealers comprise a wide distribution network throughout the country. Although the channel offers the entire product portfolio, its focus is on the postpaid product. We are also constantly updating and enhancing these stores to provide a better purchase experience to the customer, to ensure an experience that is consistent with our own stores.
- **Retail channel:** our retail channel sells postpaid and prepaid products and recharge services that are marketed by our partners' own sales teams. This channel utilizes a sales incentive program that focuses on sales of our postpaid product *Controle* and is tied directly to the performance of our retail partners' salesforce.
- **Distribution channel:** the broadest and most complex sales channel across our markets, this channel allows our prepaid customers to purchase service credits. In order to be as close as possible to potential and existing customers, this channel comprises authorized agents, lottery stores, post offices, bank branches and small retailers, such as pharmacies, newspaper stands, bookstores, stationery shops, bakeries, gas stations, bars and restaurants.
- **Door-to-door sales:** aimed at approaching clients that our other channels cannot reach, we use niche physical channels, such as door-to-door sales of services by outsourced small companies and our own team of consultants. We focus mostly on voice products, as well as our postpaid *Controle* plans. In 2017, we began a transformation process through a new initiative targeting high-value customers in residential condominiums in order to achieve an increase in premium bundle accesses (fiber broadband and postpaid mobile services).
- **Telesales:** a channel with no geographical limitations, our telesales channel can reach existing and potential customers across the whole country, offering our full product portfolio, from prepaid to postpaid products, as well as fixed voice, broadband and TV bundles. We are able to identify a wide range of prospective new clients through our active outbound telesales operations, as well as to direct all incoming inquiries through our inbound telesales operations. This solid structure consists of our own telesales team and a select group of outsourced companies specialized in this business.

We also offer our services through digital channels, which are transforming our commercial model, making transactions more efficient and promoting the integration of all points of sale. In 2017, end-to-end digital sales in our mobile segment grew 460% throughout the year, delivering a consistent experience to customers and reducing commissioning costs. Meanwhile, in the fixed segment annual gross sales increased 10% during this year. The continuous improvement in e-commerce user experience was the most remarkable achievement, which contributes to our client's digital experience and promotes Vivo's digital presence and brand awareness.

Vivo's self-service care platform "Meu Vivo" had a remarkable year in 2017: downloads improved 50% higher than previous year, reaching 24 million downloads. Unique users in the app had an annual growth by 88%. These efforts were expanded to B2B segments: our self-service care platform "Meu Vivo Empresas" increased unique users by 46%,

while e-commerce sales boosted 59% during 2017.

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The Company's virtual assistant, Vivi, reached a landmark in accesses: in October, Vivi reached for the first time 1 million accesses in one month since its launch in October 2016, proving the customers growing demand for self-assisted platforms.

In order to explore all the digital strategic initiatives mentioned above and Internet's businesses potential, the Company made special offers and promotions during Black Friday/Black November in Brazil, which reinforces Vivo's digital maturity. Handset sales went up to 32% during 2017 compared to the same period in 2016.

### ***Customer Service***

In 2017, we reaped the benefit of certain measures that were implemented at the end of 2016 and the results of revised call center service contracts, which emphasized quality of services through a competition model between suppliers. In addition to these operational measures, we invested in the digitization of the service, always keeping the focus on quality. The highlights are self-service actions, customized menus and a more humanized experience with the IVR.

Regarding customer service, our initiatives have been structured to leverage customers' online experience, transform the customer care model and increase perceived quality in interactions. We continued to work on integrating the systems used in the operation, defining processes and business rules and internalizing operations considered fundamental for transforming the customer experience in all channels and points of contact.

Seeking to maintain our leadership position, we worked to expand digital channels and developed more self-service options, aiming to provide a unique and relevant multichannel experience for customers. Our customer care mobile app reached more than 40 million contacts in December 2017 and a growing number of unique users. We worked on the refinement of the assertiveness and scope of the Virtual Assistant Vivi, which today is already capable of answering more than 90% of the queries by means of artificial intelligence and interact with social medias like Tweeter and Facebook. We advanced in the humanization of our Customer Relationship Center's electronic service, in a personalized way and with intelligent dialogue, streamlining the understanding of the request. In this process, we were able to provide answers to customers through the electronic service at levels of 72% in certain segments, shortening the path through a more convenient experience.

In 2017, we consolidated the new model of hiring of call center attendants with a repeated incentive to good performance, based entirely on quality goals, which led to an improvement of our operational indicators. We perceived a reduction in the contact rate in all segments, increased availability of agents, and increased the autonomy of representatives of the call centers to solve the customers' requisitions in the first contact. All of these results, associated with the Customer Satisfaction Survey, demonstrate that we are on the right path, converting these interactions into a positive experience with the brand.

In 2018, Telefônica Brasil maintains the strategy of enriching content and increasing the functionalities available in each of the channels, seeking integration among them, so that a client can choose how to interact with us with a high-quality experience, regardless of which channel he or she selects. We will continue to accelerate the digitalization of the customer care, providing more agility, autonomy, standardization of experience in all channels and points of contact. The Company is totally focused in provide the best experience for the customer.

### **Technology**

In order to offer a greater variety of integrated services, we have incorporated a series of new technologies in our voice and data networks.

We remain focused on the evolution and convergence of the mobile and fixed networks based on All-IP IMS technology, encouraging technological advancement and offering new services to our customers. The voice network is being prepared to initiate migrations of mobile subscribers 2G and 3G to Voice over LTE, or VoLTE, as well as fixed subscribers to VoIP. In addition to convergence and modernization, we will also invest in network virtualization promoting better use of network resources.

The voice network has been modernized with the use of new generation technology that improves redundancy, reliability and capacity. In addition, we have already started the implementation of VoLTE technology that will allow us to offer voice services over LTE access instead of CS (Circuit Switch) Fallback, or CSFB, which we currently use. As a result, we expect a faster call completion comparing with CSFB. We expect to improve the voice communication experience, offering voice service with HD quality that is native for VoLTE technology. We also have already started to implement Voice over FTTH technology that will allow us to offer voice services over FTTH access instead of voice over copper currently used. As a benefit, we expect to have cost savings for equipment, lines, manpower and maintenance. We also expect to offer new voice services, in order for that to be possible, a new Core infrastructure has already been installed in Vivo networks: the IMS Core, an ALL-IP framework that uses the IP protocol as the main protocol for the network.

We have equipped the network to support traffic bursts of enterprise inbound and outbound call center services, such as contact center and outbound dialing, by developing and implementing high-capacity and scalability core elements. In 2018, in addition to convergence and modernization, we will also invest in network virtualization.

As more services migrate to IP, our IP backbone has become a strategic asset to support customer demands and increase revenues. The migration of sensitive and demanding services such as voice and television to IP has also increased the demand for higher quality broadband networks and is further augmented by growing products like cloud services and video on demand. At the same time, the expansion of fiber to customer homes and the launch of our 4G+ services (Carrier Aggregation) strongly increases bandwidth demands over the networks. As a result, three main drivers have surfaced as critical to our business: availability, performance and cost effectiveness.

To reach these goals, which may appear to conflict with each other, it is essential to optimize network resources and find synergy multipliers. The first step is to integrate Vivo's and GVT's IP Backbones, simplifying our network and avoiding redundant infrastructure. As we have done in the mobile and fixed integration, we have designed a robust architecture, using two distinct backbones to provide public and private services using multi-protocol networks infrastructures, to guarantee service reliability to our clients and the deployment has already begun in 2018.

Nonetheless, as more and more bandwidth is offered to customers, the need to bridge the gap between revenues and investment to cope with greater traffic becomes increasingly clear. Therefore, network simplification must evolve to a deeper level, unifying specialized routers, reducing network layers, bringing services and content nearer to customers and, ultimately, transforming the backbone into one multiservice network. The new design acknowledges service evolution, as voice, messages and circuits becomes data packets and reduces the need of growing capacity in multiple hops.

Those actions not only optimize investment in an aggressive traffic increase context but also lay the grounds to deliver the next step in data services quality. Even though bandwidth has been the main technical advantage for several years, latency will take over as the main broadband selling point. To reduce network latency means delivering more responsive services and obtaining higher customer satisfaction.

In order to achieve this result, from the IP point of view, service has to be decentralized and nearer the edge of the network, closer to customers. In 2016 and 2017, by greatly expanding the use of caching solutions throughout the network, we have made content locally available to our customers, not only reducing transport costs but also strongly improving user experience without increasing access investments. We believe that in the coming years, layer simplification could allow us to bring content even further to the edge, improving costs and quality at the same time.

We further optimized costs by sharing access networks with other Brazilian operators, in which IP backbones played a key role in connecting and transporting traffic among different operator's networks, reducing the need for mobile sites expansion.





Finally, as the Internet address numbers in Brazil were exhausted in 2014 and our own resources are reaching critical levels, we have seen strong growth in the next version of the IP protocol, the IPv6. Vivo has completed IPv6 project in 2017 and received the Jim Bound Award from the IPv6 Forum for surpassing 10% of its Internet Traffic in IPv6. In fact, 40% of the traffic is already running in the new protocol version and we are part of the top 15 companies in the world in IPv6 traffic volume, according to the specialized measurement site World IPv6 Launch (<http://www.worldipv6launch.org>). Not only this is important to guarantee full connectivity to our clients but also to support sales and keep expanding our customer base.

In projects related to Local Area Network (LAN), we provide local connectivity to all platforms and servers that provide telecommunications service, fixed or mobile. The Local Area Network works as access for all services to the data network by connecting them to the IP Backbone.

Since 2014, we have adopted the strategy of evolving Ethernet Standard on all sites to a Fabric structure, using the concepts of Top Of Rack - TOR and End Of Row - EOR according to port density. It is a more robust technology, more resistant to failures and cheaper, since the network equipment is decentralized, generating in this way an economy in structured cabling and consequently reduction of cooling, energy consumption and physical space. In 2017, we implemented this concept in 23 sites.

In 2016, we implemented the Cache solution to reduce bandwidth consumption on the IP backbone by locally storing content from partners such as Google, Netflix, Akamai, and Facebook. With this, we can optimize network resources, improve service quality and user experience. In 2017, the Cache framework was expanded in six more sites.

Since 2014, we saw a variety of targets and natures of attacks with regards to cyber security, with special attention to the mobile terminal, where we already offer a comprehensive suite of applications for mobile security. On the network side, besides tightening our perimeter security, we have been focused on automation. Periodic tasks such as analyzing attacks notifications, auditing firewalls rules and evaluating security elements performance have been the main areas subject to automation, allowing security professionals to focus on problems that are more complex. In 2017, we increased the traffic capacity to be detected and mitigated by the protection tools against attacks coming from inside and outside our network.

We offer the IPTV service through the FTTH network using the Open Platform, created to revolutionize the way that Telefonica delivers the IPTV service. This platform consists of Pay TV with video broadcasting offered through the IP protocol. It consists of several global partners, developing modules in partnership with Telefonica and connecting into the exiting Global Video Platform. Our local team customized the middleware for Set-Top-Box, creating one standard version which brings better time-to-market for new developments and product releases, as well as future convergence between IPTV and DTH platforms. Several components were integrated to create a whole new ecosystem for IPTV, such as the inclusion of Instant Channel Change (ICC), Retransmission and Applications providing a better user experience. Additional services, such as pay-per-view and VoD, are also available.

For the year of 2018, we will continue to expand all the services to other cities within Brazil as the FTTH network expands. Also other companies from Telefonica based in Latin America will have the opportunity to receive the developments made in Brazil to deliver the same service and features to their clients. Besides the expansion to other cities, new features will be incremented on the client for a better experience, such as Time Shift, Catch Up, PiP, 4K content and new Apps.

We also offer digital television service via satellite (DTH) to the subscribers that receive broadcast/PPV content through a Ku band antenna and standard Set Top Box (with Smart Card), also available with a Personal Video Record (PVR) service with 4K technology. The customer has additional services through IP protocol when connecting the Set-top-box into broadband service, offering VoD and interactive applications. After four years, we expect to use one

satellite and one Middleware solution consolidating in a single platform.

Our development plan contemplates the use of the most advanced technology available, focusing on integration with the internet and an increase in the number of multimedia transmission services, with an emphasis on DSL, FTTH (GPON), NGN, DWDM, ROADM and relays technologies of TV over IP protocol (IPTV), satellite (DTH), and the continuous evolution of TV services.

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We currently offer HSPA+ technology, commercially known as 3G Plus, across 100% of our WCDMA coverage, allowing customers that have compatible terminals to achieve up to three times more than traditional 3G rate. Since 2013, we offer the LTE system in spectrum (2600 MHz). At the end of 2017, 2,600 Brazilian cities had 4G availability.

Since 2015, we started to develop the network sharing in 4G with OI and TIM. At the end of 2017, 128 Brazilian cities had radio base stations shared, and in 292 cities we provided new 4G coverage with RAN Sharing using infrastructure from TIM or OI. In 2017, we also started to develop network sharing in 3G with Claro, and at the end of 2017, 158 Brazilian cities had radio base stations shared, and in 141 cities we provided new 3G coverage with RAN Sharing using infrastructure from Claro. The strategy of Radio Access Network Shared allow us to fulfill part of the ANATEL's requirements due the LTE spectrum acquisition.

Since 2016, we started to offer new frequencies to LTE (700MHz and 1800MHz) activating 4G+ services as well, with goal to improve the coverage, capacity and customer experience (4G+ permit to reach up to double of 4G throughput). At the end of 2017, we had 2,078 sites with LTE 700MHz and 4,189 sites with LTE 1800MHz.

### ***Fraud Detection and Prevention***

During 2017, we continued our work in combating the two main types of fraud, as follows:

- *Subscription fraud*: is a type of fraud that occurs when the issuance of one or more accesses are granted without the consent of the real “holder” of identification documents with the main objective of evading payment. We had a decrease of 69% in subscription fraud-related losses, from R\$37.9 million in 2016 to R\$11.7 million in 2017. The main cause of this decrease was the review of certain detection processes and improvement of the controls used in monitoring fraud events during the year allowed us to capture more fraudulent cases relatively to the expansion of our network.
- *Identity Fraud*: also known as “social engineering”, identity fraud takes place through call centers or dealers, where a caller who has access to information belonging to our existing clients reaches out to our call centers and makes unauthorized alterations and activations. We did not have any losses related to Identity Fraud for financial accounts of expenses, representing 100% of effectiveness in 2016. The main reason for this result was the identification of cases in a shorter period of time.

### **Operating Agreements**

#### ***Interconnection Agreements***

The terms of our interconnection agreements include provisions with respect to the number of connection points and traffic signals. See “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies.”

We believe that we have adequate interconnection agreements with fixed-line operators necessary to provide our services and that we have all the necessary interconnection agreements with long-distance carriers.

### ***Roaming Agreements***

We provide international GSM roaming in over 200 destinations worldwide by means of over 500 roaming agreements with local service providers.

### ***Network Sharing Agreement***

In 2014, Telefônica Brasil announced that a network sharing agreement with Nextel was signed to provide mobile services coverage (voice, data and SMS) through our 2G and 3G network to 67 area codes. The contract is a five-year term, with a minimum payment of R\$1.0 billion for the whole period as follows: (i) R\$44.3 million in the first year; (ii) R\$132.1 million in the second year; (iii) R\$237.1 million in the third year; (iv) R\$263.0 million in the fourth year and (v) R\$361.5 million in the fifth year. Terms and payments are subject to the fulfillment of the contractual obligations assumed by the parties.

ANATEL approved the agreement and the execution of the operation in March 2014. The network sharing has been fully operational since July 31, 2014, when the Parties executed the Notice of Network Full Availability.

In 2016, both parties decided to extend the agreement throughout the national territory. The extension was approved by CADE in July 2016 and by ANATEL in August 2016. ANATEL's approval was conditioned to the effective commercialization of SMP service in the locations subject to Nextel obligations. The agreement will be revised by the regulator in two years and could be terminated depending on the parties' compliance with related obligations. Nextel has appealed on the conditions mentioned above, which are currently under review.

In March 2015, Claro and Telefônica entered into a RAN Sharing agreement in order to provide telecommunication coverage in rural areas in Brazil, which was approved by CADE and ANATEL.

In December 2015, Telefônica, Oi and TIM entered into a RAN Sharing agreement in order to provide mobile services coverage (voice, data and SMS) through the 4G network and comply with coverage commitments assumed by the operators. The agreement was approved by CADE and ANATEL.

In August 2016, ANATEL approved the agreement between Telefônica and TIM to share electronic equipment and mobile sites for the fulfilment of the obligations in order to provide telecommunication coverage in rural areas.

The approval of the aforementioned agreements, however, does not exempt the providers from fulfilling their obligations, nor from the coverage of the entire area. In the case such agreements are terminated before the expected deadline, each provider must meet its coverage commitments with its own network, under the penalty of extinction of the use of radio frequencies' authorizations.

### **Competition**

Competition in the fixed and mobile markets continued to be intense in 2017. Faced with the high demand for connectivity, Brazilian telecoms have focused on modernization and innovation as levers to remain competitive in the market. The leading companies have been directing efforts and investments towards the digital transformation of business operations, aiming to improve the balance between customer growth and loyalty, revenue growth and margins.

The Brazilian consumer market is increasingly knowledgeable and demanding, expecting not only the best service delivery, as well the best cost-benefit. Therefore, operators have prioritized the expansion and digitalization of company-customer interactions.

In the mobile market, we continued to lead in market share, with a 31.7% share according to information from ANATEL as of December 2017. This year, the competition remained aggressive in 4G network coverage and subscribers growth.

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We lead the mobile market in 13 states: Acre, Amazonas, Amapá, Bahia, Espírito Santo, Minas Gerais, Mato Grosso, Mato Grosso do Sul, Pará, Roraima, Rio Grande do Sul, Sergipe and São Paulo. TIM, a Brazilian telephone company and subsidiary of Telecom Italia lead the mobile market in six states: Alagoas, Ceará, Pernambuco, Paraná, Rio Grande do Norte and Santa Catarina. Oi leads mobile services in two states: Maranhão and Paraíba. Claro Brasil or Claro is a mobile operator controlled by the Mexican company America Móvil Group, and leads mobile service in six states: Distrito Federal, Goiás, Piauí, Rio de Janeiro, Rondônia and Tocantins (according to ANATEL, as of December 2017).

On the fixed front, the wireline and pay TV services reported net disconnections, according to Anatel. In broadband, market continued to expand mainly in ultra-broadband and fiber accesses. Our main competitors in fixed telecommunications services are Claro Brasil (which includes NET, Claro and Embratel) and Oi, which is stronger in the fixed services outside the State of São Paulo. TIM (subsidiary of Telecom Italia) has been offering its fixed broadband network 'TIM Live' in five cities. SKY, currently controlled by AT&T (expected sale to the Time Warner group), has pay TV and broadband services (LTE TDD 4G). In addition, we have competition from many regional service providers throughout the country.

### **Regulation of the Brazilian Telecommunications Industry**

Our business, including the services we provide and the rates we charge, is materially affected by comprehensive regulation under the General Telecommunications Law and various administrative rules thereunder. We operate under a concession agreement that authorizes us to provide specified services and subjects us to certain obligations, according to the General Universal Service Targets Plan (*Plano Geral de Metas de Universalização – PGMU*), and the General Quality Targets Plan (*Plano Geral de Metas de Qualidade – PGMQ*).

ANATEL is the regulatory agency established by the General Telecommunications Law, and is administratively and financially independent from the Brazilian government. Any proposed regulation by ANATEL is subject to a period of public comment and, occasionally, public hearings, and its decisions may be challenged in Brazilian courts.

### ***Concessions and Authorizations***

In accordance with the General Telecommunications Law, concessions are licenses to provide telecommunications services granted under the public regime, while authorizations are licenses to provide telecommunications services granted under the private regime.

Companies that provide services under the public regime, known as the concessionaires, are subject to certain obligations as to quality of service, continuity of service, universality of service, network expansion and modernization.

A concession may only be granted pursuant to a public bidding process. As a result, regulatory provisions are included in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. In addition, ANATEL is authorized to direct and control the provision of services, to apply penalties and to declare the expiration of the concession and the return of the reversible assets from the concessionaire to the government authority upon termination of the concession. Another distinctive feature of public concessions is the right of the concessionaire to maintain economic and financial standards, which are calculated based on the rules set forth in our concession agreement and was designed based on a price cap model. The concession is granted for a fixed period of time and is generally renewable only once.

The companies that operate concessions under the public regime are Telefônica Brasil, Oi, Algar, Sercomtel and Claro (Claro for domestic and international long distance service). These companies provide fixed-line telecommunications

services in Brazil that include local, intraregional, interregional and international long-distance services. All other telecommunications service providers, including the other companies authorized to provide fixed-line services in our concession region, operate pursuant to authorizations under the private regime.

Companies that provide services under the private regime, known as authorized companies, are not subject to the same requirements regarding continuity or universality of service; however, they may be subject to certain network expansion and quality of service requirements that are obligations set forth in their authorizations. Authorizations are granted for an indeterminate period of time. Under an authorization, the government does not guarantee to the authorized company an economic-financial equilibrium, as is the case under concessions.

An authorization is a license granted by ANATEL under the private regime, which may or may not be granted pursuant to a public bidding process, to the extent that the authorized company complies with the objective and subjective conditions deemed necessary for the rendering of the relevant type of telecommunication service in the private regime.

The General Telecommunications Law delegates to ANATEL the power to authorize private regime companies to provide local and intraregional long-distance services in each of the three fixed-line regions and to provide intraregional, interregional and international long-distance services throughout Brazil. ANATEL has already granted authorizations for companies to operate in Region III, our concession region. ANATEL has also granted other authorizations for companies to operate in other fixed-line regions and authorizations to provide intraregional, interregional and international long-distance services throughout Brazil competing with Claro, which operates under a long-distance fixed-line concession.

Concessionaires, including us, can also offer other telecommunications services in the private regime, which primarily include data transmission services, mobile services and Pay TV.

#### *Obligations of Telecommunications Companies*

Pursuant to the concessions and authorizations, we and other telecommunications service providers are subject to obligations concerning quality of service, network expansion and modernization. Telecommunication concessionaires are also subject to a set of special restrictions regarding the services they may offer, which are listed in the General Grants Plan (*Plano Geral de Outorgas – PGO*), and special obligations regarding network expansion and modernization contained in the PGMQ.

In 2001, a presidential decree published with the PGO increased the flexibility of telecommunications provider groups as fixed line concessionaires by allowing such providers to provide services in up to two of the three regions established by the PGO. Before this decree, telecommunications provider groups holding fixed-line concessions could offer fixed line services in only one region under the public regime.

In 2008, another presidential decree allowed concessionaires to operate outside their concession areas and unified sectors 31, 32 and 34. Thus, region III was comprised of sectors 31 and 33.

In December 2016, ANATEL held a public consultation relating to the new rules of the PGO containing an exclusive chapter aimed at verifying the migration of fixed telephony concessions for authorizations, in accordance with the new legal framework discussed in the Congress. The new regulation should be subject to extensive discussion in 2017 and its effects should only come after the approval of the new framework.

Any breach of telecommunications legislation or of any obligation set forth in concessions and authorizations may result in a fine of up to R\$50 million.

Our main operations are regulated as follows:



- Fixed line voice services (local and long distance) under concession agreement in the state of São Paulo and under authorization agreement in the rest of the Brazilian territory. The concession was granted in 1998 by the Brazilian Government and renewed in December 2005 for 20 more years. It authorizes us to provide fixed-line telecommunications services in the state of São Paulo, except for a small area (Sector 33) and to place and manage public telephones in our concession area. We also provide fixed-wireless services throughout our concession area, for which the authorization was granted in 2001 by the Brazilian Government for the whole Brazilian territory;

- Mobile voice and broadband services, in all 26 states and the Federal District, under the personal mobile service (*Serviço Móvel Pessoal*), or SMP authorizations.
- Multimedia communication services, such as audio, data, voice and other sounds, images, texts and other information throughout Brazil. We operate under a nationwide SCM authorization, valid for an indefinite term;
- Pay TV service, throughout all regions of Brazil under the conditioned public service (*Serviço de Acesso Condicionado*), or SeAC authorization. We operate a SeAC authorization, which is valid for indefinite term; and
- Wholesale services, such as interconnection, governed by the interconnection agreements discussed under “—Operating Agreements—Interconnection Agreements,” industrial dedicated line (*Exploração Industrial de Linha Dedicada – EILD*), which are regulated by ANATEL Resolution No. 590, dated May 15, 2012 and Mobile Virtual Network Operator, or MVNO agreements described under “—Operating Agreements—MVNO Agreements.”

We set forth below details of the concession, authorizations, licenses and regulations that regulate our operations.

#### *Quality Regulations in Brazil*

The quality of service on Fixed Broadband (SCM), Mobile Telephony (SMP), Fixed Telephony (STFC) and Pay TV (STVA) is monitored by ANATEL through the operational and network performance indicators for telecom operators. Each indicator has an associated target, which must be achieved by the service provider on a monthly basis in each geographic area that it operates.

The indicators, as well as their respective methods of collection, calculation and other quality requirements, are defined in specific regulations published by ANATEL. Fixed broadband, mobile telephony, fixed telephony and Pay TV indicators are established in the Quality Management Regulations, respectively, Resolutions 574/2011, 575/2011, 605/2012 and 411/2005.

For cases in which there are indications of performance or conduct other than those established in the regulations, Anatel establishes a noncompliance process called Procedure for Determination of Non-Compliance to Obligations (*Procedimento de Apuração de Descumprimento de Obrigações – PADO*) in detriment to the provider. When applicable, the sanctions may include warning, fine, temporary suspension, obligation demand, expiration or declaration of unworthiness.

With the objective of correcting deficiencies that may be found in the quality of service provision, ANATEL may adopt additional measures determining the execution of a plan of action for correcting conduct or improving the performance of providers, among other reasons.

On November 2017, the agency published a new public consultation on the Proposal for a new Regulation on the Quality of Telecommunications Services, which will be receiving contributions until March 2018.

#### ***Fixed Services***

##### *Our Concession Agreement*

We are authorized to provide fixed line services to render local and domestic long-distance calls originating in Region III, which comprises the state of São Paulo, except for Sector 33, established in the PGO.

The current concession agreement that is valid through December 31, 2025 was reviewed in 2006 and 2011. According to Resolution Number 678/2017 a new revision must be made on December 31, 2020. Until then, the 2011 contract remains valid.

Other regulations have been adopted to revise certain aspects of our concession. On June 30, 2011, ANATEL determined the new basis of calculation of the biannual concession fees. Every two years, during the new 20-year period of our concession, we are required to pay a renewal fee, which amounts to 2% of the total revenue in the previous year, calculated based on the revenues and social contribution of fixed line basic and alternative plans. The most recent payment of this biennial fee was made on April 28, 2017, based on 2016 revenue. The next payment is therefore scheduled for 2019 based on 2018 revenue. See Note 1 to our Consolidated Financial Statements.

In addition, the Brazilian government published Decree No. 7,512 which proposed the General Plan for the Universalization of Fixed Telephone Services under the Public Regime (*Plano Geral de Metas para a Universalização do Serviço Telefônico Fixo Comutado Prestado no Regime Público – PGMU III*). It set forth new targets for public pay phones (*Telefone de Uso Público*) availability in rural and low-income areas and targets related to low-income fixed line services (*Acesso Individual Classe Especial – AICE*).

On June 27, 2014, ANATEL held a public consultation for the PGMU. Since there was no mutual agreement between ANATEL and the operators for the signature of the 2015 concession agreement contracts, the new version of the PGMU was also delayed. At the time of release of this report, the presidential decree concerning the expected PGMU revision related to 2015 (PGMU IV) has not been published.

According to our concession agreements, all assets owned by us which are indispensable to the provision of the services described in such agreements are considered “reversible assets”. As per ANATEL’s recent interpretation of the current regulation these assets will be automatically returned to ANATEL upon the expiration of the concession agreements, in accordance to the regulation in force at that time, and would not be available to creditors in the event of insolvency, bankruptcy or similar events. With discussions relating to a new regulatory framework under way, this rule could no longer exist in light of the possibility of transforming concessions into authorizations.

On April 8, 2008, we entered into an amendment to the concession agreement to substitute the obligation to install telecommunications service posts with an obligation to roll out broadband network infrastructure throughout the municipalities serviced by such concessionaires. This amendment could be extended with the approval of the counterparties of the new regulatory framework.

On October 23, 2012, ANATEL published Resolution No. 598 addressing the criteria and procedures for the execution and control of obligations related to the universalization of services. The resolution sets deadlines to meet access requests, sets targets for the expansion of the public telephone plant, establishes a list of agencies that can request access to their location, reviews the deadline for proposing service plans and establishes obligations disclosure.

Currently, the Brazilian Congress is discussing a new regulatory framework for telecommunications that is expected to affect our concession agreements. The new regulatory framework contains several changes to the existing regime, which primarily include, among other things, the immediate replacement of the current concession-based regime for an authorization-based regime, changes in the standards for the use of frequencies and Brazilian orbital position, as well as terms relating to the transfer of reversible assets to telecommunication companies in exchange for investments in the fixed broadband infrastructure by such companies.

For information about regulations affecting rates we are able to charge under our concession agreements, see

“—Rates, Taxes and Billing.”

*Obligations and Restrictions on concessionaires to provide fixed line service under the public regime*

We and the other concessionaires are subject to the General Universal Service Targets Plan (*Plano Geral de Metas de Universalização – PGMU*), which requires that concessionaires undertake certain network expansion activities with respect to fixed-line services. The timing for network expansion is revised by ANATEL from time to time. If any given concessionaire does not fulfill its obligations under the PGMU, ANATEL may impose various monetary penalties and such concessionaire may lose its license if ANATEL determines that it will be unable to provide basic services under the Plan.

Concessionaires are also subject to certain restrictions on alliances, joint ventures, mergers and acquisitions, including:

- a prohibition on holding more than 20% of the voting shares of the facto control in any other concessionaire, according to ANATEL Resolution No. 101; and
- a prohibition on concessionaires to provide fixed-line telecommunications services through related companies.

*Fixed line service under the private regime*

In 2002, we began providing local and interregional services in Regions I and II and Sector 33 of Region III, and international long-distance services in Regions I, II and III, which constitute regions in Brazil that are outside of our public regime concession area.

*Public Telephone Regulation*

On June 30, 2014, ANATEL published the new Public Telephone Regulation. Among the new rules, it opened up the possibility of advertising on the public telephones and the possibility of alternative payment modalities.

In 2016, ANATEL extinguished the Standard for the Certification and Homologation of the Inductive Card. Instead, a list of Technical Requirements for Telecommunications Products was issued.

*Mobile Services*

In October 2016, ANATEL approved new spectrum use regulations, which facilitates access to radio frequencies and generates efficiency in its use, due to the simplification of procedures and necessary documentation. The regulation also alters spectrum pricing (for non-bidding grants), rules for extending use authorization and new rules for frequency use on a secondary basis prior to primary use.

*Mobile Service Licenses (SMP)*

Our authorizations to provide mobile services throughout Brazil consist of two licenses—one to provide mobile telecommunications services, and another to use the respective frequency spectrum for a period of 15 years. The frequency license is renewable for an additional 15-year period upon payment of 2% of net operating revenues over usage charges in the region described above, every two years for the duration of the extension period. In the 15th year, the Company will pay 1% of the aforementioned amount.

Our SMP authorizations include the right to provide mobile services for an unlimited period of time but restrict the right to use the spectrum according to the schedules listed in the radiofrequencies authorizations. The table below sets forth our current SMP authorizations, their locations, band and spectrums, date of issuance or renewal and date of expiration:

<b>Authorization</b>	<b>800 MHz</b>	<b>900 MHz</b>	<b>1800 MHz</b>	<b>1900 MHz</b>	<b>2100 MHz</b>
Rio de Janeiro	Band A November 2020	Extension 1 April 2023	Extensions 9&10 April 2023	—	Bands J, L April 2023
Espírito Santo	Band A November 2023	Extension 1 April 2023	Extensions 9&10 April 2023	—	Bands J, L April 2023
Amazonas, Roraima, Amapá, Pará and Maranhão	Band B November 2028	Extension 2 April 2023	Extensions 7, 9&10 April 2023	—	Band J April 2023
Minas Gerais (except for “Triângulo Mineiro” region)	Band A April 2023	Extension 2 April 2023	Extensions 11&14 April 2023	—	Bands J, L April 2023
Minas Gerais (“Triângulo Mineiro” region)	—	Band E April 2020	Band E April 2020	—	Bands J, L April 2023
Bahia	Band A June 2023	Extension 1 April 2023	Extensions 9&10 April 2023	—	Bands J, L April 2023
Sergipe	Band A December 2023	Extension 1 April 2023	Extensions 9&10 April 2023	—	Bands J, L April 2023
Alagoas, Ceará, Paraíba, Pernambuco, Piauí and Rio Grande do Norte	—	—	Band E April 2023 Extensions 9&10 April 2023	Band L December 2022	Band J April 2023
Paraná (except for Londrina and Tamarana) and Santa Catarina	Band B April 2028	Extension 1 April 2023	Band M April 2023	—	Bands J, L April 2023
Paraná - Londrina and Tamarana	Band B April 2028	—	Band M April 2023 Extension 10 April 2023	—	Band J April 2023
Rio Grande do Sul (except for Pelotas, Morro Redondo, Capão do Leão and Turuçu)	Band A December 2022	Extension 1 April 2023	Band M April 2023	—	Bands J, L April 2023
Rio Grande do Sul (Pelotas, Morro Redondo, Capão do Leão and Turuçu)	—	—	Bands D&M April 2023	Band L December 2022	Band J April 2023
Federal District	Band A July 2021	Extension 1 April 2023	Band M April 2023	—	Bands J, L April 2023
Goiás and Tocantins	Band A October 2023	Extension 1 April 2023	Band M April 2023	—	Bands J, L April 2023

<b>Authorization</b>	<b>800 MHz</b>	<b>900 MHz</b>	<b>1800 MHz</b>	<b>1900 MHz</b>	<b>2100 MHz</b>
Goiás (Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão)	—	—	Extensions 7 to 10 April 2023	Band L December 2022	Band J April 2023
Mato Grosso	Band A March 2024	Extension 1 April 2023	Band M April 2023	—	Bands J, L April 2023
Mato Grosso do Sul (except for Paranaíba)	Band A September 2024	Extension 1 April 2023	Band M April 2023	—	Bands J, L April 2023
Mato Grosso do Sul (Paranaíba)	—	—	Extensions 7, 9&10 April 2023	Band L December 2022	Band J April 2023
Rondônia	Band A July 2024	Extension 1 April 2023	Band M - April/23	—	Bands J, L April 2023
Acre	Band A July 2024	Extension 1 April 2023	Band M April 2023	—	Bands J, L April 2023
São Paulo	Band A August 2023	—	Extensions 9&10 April 2023	—	Bands J, L April 2023
São Paulo (Ribeirão Preto, Guatapará and Bonfim Paulista)	Band A January 2024	—	Extensions 5, 9&10 April 2023	—	Bands J, L April 2023
São Paulo (Altinópolis, Aramina, Batatais, Brodosqui, Buritizal, Cajuru, Cássia dos Coqueiros, Colômbia, Franca, Guaíra, Guará, Ipuã, Ituverava, Jardinópolis, Miguelópolis, Morro Agudo, Nuporanga, Orlândia, Ribeirão Corrente, Sales de Oliveira, Santa Cruz da Esperança, Santo Antônio da Alegria and São Joaquim da Barra)	—	—	Extensions 9&10 April 2023	Band L December 2022	Band J April 2023

In 2013, we changed the terms of our authorization regarding Band “L” (1.9 GHz) in certain locations, adapting their blocks of frequencies to 2.1 GHz and aligning them with the band “J” (3G) which provides a more efficient use of the spectrum. The alignment has not occurred in the following areas: Northeast, with the exception of Bahia and Sergipe; Pelotas, Morro Redondo, Capão do Leão and Turuçu, in Rio Grande do Sul; Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in Goiás; Altinópolis, Aramina, Batatais, Brodosqui, Buritizal, Cajuru, Cássia dos Coqueiros, Colômbia, Franca, Guaíra, Guará, Ipuã, Ituverava, Jardinópolis, Miguelópolis, Morro Agudo, Nuporanga, Orlândia, Ribeirão Corrente, Sales de Oliveira, Santa Cruz da Esperança, Santo Antônio da Alegria and São Joaquim da Barra in São Paulo; and Paranaíba in Mato Grosso do Sul. This change is foreseen in the bidding document No 001/2007. We do not have band “L” in the states of Amazonas, Roraima, Amapá, Pará and Maranhão and in the cities of Londrina and Tamarana, Paraná.



In 2012, Telefonica acquired 40MHz on the 2.5GHz to 2.69GHz frequencies for the amount of R\$ 1.05 billion. To complete the coverage requirements we had the obligation of implementing 4G coverage in 1,094 cities by December 31, 2017. However, we made 4G services available in over 2,600 municipalities by that date. To achieve these goals, Telefonica has deployed and continues to deploy 4G coverage in such municipalities and serves its customers through the use of its own network or by agreement of RAN-sharing approved by ANATEL. Verification of compliance with these targets will be controlled by the agency.

The remaining coverage commitments in cities with less than 30,000 inhabitants may be fulfilled with 3G or superior technology operating in any frequency band, respecting the following schedule:

- by December 31, 2018: another 117 cities; and
- by December 31, 2019: 156 more cities.

To complete the 450 MHz frequency requirements we had the obligation to meet voice and data demand in remote rural areas. As a commitment, we are required to provide infrastructure and service operating in any frequency band in rural areas in the states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, Sergipe, and countryside of São Paulo, for a total of 2,556 municipalities. In these areas, we are also required to provide free broadband to schools located in rural areas.

In December 2015, ANATEL and CADE approved the agreement between Telefônica Brasil, TIM and Oi for the construction, implementation and mutual assignment of network tools for supporting the Personal Mobile Service (voice and broadband) in the 2.5 GHz band, in order to make compliance with the scope of commitments between 2015 and 2017 and the expansion of 4G coverage, considering municipalities with a population over 30 thousand inhabitants. The operation involves the search for more efficiency of resources application of rationality and presenting a solution to the urban planning and environmental restrictions on the deployment of the new radio base stations (cell sites).

Regarding the 700MHz spectrum, ANATEL has allocated the band for the provision of fixed, mobile and broadband services. On September 30, 2014 we acquired 20 MHz (10+10 MHz) with nationwide coverage, for R\$1.92 billion, at the minimum price, plus R\$904 million for the band cleaning (migration of broadcasters that currently occupy the band and interference management). According to the auction rules, the winning bidders is responsible for financing and managing the band cleaning process.

In January 2016, the Ministry of Communications (now Ministry of Science, Technology, Innovations and Communications) published a new schedule for the Analog TV Switch Off, postponing the usage of the 700 MHz frequency for telecommunications in some major Brazilian cities. According to the schedule and its further revisions, 11 cities had its Analog TV services turned off in 2016, including Rio Verde (GO) and Brasília (DF). In 2017 the switch off was completed in over 404 cities. In 2018 the analog switch off is expected to be completed in 1124 cities distributed in 24 states. The switch off for the remaining 4244 cities is set for 2023, though the activation of LTE in these cities does not require the switch off to be completed.

In December 2015, ANATEL auctioned the remaining spectrum lots in the 1800 MHz, 1900 MHz and 2500 MHz bands, from which Telefônica acquired seven lots of 2.5 GHz frequency band offering a total of R\$ 185.4 million. These lots are associated to six different States, in the capital cities of the States of São Paulo, Rio de Janeiro, Porto Alegre, Florianópolis, and Palmas, and one countryside city of the State of Mato Grosso do Sul. Such frequencies are already being used for the provision of mobile broadband service on 4G.

### ***Multimedia Communication Services (SCM)***

Our multimedia services include broadband in several technologies, including fiber UBB services.

*Obligation to provide fixed broadband access*

We have assumed in the past the obligation to provide free Internet access to public schools in the area comprising in our concession area during the term of the concession agreement (until 2025). The number of schools for which we should provide broadband is determined by the school census provided by the National Education Ministry, which is published on a yearly basis or sometimes in longer intervals. Our obligation targets are adjusted according to the latest census released.

## ***Pay TV services***

### ***Regulations for Pay TV Services– SeAC***

We are authorized to provide Pay TV Services – SeAC. On September 12, 2011, the Brazilian Congress adopted Law 12,485/2011 as a result of Bill 116, which establishes a new legal framework for audiovisual communication with restricted access. This law opens the Pay TV market by enabling telecom operators to offer audiovisual content to subscribers through their networks, creating a new service called Pay TV Services (*Serviço de Acesso Condicionado - SeAC*). The absence of restrictions on foreign capital to be invested in Pay TV providers, as well as the elimination of restrictions for the provision of other telecommunications services through fixed line concession, allow us to provide Pay TV services, as well as other telecommunication services previously limited under the General Telecommunications Law.

Pursuant to Law 12,485/2011, the Pay TV service has replaced current cable subscription TV services, subscription TV, MMDS and DTH, giving power to ANATEL to regulate the Pay TV service. As a result of this law, ANATEL introduced in December 2011 the proposed regulations for Pay TV services through Public Consultation No. 65/2011, including license grants, installation and licensing of stations and mandatory distribution programming channels. The Public Consultation was finalized on February 2, 2012 and resulted in Resolution No. 581, issued by ANATEL on March 28, 2012, as well as the new Authorization Terms of the SeAC.

Law No. 12,485/2011 also established an annual payment to Condecine (*Contribuição para o Desenvolvimento da Indústria Cinematográfica*) to be made by providers of telecommunication services and amended Law No. 5,070/1966 by revising the amount due as Inspection Fee (*Taxa de Fiscalização de Funcionamento*) for telecommunication stations from 45% to 33% of the Installation Fee (*Taxa de Fiscalização de Instalação*). The amount due to Condecine is approximately 12% of the Installation Fee for telecommunication services and must be paid by March 31 every year.

As a result of Law No. 12,485/2011, the National Cinema Agency (*Agência Nacional do Cinema – ANCINE*) issued one public consultation by the end of 2011 and one public consultation in 2012 to regulate the registration of economic agents. In 2013, we had our licenses adapted to the new regulation and was recognized as an economic agent by ANCINE. In 2014, ANCINE recognized Telefônica Brasil S.A. as a Pay TV content packer.

In March 2016, ANATEL published a Public Consultation to change the regulation for Pay TV access services (SeAC). The proposal brought new rules for the isonomic treatment of open channels, transfer of grants, for the transfer of control between pay-TV companies, and the obligation to load channel accessibility resources, among other aspects. The new regulation is still under discussion within ANATEL.

### ***Interconnection Fees***

In accordance with ANATEL regulations, we must charge fees to the other telecommunications service providers based on the following:

- Fee for the use of our local fixed service network (TU-RL) - we charge local service providers an interconnection fee for every minute used in connection with a call that either originates or terminates within our local network, with the exception of calls between other providers of local fixed service, for which a fee is not charged;
- Fee for the use of our fixed service long-distance network (TU-RIU) - we charge long distance service providers an interconnection fee on a per-minute basis only when the interconnection access to our long-distance network is in use;

- Fee for the use of mobile network (MTR) – we charge mobile service providers an interconnection fee on a per-minute basis only when the interconnection access to our mobile network is in use;

- Fee for the use of leased lines by another service provider (EILD). We also lease transmission lines, certain infrastructure and other equipment to other providers of telecommunications services.

*Fixed Service*

In July 2005, ANATEL published new rules regarding interconnection. The main changes are: (i) an obligation to have a public offering of interconnection for all services, besides interconnections fees between providers of fixed and mobile telephone services; (ii) an offer of interconnections for Internet backbone providers; (iii) establishment of criteria for the treatment of fraudulent calls; and (iv) reduction of service times for interconnection requests.

In 2006, we completed the implementation of the interconnection with the mobile service providers in regions with heavier traffic, assuring the proper billing for such calls. This movement reduced the interconnection costs.

In 2007, ANATEL published a new version of Fixed Network Compensation Regulation that changed the rules to determine the interconnection fees. Local and long-distance rates that were set at all times became variable according to the rules of public service tariffs. A 20% increase was applied to tariffs of mobile service operators without significant market power in their regions.

On May 7, 2012, Resolution No. 588/12 was published determining the following:

- A maximum of two minutes of interconnection should be paid for the use of the local network on reduced hours;
- The reduction of interconnection fees from domestic and international long distance calls by 30% of the value of the local fixed service network interconnection fee (TU-RL) and the reduction of 25% and 20% by December 2012 of the value of the long distance network interconnection tariffs (TU-RIU);
- The remuneration between networks will not occur until this traffic imbalance is greater than 75% compared to 25%; and
- The partial Bill & Keep by December 31, 2013 and full Bill & Keep by December 31, 2014.

On July 1, 2014, ANATEL established gradual decreases in fixed service network interconnection fees (TU-RL), based on a cost model for the years 2016, 2017, 2018 and 2019, as described under “Item 3. Key Information—D. Risk Factors—Risks Relating to the Brazilian Telecommunications Industry and Us—Our results of operations may be negatively affected by the application of the Fixed Commuted Telephone Service (Serviço de Telefonia Fixa Comutada – STFC) rules relating to fixed telephone service and the Personal Mobile Service (Serviço Móvel Pessoal – SMP), rules relating to mobile services.”

In December 2016, ANATEL held a public consultation to discuss a new interconnection regulation (RGI). The new document aims to solve the large amount of disputes in the agreements for voice and data traffic among companies. ANATEL has proposed that in cases of default the cut in the provision of interconnection could be done without the regulator’s authorization. In addition, the new document aims to establish a list of prohibited practices in interconnection relationships and to make the interconnection technology neutral. The new rules should be published during 2018.

*Mobile service*

In November 2009, ANATEL unified the licenses of all mobile operators, resulting in the consolidation of interconnection fees, reducing the number of fees for the use of mobile network from 2 to 1.

On December 2, 2013, Act no. 7,272 was published, establishing the MTR reference values for providers determined to be a Significant Market Power (PMS), which became effective on February 24, 2014. On August 28, 2014, Act no. 7,310 replaced the reference values previously set out in Act no. 7,272.

On July 1, 2014, ANATEL established gradual decreases in mobile interconnection fees (MTR), based on a cost model for the years 2016, 2017, 2018 and 2019, as described in “Item 3. Key Information—D. Risk Factors—Risks Relating to the Brazilian Telecommunications Industry and Us—Our results of operations may be negatively affected by the application of the Fixed Commuted Telephone Service (Serviço de Telefonia Fixa Comutada – STFC) rules relating to fixed telephone service and the Personal Mobile Service (Serviço Móvel Pessoal – SMP) rules relating to mobile services.”

In addition, the General Competition Plan (“*Plano Geral de Metas de Competição* – PGMC) determined that the in the relationship among PMS and non-PMS providers in the mobile network, the interconnection fee should be paid only when the traffic out of a network in a given direction is greater than 80% of the total traffic exchanged until February 23, 2015; and 60% of the total traffic exchanged from February 24, 2015 to February 23, 2016. Since February 24, 2016, the MTR is owed to the mobile service provider when its network is used to originate or terminate calls (full billing).

In February 2015, after promoting a Public Consultation, ANATEL modified the rules regarding the interconnection fee to be paid of the outbound traffic:

- Up to February 23, 2015: 80% / 20%
- From February 24, 2015 to February 23, 2016: 75% / 25%
- From February 24, 2016 to February 23, 2017: 65% / 35%
- From February 24, 2017 to February 23, 2018: 55% / 45%
- From February 24, 2018 to February 23, 2019: 50% / 50%
- From February 24, 2019 onwards: Full Billing.

Since this change, TIM and Claro have filed a lawsuit to suspend the modification of the rules concerning the tariff reduction on the fixed-mobile introduced by Resolution 649. This lawsuit remains under way.

#### *TU-RL and TU-RIU*

On May 18, 2014, the proposed standards were approved for setting maximum values of fixed interconnection fees and for the values of mobile interconnection, based on Cost Models. In addition, values for fixed and mobile interconnection were published through the acts: No. 6210 for TU-RL and TU-RIU and No. 6211 for MTR.

For fixed and mobile termination fees, ANATEL’s decision established values for 2018 based on a bottom-up cost model. For 2016 and 2017 intermediate values were adopted.

#### *EILD*

On May 18, 2014, ANATEL approved the proposed standard for setting maximum values of Industrial Dedicated Line (EILD), based on Cost Models. Values for EILD were published through Act No. 6212, which contains a single reference table which is valid from 2016 until 2020. In addition, the general competition plan requires companies with significant market power to present a public offer every six months informing standard commercial conditions, which is subject to approval by ANATEL.

*Mobile Virtual Network Operator (MVNO)*

In 2001, ANATEL approved rules for companies to be licensed as MVNOs. In 2016, ANATEL authorized MVNO companies to be affiliates of other certain network operators, and for that reason we have signed agreements with companies authorized to operate as an MVNO in Brazil.

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### ***Internet and Related Services in Brazil***

In Brazil, Internet service providers, or ISPs, are deemed to be suppliers of value-added services and not telecommunications service providers. ANATEL requires SCM operators to act as carriers of third-party internet service providers.

#### ***Exemptions for telecommunications infrastructure***

In connection with the national plan entitled “*Plano Brasil Maior*”, instituted to promote the Brazilian technology industry and foreign trade, the Brazilian Government established the special tax regime for the taxation of national broadband plans (*Regime Especial de Tributação para o Plano Nacional de Banda Larga – RePNBL*). This regime provides tax exemptions for telecommunications companies for broadband network expansions.

Another initiative set forth by “*Plano Brasil Maior*” and approved by the government on May 5, 2014, was the establishment of exemptions for machine-to-machine services. The initiative reductions on the two taxation rates that compose the Telecommunications Inspections Fund (FISTEL). The Installation Inspection Rate (TFI), which is charged for each enabled chipset, decreased from R\$26.83 in 2013 to R\$5.68 in 2014, whereas the Operations Inspection Rate (TFF), paid every year for each chipset held by a Brazilian operator, decreased from R\$12.40 in 2013 to R\$1.89 in 2014.

On January 14, 2015, the Ministry of Communications published a decree that reduces national technology requirement in the aforementioned RePNBL. Some requirements were reviewed in mobile and electrical networks in order to accelerate projects and attract more investments.

The deadline for submission of projects for the RePNBL program was June 30, 2015. A total of 1,167 projects were approved, amounting to investments in the order of R\$15.1 billion and reaching 3,699 cities in all Brazilian states. We had 143 projects authorized, totaling an amount of approximately R\$4.3 billion in investments.

#### ***Civil Rights Framework for the Internet***

On April 23, 2014, at the opening of NetMundial, former President Dilma Rousseff approved the Civil Rights Framework for the Internet (“*Marco Civil da Internet*”), which was enacted as Law 12,965/2014. The act adopts strict Net Neutrality rules that guarantees equality of treatment for data traffic in the network and preserves the business model of Brazilian broadband offered in packages with different speeds. After three public consultations released by CGI.br (the Brazilian Internet Steering Committee), the Ministry of Justice and ANATEL, the Brazilian government published Decree 8,711/2016, which regulates the law. It establishes regulation for Net Neutrality and mechanisms to protect the data stored by service and application providers, as well as determining the circumstances in which data can be obtained by the public administration.

#### ***Personal Data Protection***

In June 2016, the Brazilian House of Representatives put into consultation a draft of law regarding the Personal Data Protection. The original text of this law is based on the European Union’s Directives on Data Protection, and as such, imposes restrictive rules on the express consent to process personal data, international data transfer, processing of sensitive data, among others. The proposed legislation is still under discussion within the House of Representatives.

#### ***Resolutions Published***

A series of new regulations, published by ANATEL as well as other regulatory bodies in Brazil, became effective in 2017. The most relevant among these regulations were:

- Resolution No. 674: Approves the regulation on channels and conditions of use of radio frequencies in the bands of 148 MHz to 174MHz.

- Resolution No. 676: Limits the use of radio frequency bands from 18.1 GHz to 18.6 GHz and from 27.9 GHz to 28.4 GHz to satellite networks from the Fixed-Satellite Service.
- Resolution No. 678: Approves changes in the Concession Contracts for the provision of Fixed Commuted Telephone Service in the modes of local service, national and international long distance.
- Resolution No. 679: Approves the Numbering Regulation for Telecommunications Networks, revokes the Numbering Regulation for the Identification of Personal Mobile Service (SMP) Accesses, Interfaces and Elements of Networks and provides change to the Regulation of the Personal Mobile Service (SMP).
- Resolution No. 680: Approves the Regulation on Restricted Radiocommunication Equipment and amends the Regulation of the Telecommunications Services, the Quality Management Regulation of the Multimedia Communication Service, the Regulation of the Multimedia Communication Service and the Regulation of the Private Limited Service.
- Resolution No. 681: Approves destination of bands of radio frequencies 430 MHz to 440 MHz and 9.300 MHz to 9.800 MHz to applications of radio localization in Private Limited Service (SLP).
- Resolution N° 683: Approves the Regulation for the sharing of infrastructure for the support of telecommunications service provision.
- Resolution N° 684: Approves the Norm for the methodology of calculation of the Transfer factor “X” applied to the readjustment of the rates for Fixed Commuted Telephone Service (STFC).
- Resolution N° 686: Revokes Technical Standards and Regulations for the Certification of Telecommunications Products.
- Resolution N° 687: Amends internal regulations of ANATEL for the review of provisions related to the rationalization of costs and procedures.

### ***Public Consultations Published***

In 2017, ANATEL, MCTIC and ANCINE announced a series of public consultations. The most relevant among these public consultations were:

- ANATEL Public Consultation No. 1: Public Consultation on the proposed Regulatory Agenda 2017 – 2018.
- ANATEL Public Consultation No. 2: Proposal for the General Grants Plan (*Plano Geral de Outorgas* – PGO) and for the single Authorization Term. This consultation also requests comments on topics related to changes to the telecommunications legal framework.
- ANATEL Public Consultation No. 4: Makes it public for comment ANATEL’s intention to grant the Foreign Satellite Exploration Right for SKY-B1 associated with the Ku band frequencies of the Appendix 30B Plan in the orbital position 43.1 ° W to Directv Enterprises LLC.
- ANATEL Public Consultation No. 7: Proposal for the new regulation on the Public Pricing of Radio Frequencies Usage Rights (RPPDUR) and changes on the regulation for public biddings of Concession, Permission and Authorization of Telecommunications Service.

- ANATEL Public Consultation No. 17: Amends the Internal Regulations of ANATEL in order to rationalize costs and procedures.
- ANATEL Public Consultation No. 19: Proposal for the allocation of radio frequency bands for the Global Mobile Satellite Service - SMGS.

- ANATEL Public Consultation No. 22: Proposal for regulation on General Numbering (RGN), which aims to update and adapt the rules regarding the administration and usage of number resources to current needs of the telecommunications industry.
- ANATEL Public Consultation No. 28: Revision of the manual for the application of the survey to measure satisfaction and perceived quality by users of telecommunications services.
- ANATEL Public Consultation No. 29: Proposal of the new Regulation on the Quality of Services in Telecommunications - RQUAL.
- ANATEL Public Consultation No. 32: Establishes the Committee of Small Telecommunications Services Providers within ANATEL and approves its internal regulations.
- MCTIC Public Consultation on the Internet of Things (IoT): Request for comments in order to identify key aspects that might enable the development of a dynamic IoT ecosystem in Brazil and support the further development of a national policy program (National Plan for the Internet of Things). The consultation was complemented by a few small questionnaires throughout the year, called “bytes”.
- MCTIC Public Consultation on the Brazilian Strategy for Digital Transformation (EBTD): Proposes a series of strategic actions within seven different policy areas in order to stimulate and accelerate digital transformation within the Brazilian society.
- MCTIC Public Consultation on the Decree of Public Policies for Telecommunications: Proposes a revision of the regulatory framework for the telecommunications sector by substituting three prior decrees: Decree 4.733/2003, Decree 7.175/2010 (which created the National Broadband Plan) and Decree 8.766/2016 (*Plano Brasil Inteligente*).
- ANCINE Public Consultation on the Regulatory Agenda 2017 - 2018: Sets out the priority and strategic topics for the biennium 2017 – 2018, proposing nine actions grouped into six major topic categories: cinematographic distribution, cinematographic exhibition, Pay TV, financing of the audiovisual sector, conflict mediation, and economic order.
- ANCINE Public Consultation on the Channels of Mandatory Distribution: Regulation proposal for the accreditation of programmer entities of channels of mandatory distribution and advertising placement in these channels.
- ANCINE Public Consultation on Copyright Management: Regulation revision on the management of rights of economic exploitation of audiovisual projects financed by public resources, and the classification criteria for works suitable to meet the obligations for Brazilian content broadcasting established by Law 12.485/11.
- ANCINE Public Consultation on Video on Demand (VOD): Proposal for definition of scope and intended objectives in a possible VOD regulation, listing the possible obligations to economic agents (such as the promotion of national content) and a model of taxation.

### ***Other Regulatory Matters***

#### *TAC*

On October 27, 2016, ANATEL’s Board of Directors approved a Conduct Adjustment Term (TAC) for the Company, subject to the approval of the Court of Auditors of the Union (TCU). This TAC aims to settle certain fines currently

imposed by ANATEL as long as the Company commits to invest in certain specific projects. Among these projects, the Company will need to make investments to improve the quality of services provided and provide fixed broadband access through FTTH to about 100 municipalities in and outside the State of São Paulo over a 4-year period.

In September 2017, after having held TAC under analysis for months, TCU unanimously decided that there were no obstacles preventing ANATEL from signing the agreement. TCU established, however, that prior to the celebration of the contract, the agency must comply with certain determinations and recommendations imposed by the court. The technical area of ANATEL worked on the necessary adjustments during the last months of 2017, and the expectation is that the new version will be submitted and approved by ANATEL's Directing Council during 2018, after which TCU will make a new summary evaluation of the conditions, thus allowing the agreement to enter into force.

#### *Fixed Broadband Cap*

In April 2016, discussions on the adoption of the fixed broadband cap model gained prominence in Brazilian media. Entities representing consumers and government agencies reacted to the strategy of some telecommunications companies, including Vivo, which foresaw the service limitation due to the depletion of the consumption cap.

In response to public disapproval, ANATEL published a preliminary order (“*cautelar*”) prohibiting the main telecommunication companies to implement speed limitation or suspension of the fixed broadband service due to full consumption of the cap, until further measures are put in place to provide the customer with information and tools to control consumption.

In November 2016, ANATEL published on its website a questionnaire about the fixed broadband cap model. The consultation was open to any citizen to respond. At the same time, this same questionnaire was sent to a list of 150 specialized entities, including universities, courts, consumer protection bodies, operators (including Telefonica) and former agency counselors. ANATEL is still analyzing the responses to this consultation.

#### *Regulation for Reference Offers of Wholesale Products Approval*

ANATEL launched, in December 2016, a Public Consultation for the Regulation that set price reference for the wholesale products. The proposal aims to determine that ANATEL's Cost Model should be the only source of information for the validation of these prices. ANATEL is still analyzing the responses and the new regulation is forecasted to be published in 2018.

#### *Productivity Factor*

In September 2017, ANATEL approved the new methodology for calculating the Productivity Factor (X Factor) of fixed telephony service. The new regulation uses the cost model to segregate revenues and costs for services. In the new formula, although gains with retail broadband were ruled out, the methodology continues to consider the productivity gains of the fixed voice authorization. Telefonica is arguing that the calculation should focus only on the productivity of the fixed voice concession.

### **C. Organizational Structure**

On December 31, 2017, 94.31% of our voting shares were controlled by three major shareholders: SP Telecomunicações Participações Ltda. with 51.46%, Telefónica S.A. with 34.67% and Telefônica Latinoamérica Holding, S.L. with 8.18%. Telefônica Latinoamérica Holding, S.L., or Telefônica Latinoamérica, is the controlling shareholder of SP Telecomunicações S.A., or SP Telecomunicações. Telefónica Latinoamérica is a wholly owned subsidiary of Telefónica S.A.. Therefore, Telefónica S.A. was the beneficial owner of 94.47% of our voting shares, as Telefónica Chile S.A., holder of 0.16% of our voting shares, is also a wholly owned subsidiary of Telefónica S.A.. See “Item 7. Major Shareholders and Related Party Transactions—A. Major Shareholders.”





Our current general corporate and shareholder structure is as follows:

### **Significant Subsidiaries**

Our subsidiaries are *Telefonica Data S.A.*, or TData, and *POP Internet Ltda.*, or POP, both wholly owned subsidiaries headquartered in Brazil.

### **Associated Companies**

*Aliança Atlântica Holding B.V. (Aliança)*: Headquartered in Amsterdam, Netherlands, this entity is 50% owned by Telefônica Brasil and holds proceeds generated from the sale of its Portugal Telecom shares in June 2010. For more information, see “Item 4. Information On The Company—A. History and Development of the Company—Historical Background—Corporate Restructuring Involving Telefônica Brasil and Vivo Participações.”

*Companhia AIX de Participações (AIX)*: Headquartered in Brazil, this entity is 50% owned by Telefônica Brasil and holds a 93% equity interest in the Refibra consortium, which was formed to finalize a network of underground fiber pipelines in Brazil in order to make them commercially viable.

*Companhia ACT de Participações (ACT)*: Headquartered in Brazil, this entity is 50% owned by Telefônica Brasil and holds a 2% equity interest in the Refibra consortium.

With the implementation of IFRS 11 *Joint Arrangements* in January 1, 2013, our investments in these entities were accounted for retroactively using the equity method.

### **Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act**

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 added Section 13(r) to the Exchange Act. Section 13(r) requires an issuer to disclose in its annual or quarterly reports filed with the SEC whether the issuer or any of its affiliates has knowingly engaged in certain activities, transactions or dealings with the Government of Iran, relating to Iran or with designated natural persons or entities involved in terrorism or the proliferation of weapons of mass destruction during the period covered by the annual or quarterly report. Disclosure is required even when the activities were conducted outside the United States by non-U.S. entities and even when such activities were conducted in compliance with applicable law.

The following information is disclosed pursuant to Section 13(r). None of these activities involved U.S. affiliates of Telefónica or the Company.

***Roaming Agreements with Iranian Operators***

Various subsidiaries of our controlling shareholder, Telefónica, have entered into roaming agreements with Iranian telecommunication companies. Pursuant to such roaming agreements these subsidiaries' customers are able to roam in the particular Iranian network (outbound roaming) and customers of such Iranian operators are able to roam in the network of Telefónica's relevant subsidiary (inbound roaming). For outbound roaming, these subsidiaries pay the relevant Iranian operator roaming fees for use of its network by our customers, and for inbound roaming the Iranian operator pays the relevant subsidiary roaming fees for use of our network by its customers.

We have a roaming agreement with MTN Irancell. During 2017, we recorded 43.87 euros in roaming revenues and 5,445.94 euros of expenses payable to Irancell under this agreement. In addition, as part of the Telefónica group, we adhere to the roaming agreements with Telefónica's subsidiaries described below.

Telefónica's subsidiaries were party to the following roaming agreements with Iranian telecommunication companies in 2017:

(1) *Telefónica Móviles España* ("TME"), Telefónica's Spanish directly wholly-owned subsidiary, has respective roaming agreements with (i) Mobile Telecommunication Company of Iran ("MTCI"), (ii) MTN Irancell ("Irancell"), (iii) Taliya ("Taliya") and (iv) Telecommunications Kish Co. ("TKC"). During 2017, TME recorded the following revenues related to these roaming agreements: (i) 40,450.45 euros from MTCI, (ii) 13,086.49 euros from Irancell, (iii) no revenues from Taliya and (iv) no revenues from TKC.

TME also holds Roaming Hub through its 55% directly-owned subsidiary, Link2One, a.e.i.e. ("L2O"). Under the related agreement, L2O provides a roaming hub service to Irancell enabling the latter to maintain a relationship with other members of the hub. Some members of the hub are also entities of the Telefónica Group. During 2017 L2O recorded revenues of 48,283.42 euros from Irancell.

(2) *Telefónica Germany GmbH & Co. OHG* ("TG"), Telefónica's German 69.22% indirectly-owned subsidiary, has respective roaming agreements with (i) MTCI and (ii) Irancell. During 2017, TG recorded revenues of (i) 100,501.29 euros from MTCI and (ii) 997.08 euros from Irancell.

(3) *Telefónica UK Ltd* ("TUK"), Telefónica's English directly wholly-owned subsidiary, has respective roaming agreements with (i) MTCI and (ii) Irancell. During 2017 TUK recorded (i) no revenues from MTCI and (ii) 2,817.33 euros from Irancell.

(4) *Telefónica Argentina, S.A.* and *Telefónica Móviles Argentina, S.A.* (together "TA"), Telefónica's Argentinean directly and indirectly wholly-owned subsidiaries, have a roaming agreement with Irancell. During 2017 TA recorded 15.38 euros in roaming revenues under this agreement.

(5) *Pegaso Comunicaciones y Sistemas, S.A. de C.V.* ("PCS"), Telefónica's Mexican directly wholly-owned subsidiary, has a roaming agreement with Irancell. During 2017 PCS recorded 14.53 euros in roaming revenues under this agreement.

(6) *Telefónica del Perú, S.A.A.* ("TdP"), Telefónica's Peruvian 98.57% indirectly-owned subsidiary, has a roaming agreement with Irancell and during 2017 it paid 0.29 euros thereunder due to traffic. TdP recorded no revenues under this agreement during 2017.

(7) *Colombia Telecomunicaciones, S.A. ESP* (“ColTel”), Telefónica’s Colombian 67.50% directly and indirectly-owned subsidiary, holds a roaming hub through L2O. L2O, in turn, provides a roaming hub service to Irancell enabling the latter to maintain a relationship with other members of the hub. During 2017 ColTel recorded 11.26 euros in roaming revenues under this roaming hub service.

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The net profit recorded by Telefónica's subsidiaries pursuant to these agreements did not exceed the related revenues recorded thereunder.

The purpose of all of these agreements is to provide the Telefónica group's customers with coverage in areas where the group does not own networks. For that purpose, Telefónica's subsidiaries intend to continue maintaining these agreements.

#### ***International Carrier Agreement with Iran***

Telefónica de España has an international carrier agreement with Telecommunication Company of Iran.

Pursuant to this agreement, both companies interconnect their networks to allow international exchange of telephone traffic. Telefónica de España recorded 7,992.64 euros in revenues under this agreement in 2017. The net profit recorded by Telefónica de España pursuant to this agreement did not exceed such revenues.

The purpose of this agreement is to allow exchange of international telephone traffic. Consequently, Telefónica intends to continue maintaining this agreement.

#### **D. Property, Plant and Equipment**

On December 31, 2017, we had fixed and mobile operations in 2,905 properties, 1,470 of which we own, of which 127 are administrative buildings. Besides that, we have entered into standard leasing agreements to rent the remaining properties, under which 119 administrative areas, 10 kiosks and 292 retail stores are leased.

Our main physical properties for providing fixed line telephone services involve the segments of switching (public switching telephone network, or PSTN), transmission (optic and wireless systems), data communication (multiplex devices, IP network), infrastructure (energy systems and air conditioning) and external network (fiber optic and metallic cables), which are distributed in many buildings throughout the state of São Paulo and in the main cities outside the state of São Paulo. Some of these buildings are also used for administrative and commercial operations.

Our main physical property for mobile services consists of transmission equipment, switching equipment, base stations, and other communication devices, such as voicemail, prepaid service, short message service, home location registers, signaling transfer point, packet data switching network and gateways. All switches, cellular sites, administrative buildings, administrative facilities, warehouses and stores are insured against damages for operation risks.

Pursuant to Brazilian legal procedures, liens have been attached to several properties pending the outcome of various legal proceedings to which we are a party. See "Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings." In addition, certain of our properties are still pending the applicable licenses and approvals from the local fire departments.

We are constantly making improvements to our facilities and network to meet customer demand and to improve the level of services we offer our clients.

On December 31, 2017, the net book value of our property, plant and equipment amounted R\$33.2 billion (R\$31.9 billion on December 31, 2016), which included reversible assets in the amount of R\$8.7 billion.

***Environmental Matters***

Brazilian Federal, State and Municipal legislation provide for the control and protection of the environment. These laws govern the appropriate use of natural resources, control of atmospheric emissions and noise, treatment of effluents, handling and final disposal of hazardous materials, amongst others.

Under these laws, certain environmental licenses must be secured prior to the construction, installation, expansion and operation of facilities that use natural resources or that may pollute the environment, including those related to installation and operation of radio/cell stations and antennas. According the stage of the project, the environmental licenses may be: (1) a preliminary license, which approves the location and design of the project and must be obtained in the early stages of the project or activity to certify its environmental feasibility; (2) an installation license, which authorizes the installation of the project or activity in accordance with the specifications set forth in approved plans, programs and projects; or (3) an operation license, which authorizes commencement of operations once the conditions for compliance with the preliminary and installation licenses are met, and may impose additional conditions applicable to the project's operations.

Besides environmental licensing, other environmental regulations may affect our operations, such as, among other matters, regulations related to emissions into the air, soil and water, take-back systems, recycling and waste management, protection and preservation of fauna, flora and other features of the ecosystem, water use, interference with areas of cultural and historical relevance and with Conservation Units (UCs) or their surroundings, Permanent Preservation Areas (APPs) and contaminated areas.

Regarding the last subject matter, in accordance with the Environmental National Policy (Law No. 6,938/1981), the owner of a real estate property located in a contaminated area may be compelled by the relevant environmental agency to clean up the area, regardless of fault and the damage causes. Environmental authorities have been adopting an increasingly stringent position in connection with the handling of contaminated areas, including the creation of environmental standards to preserve the quality of land and underground water. Non-compliance with guidelines set by the relevant environmental and health authorities with respect to surveys and analyses of potentially contaminated areas or the exposure of persons to toxic fumes or residues may result in administrative and legal penalties for the developments and their management. We perform periodic environmental investigations to assess any possible liability with respect to contamination of soil.

We are subject to administrative review of our activities and corporations found to be in violation of these administrative environmental regulations can be fined up to R\$50 million, have their operations suspended, be barred from entering into certain types of government contracts, be required to repair or provide indemnification in respect of any environmental damages they cause, be required to suspend tax benefits and incentives, among others.

In Brazil, violating environmental rules or regulations may result in civil, administrative or criminal liability. With respect to civil liability, Brazilian environmental laws adopt a standard of unlimited strict, several and joint liability in determining the obligation to remediate damages caused to the environment. In addition, Brazilian courts may pierce the corporate veil when and if it poses an obstacle to the full recovery of environmental damages.

We have a series of systems in place to protect our networks and operations from environmental damage.

Additionally, we have systems in place for the proper disposal of batteries and oil, in our construction operations and to address other environmental issues that may arise in the operation and maintenance of our properties. In 51 cities (that cover more than 40% of our clients) we have a certified Environmental Management System that meets ISO14.001 requirements since 2016. We also maintain the control of radio frequency energy levels transmitted by our antennas, in accordance with current legislation. The energy consumption of our network infrastructure is very high

and as a result we have implemented energy efficient technologies in order to reduce consumption and meet greenhouse gas emission reduction targets. We have also invested in clean energy as the source of our energy consumption, reaching the amount of 25% currently consumed from this type of source with targets to reach 50% until 2020 and 100% until 2030.

Also, to comply with Brazilian Federal regulations, (National Waste Policy - Law 12,305/10), we were the first telecommunications company in Brazil to offer collection points at all of our stores for old mobile phones, accessories and batteries, where customers and other individuals can dispose of their used equipment ensuring proper disposal of these materials. At fixed line telecom business, we directly pick up equipment that is defective from customers or once the contract Ends. These materials underwent triage and can be refurbished to be used again with full technical capacity and layout conditions. Through an online portal on our website, customers can schedule pick-ups of equipment that they no longer use. These processes ensure that more than 98% of our electronic waste is recycled.

Moreover, we must emphasize that we perform periodic environmental investigations to assess any possible liability with respect to contamination of soil and groundwater. Currently, we are executing remediation measures in the following units located at the Municipality of São Paulo: (i) Ibirapuera; (ii) Brooklin; (iii) Santo Amaro; (iv) Palmeira.

#### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

#### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

##### **A. Operating Results**

The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes and other information appearing elsewhere in this annual report and in conjunction with the financial information included under “Item 3. Key Information—A. Selected Financial Data.” We prepared our consolidated financial statements included in this annual report in accordance with IFRS.

##### **Overview**

Our results of operations are principally affected by the following key factors.

##### ***Brazilian Economic Environment***

The Brazilian economy has experienced varying rates of growth this decade. According to IBGE (*Instituto Brasileiro de Geografia e Estatística*), the Brazilian GDP decreased by 3.5% in 2016, after the same decrease of 3.5% registered in 2015. According to market data, in 2017, the Brazilian GDP grew approximately 1%.

Consumer prices, as measured by the IPCA, increased 2.95% in 2017. Accordingly, growth in consumer prices stood below the lower limit of inflation target band established by the Central Bank of 4.5% +/- 1.5%. In 2015 and 2016, the increases in IPCA were 10.7% and 6.3%, respectively. Inflation, as measured by the Brazilian general price index (*Índice Geral de Preços - Disponibilidade Interna*), or the IGP-DI, calculated by the FGV, which includes wholesale, retail and home-building prices, increased 10.7% and 7.2% in 2015 and 2016, respectively. In 2017, the IGP-DI decreased 0.42%.

As inflation rate measured by IPCA fell by 3.35 percentage points during 2017 and stood below the target band, the Central Bank decreased the basic interest rate (*Sistema Especial de Liquidação e de Custódia*), or SELIC rate, to 7.00% by the end of 2017 and to 6.75% in February of 2018, from 13.75% as of the end of 2016.

Brazil closed 2017 with a trade balance surplus of US\$67 billion, an improvement in relation to the surplus of US\$47.7 billion at the end of 2016. Exports increased 17.6%, registering US\$217.8 billion, while imports increased

9.6%, to US\$150.7 billion. Foreign Direct Investments inflows into the country have decreased, reaching US\$70.3 billion, compared to US\$79 billion in 2016. Portfolio investments have registered negative net flows of US\$0.8 billion in 2016, in comparison to negative flows of US\$20 billion in 2016. As a result of this performance of external accounts, international reserves at the end of 2017 were US\$382 billion, an increase of US\$10 billion compared to December 31, 2016.



Despite the improvement in economic activity, inflation and external accounts, some areas of the economy remained unfavorable, as is the case of the primary fiscal deficit. The fiscal result this year was another deficit, of 1.7% of the GDP, compared to 2.5% in 2016's result. The recurring deficit in public finances in the past years led to another loss of investment grade by S&P in 2018. However, risk premium indexes have lowered. The J.P. Morgan Emerging Markets Bond Index Plus (EMBI + Brazil), which tracks total returns for traded external debt instruments in emerging markets, reached 240 basis points by the end of 2017, down from 328 basis points at the end of 2016 and 532 basis points at the end of 2015. Factors such as the favorable external scenario and improvement of some of the macroeconomic fundamentals contributed to diminish the EMBI.

The *Real* depreciated against the U.S. dollar in 2017 by 1.5%. The exchange rate on December 29, 2017 was R\$3.3080 per US\$1.00, from R\$3.2591 per US\$1.00 on December 31, 2016.

Our business is directly affected by the external environment and the Brazilian economy. Lower volatility of the Brazilian *Real* against the U.S. dollar contributes to the maintenance of the purchasing power of Brazilian consumers and, preventing a negative impact on the ability of our customers to pay for our telecommunications services.

### ***Impact of Inflation on Our Results of Operations***

Before 2006, the fees we charged our customers were periodically adjusted by ANATEL based on the inflation rates measured by the IGP-DI.

Starting in 2006, telephone fees were indexed to the IST, which is a basket of Brazilian indexes that reflect the telecommunications sector's operating costs. Such indexing reduced inconsistencies between revenue and costs in our industry and therefore reduced the adverse effects of inflation on our business. The IST for the twelve-month period ending December 2017 was 3.2% according to the most recent data published by ANATEL.

The table below shows the Brazilian general price inflation (according to the IGP-DI, IPCA and the IST) for the years ended December 31, 2013 through 2017:

	<b>Inflation Rate (%) as Measured by IGP-DI(1)</b>	<b>Inflation Rate (%) as Measured by IPCA(2)</b>	<b>Inflation Rate (%) as Measured by IST(3)</b>
December 31, 2013	5.5	5.9	5.0
December 31, 2014	3.8	6.4	5.9
December 31, 2015	10.7	10.7	11.1
December 31, 2016	7.2	6.3	6.0
December 31, 2017	(0.4)	2.9	3.2

(1) Source: IGP-DI, as published by the FGV.

(2) Source: IPCA, as published by the *IBGE*.

(3) Source: IST, as published by the *Agência Nacional de Telecomunicações*.

### **Discussion of Critical Accounting Estimates and Policies**

The preparation of the financial statements included in this annual report in accordance with IFRS involves certain assumptions and estimates that affect the amounts presented for revenue, expenses, assets and liabilities and disclosures of contingent liabilities in the notes to the financial statements. Therefore, the uncertainty relating to these assumptions and estimates could lead to results that require a significant adjustment to the accounting value of assets or liabilities affected in future periods. Although we review these estimates and assumptions in the ordinary course of business, the presentation of our financial condition and results of operations often requires our management to make judgments regarding the effects on our financial condition and results of operations of matters that are inherently uncertain. Actual results may differ from those estimated under different variables, assumptions or conditions. For a summary of significant accounting policies and methods used in the preparation of those financial statements, see Note 3 to our Consolidated Financial Statements. The areas involving a higher degree of judgment or complexity are described below.

***Accounting for long-lived assets***

Property, plant and equipment and intangible assets, other than goodwill, are recorded at acquisition cost. Property, plant and equipment and intangible assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives. Intangible assets with indefinite useful lives, including goodwill, are not amortized, but are instead, subject to an impairment test on a yearly basis and whenever there is an indication that such assets may be impaired.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining the fair value at their acquisition dates, particularly for assets acquired in business combinations and for determining the useful lives over which they are to be depreciated or amortized as well as their residual value. Useful lives are assessed annually and changed when necessary to reflect current evaluation on the remaining lives in light of technological change, network investment plans, prospective utilization and physical condition of the assets concerned.

The carrying values and useful lives applied to the principal categories of property, plant and equipment, and intangibles, are disclosed in Notes 12 and 13 to our consolidated financial statements.

***Impairment of nonfinancial assets, including goodwill***

An impairment loss exists when the accounting value of an asset or cash-generating unit exceeds its recoverable amount, which is the higher between the fair value less selling costs and the value in use. The estimated fair value less selling costs is based on the information available from transactions involving the sale of similar assets or the market price less additional costs regarding the disposition of such asset. The value in use is based on the model of discounted cash flow. Cash flows are derived from the budget and do not include activities of reorganization for which the company has not yet been committed or significant future investments that will improve the group of assets of the cash-generating unit subject to the test. The recoverable amount is sensitive to the discount rate used in the method of discounted cash flows as well as to the projected future cash flow and the expected future growth rate used for the purposes of determining terminal value. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The carrying value of goodwill and the key assumptions used in performing the annual impairment assessment are disclosed in Notes 3(i) and 13 to our consolidated financial statements.

***Provisions for tax, labor, civil and regulatory proceedings***

We record provisions for tax, labor, civil and regulatory claims where an outflow of resources is considered probable and a reasonable estimate can be made of the likely outcome. The assessment of the likelihood of loss includes assessing the available evidence, the hierarchy of laws, the available jurisprudence, the most recent court decisions and its materiality in the legal system as well as the evaluation of the case by external counsels. Provisions are reviewed and adjusted to take into account changes in circumstances such as the applicable prescriptive period, results from tax inspections or additional exposure identified based on newly issued court decisions. A significant change in these circumstances or assumptions could result in a corresponding increase or decrease the amount of our provisions.

Additional information on provisions for tax, labor, civil and regulatory proceedings is disclosed in Notes 3(p) and 18 to our consolidated financial statements.

***Pension and other post-retirement benefit plan***

The cost of defined benefit retirement plans and other post-employment medical care benefits and the present value of pension and other postretirement obligations are determined using actuarial valuation methods. The actuarial valuation methods involve the use of assumptions about discount rates, expected future salary increases, mortality rates, health care costs trend rates and future increases in retirement benefits and pensions. The obligation of a defined benefit is highly sensitive to changes in these assumptions. All assumptions are reviewed at each year-end. The mortality rate is based on mortality tables available in the country. Future increases in wages and retirement benefits and pensions are based on expected future inflation for Brazil. The assumptions reflect historical experience and our judgment regarding future expectations.

The value of our net pension obligation on December 31, 2017, the key financial assumption used to measure the obligation as well as the sensitivity of our pension liability on December 31, 2017 and of the income statement charge in 2015, 2016 and 2017 to changes in these assumptions, is disclosed in Note 30 to our consolidated financial statements.

### ***Fair value of financial instruments***

When the fair value of financial assets and liabilities presented on the balance sheet cannot be obtained in active markets, it is determined using valuation techniques, including the method of discounted cash flow. The data obtained for the use of these methods are based as much on the information prevailing in the market as possible. However, when it is not feasible to obtain such information in the market, a certain assumption level is required to establish the fair value. The assumption includes consideration of the data that was used, such as the liquidity risk, credit risk and volatility. Changes in the assumptions regarding these factors could affect the presented fair value of financial instruments.

Additional information on fair value of financial instruments is disclosed in Notes 3(k) and (l) and 31 to our consolidated financial statements.

### ***Taxes***

There may be uncertainties regarding the interpretation of complex tax regulations and the amount and timing of future taxable income. We record provisions based on reasonable estimates for potential disagreement with tax authorities from the jurisdictions in which we operate. The value of these provisions is based on several factors such as experience from previous tax audits and different interpretations of tax regulations by the taxable entity and the competent tax authority in charge. Such differences of interpretation may arise in a wide variety of subjects, depending on the prevailing conditions in the domicile of the company. As a result, we may be required to pay more than our provisions or may not be able to recover the full amount of the related tax assets recognized.

We evaluate the recoverability of deferred tax assets based on estimates of future results. This recoverability ultimately depends on our ability to generate taxable profits over the period in which the temporary difference is deductible. The analysis considers the reversal period of deferred tax liabilities, as well as estimates of profits from operations, based on updated internal projections reflecting the latest trends.

Determining the proper valuation of the tax items depends on several factors, including an estimate of the period and the realization of the deferred tax asset and the expected date of payments of these taxes. The actual flow of receipt and payment of income tax could differ from estimates made by us, as a result of changes in tax laws or of unexpected future transactions that may impact tax balances.

Additional information on taxes is disclosed in Notes 3(q), 7 and 16 to our consolidated financial statements.

### ***Revenue recognition***

#### ***Customer Loyalty Program***

We have a customer loyalty program that allows customers to accumulate points when generating traffic from the use of our mobile services. The accrued points may be exchanged for handsets or services, provided the customer has a minimum stipulated balance of points. The consideration received is allocated to the cost of handsets or services and the related points earned based on the relative fair value. The fair value of the points is calculated by dividing the discount value granted as a result of the customer loyalty program by the amount of points needed to carry out the

redemption. The fair value accrued on the balances of generated points is deferred and recognized as income upon redemption of points.

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For determining the quantity of points to be recognized, we apply statistical techniques, which take into consideration assumptions such as estimated redemption rates, expiration dates, cancellation of points and other factors. These estimates are subject to variations and uncertainties due to changes in the redemption behavior of the customers.

A change in the assumptions regarding these factors could affect the estimated fair value of the points under the customer loyalty program and it could affect the apportionment of revenue among the elements and, as a result, revenues in future years.

#### *Multiple-element arrangements*

Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective fair values.

Determining fair values for each identified element requires estimates that are complex due to the nature of the business.

Changes in estimates of fair values could affect the apportionment of revenue among the elements and, as a result, revenues in future years.

Additional information on revenue recognition is disclosed in Note 3(u) to our consolidated financial statements.

#### **Sources of Revenue**

The breakdown of our gross operating revenue is presented net of discounts granted. In addition, we categorize our revenue according to the following groups:

- Fixed and mobile telephone services

Includes revenues from fixed and mobile telephone, principally:

- Local: includes the sum of revenues from monthly subscription fees, installation fees, local services, public telephones and fixed-to-mobile revenues;
- Domestic long-distance: includes the sum of fixed-to-mobile revenues and domestic long distance calls and domestic long-distance calls placed on public telephones;
- International long-distance: includes the sum of revenues from international long distance calls and international long-distance placed on public telephones; and
- Usage charges: include measured service charges for calls, monthly fee and other similar charges.

- Data Transmission and value added services

- Wholesale: includes the sum of infrastructure rental revenues; and

- Value Added Services: Vivo Música, Vivo Educa, Vivo Sync, Vivo PlayKids, Vivo NBA, Vivo Família Online, Vivo Meditação, among others; and

- Data Transmission: Fixed and mobile data including FTTH, xDSL, cable on the fixed side and 3G and 4G on the mobile side.

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- Interconnection fees
- Interconnection fees are amounts we charge other cellular and fixed-line service providers for the use of our network.
- Pay TV
- Includes TV services through satellite, cable or IPTV technology.
- Sale of goods and equipment
- The sale of wireless devices and accessories.
- Other Services
- Other services include integrated solution services offered to residential and corporate clients, such as Internet access, private network connectivity and leasing of computer equipment; and
- Other telecommunications services such as extended service, detects, voice mail and cellular blocker, among others.

## **Results of Operations**

The following table sets forth certain components of our net income for each year ended December 31, 2017, 2016 and 2015 as well as the percentage change of each component.

In 2017, we acquired 100% of shares of Terra Networks Brasil S.A. (“Terra Networks”). Results of Terra Networks S.A. are consolidated into our financial statements as from July 3, 2017. Notwithstanding, results from Terra are not material and therefore our results of operations for the year ended December 31, 2017 are comparable with our results of operations for the years ended December 31, 2016, 2015, 2014 and 2013. See Note 1 c.1) to our consolidated financial statements and “Item 4.A.—Historical Background—Acquisition of Terra Networks by TData” for further information.

In 2015, we acquired 100% of shares of GVT Participações S.A. (“GVT”). Results of GVT are consolidated into our financial statements as from May 1, 2015. See Note 1 c.3) to our consolidated financial statements and “Item 4.A.—Historical Background—Acquisition of GVT” for further information. As mentioned in footnote 1.c2, as part of the corporate restructuring in 2016, GVT was merged into Telefônica Brasil S.A.

	Year ended December 31,			Percent	Percent
	2017	2016	2015	change	change
	(in millions of reais)			2017-2016	2016-2015
Net operating revenue	43,206.8	42,508.4	40,286.8	1.6%	5.5%
Cost of sales	(20,272.6)	(20,823.0)	(20,345.1)	(2.6%)	2.3%
Gross profit	22,934.2	21,685.4	19,941.7	5.8%	8.7%
Operating expenses:					
Selling expenses	(13,136.4)	(12,455.4)	(12,005.5)	5.5%	3.7%
General and administrative expenses	(2,443.1)	(2,793.3)	(2,142.4)	(12.5%)	30.4%
Other net operating income (expenses), net	(722.5)	(68.7)	(554.2)	951.7	(87.6%)
Total operating income (expenses), net	(16,302.1)	(15,317.4)	(14,702.1)	6.2%	4.2%
Operating income	6,632.2	6,368.0	5,239.6	4.2%	21.5%
Financial income (expenses), net	(903.0)	(1,234.5)	(848.2)	(26.9%)	45.5%
Equity pickup	1.5	1.2	2.0	25.0%	(40.0%)
Income before taxes	5,730.7	5,134.7	4,393.4	11.6%	16.9%
Income and social contribution taxes	(1,121.9)	(1,049.5)	(973.2)	6.9%	7.8%
Net income for the year	4,608.8	4,085.2	3,420.2	12.8%	19.4%
Net income attributable to:					
Controlling shareholding	4,608.8	4,085.2	3,420.2	12.8%	19.4%
Net income for the year	4,608.8	4,085.2	3,420.2	12.8%	19.4%

## Results of Operations for the Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016

### Gross Operating Revenue

Our gross operating revenue increased by 1.9% to R\$66,243.2 million in 2017 from R\$65,006.7 million in 2016. The table and descriptions below set forth explanations for these variations:

	Year ended December 31,		Percent change
	2017	2016	2017-2016
	(in millions of reais)		
Gross operating revenue (a)	66,243.2	65,006.7	1.9%
Deductions from gross operating revenue	(23,036.4)	(22,498.3)	2.4%
Net operating revenues	43,206.8	42,508.4	1.6%

(a) Includes revenues from: telephone services; data transmission and value added services; interconnection fees charged; pay TV and other services.

### Net Operating Revenue

Net Operating Revenue increased by 1.6% to R\$43,206.8 million in 2017 from R\$42,508.4 million in 2016, due to the increase of revenues from telecommunication services, as a result of strong increase in data transmission and value added services revenues from the successful upselling of mobile data bundles, strong migration to 4G and higher smartphone penetration within our customer base, and robust fixed broadband evolution, mainly due to strong growth in ultra-broadband revenues driven by higher adoption of FTTH and footprint expansion. These factors were partially offset by decreasing outgoing voice and interconnection revenues, resulting from decreases in mobile and fixed termination rates mandated by ANATEL, which became effective in February 2017, as described in "Item 4. Information On The Company—B. Business Overview—Regulation of the Brazilian Telecommunications Industry—Mobile

Services—Interconnection Fees—Mobile service.”

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