

TELEFONICA BRASIL S.A.
Form 20-F
February 23, 2017

As filed with the Securities and Exchange Commission on February 23, 2017

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, 2016

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

Date of event requiring this shell company report _____
For the transition period from _____ to _____

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, 28° andar
04571-936 São Paulo, SP, Brazil**

(Address of principal executive offices)

David Melcon Sanchez-Friera

Telephone +55 11 3430 3687

Avenida Engenheiro Luis Carlos Berrini, 1376, CEP 04571-936, São Paulo, SP, Brazil

Email: ir.br@telefonica.com

(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:

Title of each class

**Preferred Shares, without par value
American Depositary Shares (as evidenced by American Depositary Receipts),
each representing one share of Preferred Stock**

Name of each exchange on
which registered

**New York Stock Exchange*
New York Stock Exchange**

* 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

Edgar Filing: TELEFONICA BRASIL S.A. - Form 20-F

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, 2016 was:

Title of Class	Number of Shares Outstanding (excluding treasury shares)
Shares of Common Stock	569,354,053
Shares of Preferred Stock	1,119,340,367

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
x Yes o No

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. o Yes x 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. x Yes o 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) o Yes o No

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

Large Accelerated Filer x Accelerated Filer o Non-accelerated Filer o

Edgar Filing: TELEFONICA BRASIL S.A. - Form 20-F

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

Table of Contents

	<u>Page</u>
PART I	1
<u>ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</u>	<u>1</u>
<u>ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE</u>	<u>1</u>
<u>ITEM 3. KEY INFORMATION</u>	<u>1</u>
<u>ITEM 4. INFORMATION ON THE COMPANY</u>	<u>17</u>
<u>ITEM 4A. UNRESOLVED STAFF COMMENTS</u>	<u>57</u>
<u>ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	<u>57</u>
<u>ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	<u>77</u>
<u>ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	<u>90</u>
<u>ITEM 8. FINANCIAL INFORMATION</u>	<u>92</u>
<u>ITEM 9. THE OFFER AND LISTING</u>	<u>102</u>
<u>ITEM 10. ADDITIONAL INFORMATION</u>	<u>106</u>
<u>ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>131</u>
<u>ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	<u>132</u>
PART II	134
<u>ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	<u>134</u>
<u>ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	<u>134</u>
<u>ITEM 15. CONTROLS AND PROCEDURES</u>	<u>134</u>
<u>ITEM 16. [RESERVED]</u>	<u>135</u>
<u>ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT</u>	<u>135</u>
<u>ITEM 16B. CODE OF ETHICS</u>	<u>135</u>
<u>ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	<u>135</u>
<u>ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES PROCEDURES</u>	<u>136</u>
<u>ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u>	<u>136</u>
<u>ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT</u>	<u>137</u>
<u>ITEM 16G. CORPORATE GOVERNANCE</u>	<u>137</u>
<u>ITEM 16H. MINE SAFETY DISCLOSURE</u>	<u>140</u>
PART III	141
<u>ITEM 17. FINANCIAL STATEMENTS</u>	<u>141</u>
<u>ITEM 18. FINANCIAL STATEMENTS</u>	<u>141</u>
<u>ITEM 19. EXHIBITS</u>	<u>141</u>
<u>GLOSSARY OF TELECOMMUNICATIONS TERMS</u>	<u>145</u>
<u>SIGNATURES</u>	<u>147</u>

Table of Contents

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;

· “BM&FBOVESPA” are to the *BM&FBOVESPA S.A. – Bolsa de Valores, Mercadorias e Futuros*, the Brazilian Securities, Commodities and Futures Exchange or São Paulo stock exchange;

· “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;

Table of Contents

- “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;
- “Number portability” are to *Portabilidade Numérica*, the service mandated by ANATEL that provides customers with the option of keeping the same telephone number when switching telephone service providers;
- “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;

“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.

“Vivo Participações” are to *Vivo Participações S.A.* (formerly *TELESP Celular Participações S.A.*) and its consolidated subsidiaries (unless the context otherwise requires); and

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

The “Glossary of Telecommunications Terms” that begins on page 145 provides the definition of certain technical terms used in this annual report.

Table of Contents

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."

Table of Contents

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.

Table of Contents

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.

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, 2016 and December 31, 2015 and for the years ended December 31, 2016, December 31, 2015 and December 31, 2014 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, 2016 and 2015 and for each of the three years in the period ended December 31, 2016 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, 2016.

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.

Results of GVT Participações S.A. are consolidated into our financial statements as from May 1, 2015. Consequently, our results of operations for the year ended December 31, 2016 are not comparable with our results of operations for the years ended December 31, 2015, 2014, 2013 and 2012.

Table of Contents

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, 2016 and 2015 and for the years ended December 31, 2016, 2015 and 2014 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 GVT are consolidated into our financial statements as from May 1, 2015. Consequently, our results of operations for the years ended December 31, 2016 are not comparable with our results of operations for the year ended December 31, 2015, 2014, 2013 and 2012. For further information on our corporate restructurings, 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.”

Income Statement Data:	Year ended December 31,					
	2016	2016	2015	2014	2013	2012
	(in	(in millions of <i>reais</i>)				
	millions					

Edgar Filing: TELEFONICA BRASIL S.A. - Form 20-F

	of U.S. dollars)(1) (except for share and per share data)					
Net operating revenue	13,043	42,508	40,287	35,000	34,722	33,919
Cost of goods and services	(6,389)	(20,823)	(20,345)	(17,223)	(17,542)	(16,557)
Gross profit	6,654	21,685	19,942	17,777	17,180	17,362
Operating expenses, net	(4,700)	(15,317)	(14,702)	(12,668)	(12,248)	(10,152)
Equity in earnings (losses) of associates	-	1	2	7	(55)	1
Operating income, net	1,954	6,369	5,242	5,116	4,877	7,211
Financial expense, net	(379)	(1,234)	(848)	(362)	(215)	(291)
Income before tax	1,575	5,135	4,394	4,754	4,662	6,920
Income and social contribution taxes	(322)	(1,050)	(974)	183	(946)	(2,468)
Net income	1,253	4,085	3,420	4,937	3,716	4,452
Attributable to:						
Controlling shareholders	1,253	4,085	3,420	4,937	3,716	4,453
Non-controlling shareholders	—	—	—	—	—	(1)
Basic and diluted earnings per share:						
Common Shares	0.70	2.27	2.15	4.12	3.10	3.72
Preferred Shares	0.77	2.50	2.37	4.53	3.41	4.09
Cash Dividends per share in <i>reais</i> , net of withholding tax:						
Common Shares	0.51	1.65	2.04	2.04	1.86	2.57
Preferred Shares	0.56	1.81	2.25	2.25	2.04	2.82

Table of Contents

Balance Sheet Data:	As of December 31,					
	2016	2016	2015	2014	2013	2012
	(in millions of U.S. dollars)(1)					
	(except for share and per share data)					
Property, plant and equipment, net	9,796	31,925	30,477	20,454	18,442	17,604
Total assets	31,317	102,066	101,685	73,065	69,504	70,251
Loans and financing—current portion	780	2,543	2,222	1,509	1,237	1,270
Loans and financing—noncurrent portion	959	3,127	4,455	2,123	3,215	3,774
Debentures—current portion	651	2,120	121	755	287	702
Debentures—noncurrent portion	440	1,434	3,424	3,412	4,015	2,254
Shareholders' equity	21,246	69,244	68,567	44,950	42,894	44,681
Attributable to:						
Controlling shareholders	21,246	69,244	68,567	44,950	42,894	44,681
Noncontrolling shareholders	—	—	—	—	—	—
Capital stock	19,506	63,571	63,571	37,798	37,798	37,798
Number of shares outstanding (in thousands)(2)		1,688,694	1,688,694	1,123,269	1,123,269	1,123,269

Cash Flow Data:	Year ended December 31,					
	2016	2016	2015	2014	2013	2012
	(in millions of U.S. dollars)(1)					
Operating activities:						
Net cash provided by operating activities	3,510	11,440	9,897	9,384	9,576	10,054
Investing activities:						
Net cash used in investing activities	(2,115)	(6,895)	(14,626)	(7,608)	(5,543)	(3,721)
Financing activities:						
Net cash provided by (used in) financing activities	(1,466)	(4,777)	5,373	(3,627)	(4,622)	(2,089)
Increase (decrease) in cash and cash equivalents	(71)	(232)	644	(1,851)	(589)	4,244
Cash and cash equivalents at beginning of year	1,637	5,337	4,693	6,544	7,133	2,889
Cash and cash equivalents at end of year	1,566	5,105	5,337	4,693	6,544	7,133

Translated for convenience only using the commercial offer rate as reported by the Central Bank as of December 31, 2016 for *reais* into U.S. dollars of R\$3.2591 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 2,291 thousand 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 2012, the *real* depreciated 8.9% against the U.S. dollar. In 2013 and 2014, the *real* depreciated further 14.6% and 13.4%, respectively against the U.S. dollar. In 2015, the depreciation of the *real* against the U.S. dollar was 47%. In 2016, the *real* appreciated 16.5%, against the U.S. dollar, ending the year at an exchange rate of R\$3.2591 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.

Table of Contents

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.

Year ended December 31, 2012 2013 2014 2015 2016	Exchange Rates of R\$ per US\$1.00			
	Period-End	Average(1)	High	Low
2012	2.0435	1.9550	2.1121	1.7024
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
Month				
August 2016	3.2403	3.2097	3.2733	3.1302
September 2016	3.2462	3.2564	3.3326	3.1934
October 2016	3.1811	3.1858	3.2359	3.1193
November 2016	3.3967	3.3420	3.4446	3.2024
December 2016	3.2591	3.3523	3.4650	3.2591
January 2017	3.1270	3.1966	3.2729	3.1270
February 2017 (through February 22)	3.0824	3.1070	3.1479	3.0510

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 22, 2017, the exchange rate was R\$3.0824 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.

In the past, the Brazilian government has intervened in the Brazilian economy and made changes in policy and regulations. The Brazilian government's actions to control inflation and affect other policies have often involved wage and price controls, currency devaluations, capital controls and limits on imports, among other things. 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:

·
currency fluctuations;

Table of Contents

- exchange control policies;
- internal economic growth;
- inflation;
- energy policy;
- interest rates;
- liquidity of domestic capital and lending markets;
- tax policies; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Uncertainty regarding changes by the Brazilian government to the policies, regulations or standards affecting these or other factors in the future may contribute to economic uncertainty in Brazil and heightened volatility in the Brazilian securities markets and securities issued abroad by Brazilian companies. In addition, possible political crises may affect the confidence of investors and the public in general, which may result in economic deceleration and affect the trading prices of shares issued by companies listed on the stock exchange, such as us.

Our business may be vulnerable to the current disruptions and volatility in the global financial markets.

We are susceptible to swings in global economic conditions, typified most recently by difficult credit and liquidity conditions and disruptions leading to greater volatility commencing in mid-2007 with the global financial crisis. The global economy has largely recovered, however markets remain subject to ongoing volatility factors including interest rate divergence, geopolitical events, and global growth expectations, and there is no assurance that similar conditions will not arise again. In the long term, as a consequence, global investor confidence may remain low and credit may remain relatively lacking. Hence, additional volatility in the global financial markets may occur. The Brazilian economy remains subject to risks and adjustments arising from international financial conditions. Various governments may continue to intervene in their financial systems and perform fiscal and monetary adjustments. There is no assurance, however, that these measures will be successful in stimulating growth or in stabilizing conditions in international financial markets.

The conditions and volatility in the global financial markets may have a material adverse effect on our ability to access the capital markets under appropriate financial conditions, which may adversely affect our operations. Furthermore, an environment of economic downturn may negatively affect the financial stability of our customers, which could result in a general reduction in Brazil's economic activity and the consequent loss of income for us.

Political instability may have an adverse impact on the Brazilian economy and on our business.

Political conditions in Brazil may affect the confidence of investors and the public in general, as well as the development of the economy. For example, 2016 was marked by an unstable political scenario evidenced by widespread protests and ongoing investigations into allegations of corruption in state-controlled enterprises that contributed to the decline of the confidence of investors and the public in general. The Brazilian Congress commenced impeachment proceedings against then President Dilma Rousseff on December 2, 2015, for violating budgetary laws to prop up the Brazilian economy during her reelection campaign in 2014. On April 17, 2016, more than two-thirds of Brazil's Congress voted to proceed with the impeachment proceedings. The proceedings then moved to the Senate, which on May 12, 2016 voted to commence a trial of President Rousseff, resulting in her suspension from the post for up to 180 days, during which time Vice President Michel Temer assumed the Presidency. On August 31, 2016, President Rousseff was convicted by the Senate and definitively removed from office. On the same date, Michel Temer assumed the Presidency of Brazil until the next general elections, scheduled for October of 2018. Rousseff appealed the Senate's final decision to the Supreme Court, whose decision is pending. In this context, it is currently uncertain whether Temer will enjoy the support of the Brazilian Congress, or what policies he will be able to implement. In addition, Temer and his government have been the target of protests throughout Brazil since he assumed power on a provisional and now definitive basis. The resolution of the political and economic crisis in Brazil still depends on the outcome of Operation "Lava Jato" and approval of reforms that are expected to be promoted by the new president. We have no control over the situation and cannot foresee what policies or actions the Brazilian government may pursue. 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. During the past years, the Central Bank has maintained a tight monetary policy with high interest rates, thus restricting the availability of credit and reducing economic growth in order to control inflation. We cannot foresee what policies the government will adopt. Furthermore, any indecision by the Brazilian government in implementing changes in certain policies or regulations may contribute to economic uncertainty in Brazil, and increase stock market volatility. Any of these factors may adversely affect the Brazilian economy, our business, financial condition, results of operations and the market price of our preferred shares and ADSs.

Table of Contents

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

Brazil has historically experienced high rates of inflation. Inflation and certain governmental measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. In 2015, inflation measured by the Brazilian consumer price index (*Índice de Preços ao Consumidor*), or IPCA, reached 10.67%, above the upper limit of 6.5%, established by the CMN. In 2016, inflation as measured by the IPCA retreated to 6.3%, below the upper limit of 6.5%, established by the CMN. In 2017, the Brazilian monetary policy will continue to use the IPCA as a reference for the inflation target. The inflation target for 2017 is set at 4.5%, allowing 1.5 percentage points below or above this target, which means a reduction of 0.5 percentage points to this interval in relation to the target for 2016. If the Central Bank's assessment is that inflation will be above this target, it may raise interest rates, directly affecting the cost of our debt and indirectly reducing the demand for products and services related to telecommunications. In 2017, factors that may adversely affect consumer inflation are, among others, the depreciation of the *real* against global benchmark currencies, a possible decision by the Brazilian federal government to raise utility prices (such as electricity tariffs) and potential tax increases.

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 TV 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, or IST, adjusted by a factor of productivity, which is defined by ANATEL Resolution 507/2008. The IST is an index composed of other domestic price indexes 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 upon our operations.

The authorization by ANATEL to adjust the rate of fees, which is pegged to the IST, is reduced by a factor of productivity, which is calculated based on a compensation index established by ANATEL to share earnings from fixed charge services with their users. 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.

Increases in interest rates may have a material adverse effect on our business. The Monetary Policy Committee of the Central Bank (*Comitê de Política Monetária do Banco Central do Brasil*) sets the basic interest rate for the Brazilian financial system based on the future inflation rate and the central inflation target. On December 31, 2016, the basic interest rate was 13.75% per year, compared to 14.25% per year on December 31, 2015. The basic interest rate decreased 75 basis points on January 11, 2017 and is currently 13.00% per year. The current market consensus is converging towards an IPCA target of 4.5%. The Copom justified its decision based on the lower-than-expected economic activity, lower inflation expectations and positive advances on the necessary economic reforms. As a result, the Central Bank may keep the pace of the cuts of the overnight rate (*Sistema Especial de Liquidação e de Custódia – Selic*) in the next months, but may increase rates depending on how the macroeconomic scenario evolves. Such rate

increases may adversely affect our business and results of operations.

Table of Contents

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 exchange rate between the U.S. dollar and the Brazilian *real* has experienced significant fluctuations in recent years. The *Real* depreciated 12.6% against the U.S. dollar in 2011, 8.9% in 2012, 14.6% in 2013, 13.4% in 2014, 47% in 2015 and appreciated 16.5% in 2016.

As of December 31, 2016, 14% of our total indebtedness of R\$9.2 billion was denominated in foreign currency (of which 10% was denominated in U.S. dollars). As of December 31, 2016, we had currency hedges in place to cover all of our financial foreign currency-denominated indebtedness.

Approximately 6.2% 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.

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. We believe this strategy has substantially reduced our exposure to fluctuations in exchange rates.

Additionally, 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.

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. 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. Any of the foregoing developments may adversely affect the market value of our preferred shares and hinder our ability to access the capital markets and finance our operations in the future on acceptable terms and costs, or at all.

Exchange controls and restrictions on remittances abroad may adversely affect holders of our preferred shares and ADSs.

Brazilian law allows for the Brazilian government to impose temporary restrictions on capital outflows whenever there is a significant imbalance in Brazil's balance of payments or a significant possibility that such imbalance will exist. Such restrictions could hinder or prevent the holders of our preferred shares or the custodian of our shares in Brazil, Citibank N.A. (acting as the agent for the depositary), from remitting dividends abroad. The Brazilian government last imposed restrictions on capital outflows for a six-month period at the end of 1989. If similar restrictions are introduced in the future, they would likely have an adverse effect on the market price of our preferred shares and ADSs.

Table of Contents

Risks Relating to the Brazilian Telecommunications Industry and Us

Extensive government regulation of the telecommunications industry and our concession 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. ANATEL, the main telecommunications industry regulator in Brazil, regulates, among other things:

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

Brazil's 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 regulatory framework, we cannot provide assurances that ANATEL will not adversely modify the terms of our authorizations.

Furthermore, according to the terms of our operating authorizations and concession, we must meet certain requirements and maintain minimum quality, coverage and service standards. Failure by us to comply with these requirements may result in the imposition of fines or other regulatory responses, including the termination of our operating authorizations and concession. Any partial or total revocation of any of our operating authorizations 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 also been reviewing and introducing changes to its regulation, especially regarding asymmetric competition measures and interconnection fees charged among Brazilian telecommunications service providers. 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 materially adversely affect our business, financial condition, revenues, results of operations and prospects.

Interconnection fees, which are fees charged by telecommunications service providers to each other to interconnect to each other's networks, are an important part of our revenue and cost bases. To the extent that changes to the rules governing interconnection fees reduce the amount of interconnection fees we are able to collect, 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;

Table of Contents

· 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.

We may be unable to successfully accomplish expected synergies of the GVT acquisition.

In order to achieve the full potential of expected GVT synergies, we will depend on our ability to continue to effectively integrate GVT's business and management into our business and management, as well as the overall macroeconomic environment. The integration of GVT into Telefônica has been progressing according to schedule; however, there are inherent risks to any integration that may harm the process. We have to integrate certain systems and processes, such as customer service, field operations, investments optimization, as well as GVT's services into our mix of products. While the integration process has progressed smoothly so far, it consumes time and brings uncertainties to the business. An inability to fully capture the benefits of synergy opportunities, including delays on integration process, would have an adverse effect on our operations and financial results.

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, expansion of our network to provide public pay-phone service for all locations with a population over 100 inhabitants, expansion of our network to provide 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. Our failure to comply with the requirements of our concession may result in the imposition of fines up to R\$50.0 million or other government actions, including the termination of our concession. Any partial or total revocation of our concession would have a material adverse effect on our financial condition and results of operations.

Moreover, the concession agreements establish that all assets owned by us, 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 recent interpretations by ANATEL of current regulation, reversible assets will be automatically returned to ANATEL upon expiration of the concession agreements, according to the regulation in force at that time and would not be available to creditors in the event of insolvency, bankruptcy or similar events. As of December 31, 2016, the net book value of our reversible assets is estimated at R\$8.8 billion, which are comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation 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. The concession agreements contain a provision allowing ANATEL to review the concession terms in 2015 and 2020. This provision permits ANATEL to update the renewed concession agreements with respect 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 27, 2014, as set forth in our concession agreement for fixed line services, ANATEL opened a public review and comment period for the revision of the terms of our concession agreement with respect to the 2016-2020 period. The review period was scheduled to expire on December 26, 2014. As the Federal Senate is currently holding discussions over a new regulatory framework for telecommunications that are expected to affect our concession agreement, the deadline for the termination of this review period and the finalization of any revisions to our concession contracts has been continuously postponed. On December 30, 2016, the review period deadline was postponed once more, to June 30, 2017, as ANATEL cannot publish a new version of the contract while this discussion is in progress within the Brazilian legislative branch.

Table of Contents

Changes to our concession agreement, or to the regulatory framework more broadly, may entail new requirements imposed on us, including requirements to make certain investments and/or capital expenditures, as well as the imposition of conditional investment requirements in order to obtain certain benefits under a new regulatory framework. Moreover, ANATEL may 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. 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 the Law nº 12.846/2013 and, in the United States, to the U.S. Foreign Corrupt Practices Act of 1977.

Although the Company has 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 the Company's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Company's policies and procedures (or otherwise in violation of the relevant anti-corruption laws and regulations) for which the Company or they may be ultimately held responsible. Violations of anti-corruption laws and regulations could lead to financial penalties, damage to the Company's reputation or other legal consequences that could have a material adverse effect on the Company's 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 (Telefónica, 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.

Table of Contents

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.

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.

Table of Contents

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.

The Brazilian telecommunications market growth (measured in revenues) declined in 2016, mainly due to mandatory reductions in mobile termination rates required by Brazilian regulators, as well as a decrease in the use of traditional services (voice and lower speed broadband). By contrast, premium services such as ultra-broadband and mobile data boosted the revenues of telecommunications companies. Customers are demanding higher quality and more data availability, which require investments in the development and expansion of new technologies (Fiber and 4G), pressing companies' results.

Additionally, the following factors have also impacted competition in the telecommunications sector: (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 2014, ANATEL established gradual decreases in mobile interconnection fees, also known as mobile termination rates, or MTR, based on a cost model. Such figures appear in the following table:

	2015	2016	2017	2018	2019
Sector 31 (fixed)					
TU-RL	N/A	0.01139	0.00574	0.00289	0.00146
TU-RU1	N/A	0.05339	0.02191	0.00899	0.00369
TU-RU2	N/A	0.06129	0.02348	0.009	0.00345
Mobile					
Region I	0.16751	0.09317	0.04928	0.02606	0.01379
Region II	0.16237	0.10309	0.05387	0.02815	0.01471
Region III	0.14776	0.11218	0.06816	0.04141	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 or that future negotiations regarding mobile termination rates will be as favorable as those that were previously set by ANATEL. 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.

Table of Contents

ANATEL's annual regulations regarding interconnection fees could have an adverse effect on our results.

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 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”); (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 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 telecommunications regulations targets several areas of vital importance for the mobile telecommunications business, such as regulations (A) to improve the quality of services, which may cause an increase in operating costs, (B) of virtual mobile operations, or MVNO, which may cause an increase in competitive pressure, (C) 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 (D) 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, for instance over-the-top, or OTT, players (that provide voice and messages over IP), and creation of new digital services. New product and technologies may also be superior to, and render obsolete, the products and services we offer and the technologies we use, thus requiring investment in new technology.

Furthermore, such new technologies will demand changes in the regulatory environment challenging the government agencies and telecommunication companies. For example, companies that provide OTT services, that have some characteristics of the telecommunications service, are not subject to the same rules that a telecommunications operator, this gap can bring additional challenges to telecommunications operators. Currently, it is unclear what the level of regulation for this type of service will be.

Resolution No. 600, approved in November 2012, establishes relevant markets and asymmetric measures which were intended to stimulate the competition in such markets. We are subject to review by ANATEL to decide if we have a significant market power in a specific relevant market and, as a result, are subject to asymmetric measures. Both relevant markets and asymmetric measures will be evaluated every four years beginning in 2016 and the list of companies deemed to have significant market power will be reviewed every two years. Such asymmetric measures may have material adverse effect on our financial condition and results of operations.

In December 2016 and January 2017, ANATEL held a public consultation to discuss new parameters to regulate asymmetries in the telecommunications market. In contrast to the current model, ANATEL is proposing to regulate companies not based on their market power throughout the country, but according to the degree of competition present in each municipality.

Additionally, a new regulatory framework for the telecommunications sector is being considered by the Brazilian government. In this regard, legislators are considering the possibility of switching the STFC from the current concession regime to an authorization regime, as well as revisions to the reversibility of assets associated with a concession regime, in order to take account of ongoing technological convergence and changing market dynamics in the sector. Those measures would remove the current legal uncertainty imposed on concession holders and are expected to encourage a more efficient use of assets. The failure to implement any such changes to the regulatory infrastructure could adversely affect the operational and financial results of concession holders.

Changes to any of the above described regulations may have a material effect on our financial condition and results of operations.

Table of Contents

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 2010, ANATEL required multichannel multipoint distribution service, or MMDS, companies, including us, to return a significant portion of the 2.5GHz spectrum we owned at that time. In addition, on June 12 and 13, 2012, ANATEL held a public auction for 273 lots of 4G, on the 2.5GHz to 2.69GHz frequencies. We acquired the “X” band, with a nationwide coverage, for R\$1.05 billion. According to spectrum cap rules for bidding processes, we had to return the remaining portion of the 2.5GHz spectrum we previously owned to operate our MMDS services. In order to meet the coverage obligations and the schedule defined by ANATEL, we have made 4G services available to 516 cities in Brazil. To complete the coverage requirements, we will need to implement 4G coverage in 787 cities with between 30,000 and 100,000 residents by December 31, 2017.

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 made by the Agency under a supervisory.

The 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, 2017: 117 cities;

by December 31, 2018: another 117 cities; and

by December 31, 2019: 156 more cities.

In 2012, ANATEL auctioned a 450 MHz frequency lot tied to the 2.5 GHz band, to meet voice and data demand in remote rural areas. Under band “X,” which we acquired in the bidding process, we will be required to provide infrastructure 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 2016, ANATEL’s board of directors approved a request made by telecommunications companies to allow for coverage in those remote areas with other technologies, since there is no available ecosystem to use the 450 MHz frequency.

Regarding the 700 MHz spectrum, ANATEL has allocated the band for the provision of fixed, mobile and broadband services. On September 30, 2014, ANATEL held the public bidding for 18 blocks of 4G, on the 708 to 803 MHz frequencies. 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 will be responsible for financing and managing the band cleaning process and ANATEL has deducted the cleaning cost associated with two blocks for which no bids were made.

In January 2016, the Ministry of 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 new schedule, two cities were turned off in 2016: Rio Verde (GO) and Brasília (DF). Despite minor delays, the program implementation was considered successful. According to the schedule, analog TV services in 349 municipalities in 8 states (Bahia, Ceará, Espírito Santo, Goiás, Minas Gerais, São Paulo, Rio de Janeiro and Pernambuco) will be shut down in 2017, including the capitals of these states. The list of municipalities for 2018 has not yet been defined.

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

Table of Contents

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 improvement action plan. 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 plan can be produced and approved by ANATEL, which may materially affect our business and results of operations.

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, which 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. The federal law, that establishes new guidelines to create a consolidated plan for the installation of antennas was approved in 2015, however, it is still pending specific regulation. Despite the federal initiative, 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.

Table of Contents

Additional antenna installation is also limited as a result of concerns that radio frequency emissions from base stations may cause health problems. 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, or 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. However, perceived risks may delay expansion of our network if we experience problems in finding new sites, which in turn may delay expansion and may affect the quality of our services.

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. In addition, this law further restricts the installation of new antennas.

New laws may create additional transmission regulations, which in turn, could have an adverse effect on our business. Also, health concerns regarding the effects of radio frequency emissions may 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.

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.