

TELEFONICA BRASIL S.A.  
Form 20-F  
February 27, 2015

As filed with the Securities and Exchange Commission on February 27, 2015

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

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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, 2014

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

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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)

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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:

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

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, 2014 was:

Title of Class	Number of Shares Outstanding (excluding treasury shares)
Shares of Common Stock	381,335,671
Shares of Preferred Stock	741,933,573

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

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

	International Financial Reporting Standards as issued by the International Accounting Standards Board <input checked="" type="checkbox"/>	
U.S. GAAP <input type="checkbox"/>		Other <input type="checkbox"/>

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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TABLE OF CONTENTS

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	Page
<u>PART I</u>	<u>1</u>
<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>16</u>
<u>ITEM 4A. UNRESOLVED STAFF COMMENTS</u>	<u>57</u>
<u>ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	<u>59</u>
<u>ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	<u>77</u>
<u>ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	<u>88</u>
<u>ITEM 8. FINANCIAL INFORMATION</u>	<u>89</u>
<u>ITEM 9. THE OFFER AND LISTING</u>	<u>99</u>
<u>ITEM 10. ADDITIONAL INFORMATION</u>	<u>102</u>
<u>ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>126</u>
<u>ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	<u>127</u>
<u>PART II</u>	<u>129</u>
<u>ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	<u>129</u>
<u>ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	<u>129</u>
<u>ITEM 15. CONTROLS AND PROCEDURES</u>	<u>129</u>
<u>ITEM 16. [RESERVED]</u>	<u>130</u>
<u>ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT</u>	<u>130</u>
<u>ITEM 16B. CODE OF ETHICS</u>	<u>130</u>
<u>ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	<u>130</u>
<u>ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES PROCEDURES</u>	<u>131</u>
<u>ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u>	<u>131</u>
<u>ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT</u>	<u>132</u>
<u>ITEM 16G. CORPORATE GOVERNANCE</u>	<u>132</u>
<u>ITEM 16H. MINE SAFETY DISCLOSURE</u>	<u>134</u>
<u>PART III</u>	<u>135</u>
<u>ITEM 17. FINANCIAL STATEMENTS</u>	<u>135</u>
<u>ITEM 18. FINANCIAL STATEMENTS</u>	<u>135</u>
<u>ITEM 19. EXHIBITS</u>	<u>135</u>
<u>GLOSSARY OF TELECOMMUNICATIONS TERMS</u>	<u>138</u>

SIGNATURES

140

i

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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;
  - “DOU” are to the Diário Oficial da União, the Official Newspaper of the Brazilian Government;
- “Federal District” are to Distrito Federal, the federal district where Brasilia, 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;
- “GVTPar” are to GVT Participações S.A., the controlling shareholder of Operating GVT;
- “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.;
- “PTAX” or “PTAX rate” are to the weighted average daily buy and sell exchange rates between the real and U.S. dollar that is calculated by the Central Bank;
  - “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 conducts cellular operations including SMP (as defined in the Glossary of Telecommunication Terms), nationwide.
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“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 138 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;
- our ability to consummate the GVT acquisition (as described herein) or, if consummated, to successfully integrate GVT’s operations or to realize expected benefits;
  - 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, 2014 and December 31, 2013 and for the years ended December 31, 2014, December 31, 2013 and December 31, 2012 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, 2014 and 2013 and for each of the three years in the period ended December 31, 2014 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, 2014.

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 Vivo Participações and Vivo are consolidated into our financial statements for nine months in 2011, as from April 1, 2011. Consequently our results of operations for the years ended December 31, 2011 and 2010 are not comparable with our results of operations for the year ended December 31, 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 and for the years ended December 31, 2014, 2013 and 2012 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.

On March 25, 2011, the boards of directors of Vivo Participações, our former subsidiary, and Telefônica Brasil approved the terms and conditions of the corporate restructuring of both companies, which was approved unanimously by the shareholders of both companies on April 27, 2011.

The transaction consisted of the unification of the fixed and mobile operations of the Telefônica group in Brazil through the merger of all shares of Vivo Participações into Telefônica Brasil, with Telefônica Brasil as the surviving entity. Telefônica Brasil exchanged each share of Vivo Participações held by shareholders of Vivo Participações for shares of Telefônica Brasil. The exchange of shares of Vivo Participações for shares of Telefônica Brasil was based on the exchange ratio of 1.55 shares of Telefônica Brasil for each share of Vivo Participações. Upon closing of the merger and the share exchange, Vivo remained our wholly owned direct subsidiary. We assessed the fair value of the assets acquired and the liabilities assumed from Vivo Participações as of March 31, 2011 for purposes of applying the acquisition method to the transaction as a business combination and we consolidated and included Vivo Participações in our results of operations as of April 1, 2011.

Our consolidated financial statements include Vivo Participações and Vivo as of April 1, 2011 through the full consolidation method. Because Vivo Participações and Vivo are consolidated into our financial statements as of April 1, 2011, our results of operations for the years ended December 31, 2011 and 2010 are not comparable with our results of operations for the year ended December 31, 2014, 2013 and 2012. For further information on our corporate restructuring, see “Item 4.A Historical Background – Corporate Restructuring Involving Telefônica Brasil and Vivo Participações.”

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.”

Year ended December 31,

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Income Statement Data:	2014 (in millions of U.S. dollars)(1)	2014	2013	2012	2011	2010
				(in millions of reais)		
						(except for share and per share data)
Net operating revenue	13,177	35,000	34,722	33,919	29,117	15,788
Cost of goods and services	(6,484 )	(17,223 )	(17,542 )	(16,557 )	(15,035 )	(8,837 )
Gross profit	6,693	17,777	17,180	17,362	14,082	6,951
Operating expenses, net	(4,769 )	(12,668 )	(12,248 )	(10,152 )	(8,290 )	(3,408 )
Equity in earnings (losses) of associates	3	7	(55 )	1	4	25
Operating income before financial expense, net	1,927	5,116	4,877	7,211	5,796	3,568
Financial expense, net	(136 )	(362 )	(215 )	(291 )	(141 )	(125 )
Income before tax and social contribution	1,791	4,754	4,662	6,920	5,655	3,443
Income tax and social contribution	69	183	(946 )	(2,468 )	(1,293 )	(1,045 )
Net Income	1,860	4,937	3,716	4,452	4,362	2,398
Attributable to:						
Controlling shareholders	1,860	4,937	3,716	4,453	4,355	2,398
Non-controlling shareholders	—	—	—	(1 )	7	—
Basic and diluted earnings per share:						
Common Shares	1.55	4.12	3.10	3.72	4.40	4.45
Preferred Shares	1.71	4.53	3.41	4.09	4.84	4.89
Cash Dividends per share in reais, net of withholding tax:						
Common Shares	0.77	2.04	1.86	2.57	4.78	3.62
Preferred Shares	0.85	2.25	2.04	2.82	5.26	3.98

Table of Contents

Balance Sheet Data:	2014		As of December 31,			
	(in millions of U.S. dollars)(1)	2014	2013	2012	2011	2010
			(in millions of reais)			
			(except for share and per share data)			
Property, plant and equipment, net	7,700	20,454	18,442	17,604	17,147	10,193
Total assets	27,507	73,065	69,504	70,251	65,489	19,962
Loans and financing—current portion	568	1,509	1,237	1,270	1,000	432
Loans and financing—noncurrent portion	799	2,123	3,215	3,774	3,969	1,429
Debentures—current portion	284	755	287	702	469	—
Debentures—noncurrent portion	1,285	3,412	4,015	2,254	788	—
Shareholders' equity	16,923	44,950	42,894	44,681	43,331	11,667
Attributable to:						
Controlling shareholders	16,923	44,950	42,894	44,681	43,326	11,667
Noncontrolling shareholders	—	—	—	—	5	—
Capital stock	14,230	37,798	37,798	37,798	37,798	6,575
Number of shares outstanding (in thousands)(2)	1,123,269	1,123,269	1,123,269	1,123,269	1,123,884	505,841
Cash Flow Data:			Year ended December 31,			
	2014	2014	2013	2012	2011	2010
	(in millions of U.S. dollars)(1)		(in millions of reais)			
Operating activities:						
Net cash provided by operating activities	3,532	9,384	9,576	10,054	8,128	4,481
Investing activities:						
Net cash used in investing activities	(2,864 )	(7,608 )	(5,543 )	(3,721 )	(2,007 )	(1,658 )
Financing activities:						
Net cash used in financing activities	(1,365 )	(3,627 )	(4,622 )	(2,089 )	(4,729 )	(3,603 )
Increase (decrease) in cash and cash equivalents	(697 )	(1,851 )	(589 )	4,244	1,392	(780 )
Cash and cash equivalents at beginning of year	2,464	6,544	7,133	2,889	1,497	2,277
Cash and cash equivalents at end of year	1,767	4,693	6,544	7,133	2,889	1,497

(1) Translated for convenience only using the commercial offer rate as reported by the Central Bank as of December 31, 2014 for reais into U.S. dollars of R\$2.6562 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) On February 24, 2015, our board of directors approved the cancellation of all our treasury shares. As of the date of this annual report, we did not hold any 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.

Table of Contents

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 2010, the real appreciated by 4.3 % against the U.S. dollar. In 2011 and 2012, the real depreciated by 4.8 % and 8.9 %, respectively, against the U.S. dollar. In 2013 and 2014, the real depreciated a further 14.6 % and 13.4 %, respectively against the U.S. dollar. On December 31, 2014, the year-end real/U.S. dollar exchange rate was R\$2.6562 per U.S. \$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.

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, Month	Exchange Rates of R\$ per US\$1.00			
	Period-End	Average(1)	High	Low
2010	1.6662	1.7589	1.8811	1.6554
2011	1.8758	1.6709	1.9016	1.5345
2012	2.0435	1.9588	2.1121	1.7024
2013	2.3426	2.1741	2.4457	1.9528
2014	2.6562	2.3599	2.7403	2.1974
August 2014	2.2396	2.2680	2.2986	2.2396
September 2014	2.4510	2.3329	2.4522	2.2319
October 2014	2.4442	2.4483	2.5341	2.3914
November 2014	2.5601	2.5484	2.6136	2.4839
December 2014	2.6562	2.6386	2.7403	2.5607
January 2015	2.6623	2.6329	2.7107	2.5690
February 2015 (through February 26)	2.8728	2.8128	2.8811	2.6894

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 26, 2015, the exchange rate was R\$2.8728 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.

3

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Table of Contents

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;
- 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 over the possibility of the Brazilian government implementing changes in policy or regulation 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.

The Brazilian economy remains subject to risks and adjustments arising from international financial conditions. The international financial system remains susceptible to unfavorable credit and liquidity conditions. Foreign and national financial institutions, including some of the largest commercial banks, investment banks, mortgage lenders, guarantors and mortgage insurance companies, could experience significant difficulties, including runs on their deposits and inadequate liquidity.

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 stabilizing conditions in international financial markets.

Despite the extent of the above-mentioned interventions, the global financial markets could remain volatile and access to credit could still be lacking. 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.

Table of Contents

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. Brazilian president Dilma Rousseff has been reelected for a second four year term, which began in January 2015. Uncertainty regarding future policies and appointments to influential governmental positions following the reelection as well as ongoing investigations into allegations of corruption in state-controlled enterprises may also affect the confidence of investors and the general public. It may also have an adverse impact on 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.

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 2014, inflation measured by the Brazilian consumer price index (Índice de Preços ao Consumidor), or IPCA, reached 6.41%, below the upper limit established by the CMN, of 6.5% but above the inflation target of 4.5%. In 2015, the Brazilian monetary policy will continue to use the IPCA as a reference for the inflation target. The inflation target for 2015 is set at 4.5%, allowing for a range of 2% above or below this target, which is similar to the target for 2014. If the Central Bank's assessment is that inflation will be above this target in the near future, 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 2015, 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, 2014, the basic interest rate was 11.75% per year, compared to 10.0% per year on December 31, 2013. The basic interest rate was further adjusted on January 21, 2015 and is currently 12.25% per year. Further increases in the basic interest rate may occur throughout 2015 and may have adverse effects on our business and results of operations. According to current market consensus, inflation measured by the IPCA will be higher than the established inflation target of 4.5% for 2015. As a result, the Central Bank may increase the overnight rate (Sistema Especial de Liquidação e de Custódia),

or SELIC rate, in 2015 to attempt to align actual inflation with the inflation target. 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 68% against the U.S. dollar between 2000 and 2003, appreciated by 40% from 2004 to 2010 and depreciated by 34% from 2011 to 2014 (calculated according to the annual average exchange rates).

As of December 31, 2014, 15.9% of our total indebtedness of R\$7.8 billion was denominated in foreign currency (of which 9.2% was denominated in U.S. dollars). As of December 31, 2014, we had currency hedges in place to cover all of our financial foreign currency-denominated indebtedness.

Approximately 36.6% and 9.1% of the costs relating to our network infrastructure and services provided by outside vendors is payable or linked to payment by us in U.S. dollars or Euros, respectively. By contrast, 99.8% 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 government 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 in the applicable regulation, especially regarding the interconnection fees among telecommunications service providers in Brazil. 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;
- 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.

Table of Contents

The GVT acquisition may not be consummated.

Our ability to consummate the GVT acquisition is subject to various closing conditions. These include customary closing conditions in addition to others that are beyond our control, such as the requirement to obtain approvals from certain regulatory authorities. We believe that the most significant risk posed by these closing conditions is related to the regulatory approvals that are required to be granted by the Brazilian competition authority (CADE) and telecommunications regulator (ANATEL). As of the date of this annual report, we have received approval from ANATEL, subject to the satisfaction of certain conditions, as described in “Item 4. Information on the Company—A. History and Development of the Company—Historical Background—Acquisition of GVT.” In addition, ANATEL required that the subsequent swap transaction, which contemplates that Vivendi will exchange a portion of its stake in Telefônica Brasil for a portion of Telefónica S.A.’s indirect stake in Telecom Italia be subject to a distinct and specific approval process. Such additional approval request was filed on December 30, 2014, and approval is still pending. In addition, the GVT acquisition remains subject to CADE’s approval, which we requested on November 17, 2014.

On February 13, 2015, CADE’s superintendent board recommended the approval of the transaction on the basis of certain confidential commitments offered by Telefônica Brasil S.A. and Vivendi S.A. The commitments include the execution of two merger control agreements: the first between CADE and us and the second one between CADE and Vivendi S.A. The GVT acquisition is under the review of CADE’s administrative tribunal, which will issue a final decision. As of the date hereof, it is still possible that the remaining approvals required for the consummation of the GVT acquisition may not be obtained or, if they are obtained, could impose unanticipated or adverse conditions. Therefore, depending on these conditions, it may not be possible to consummate the GVT acquisition according to the expected timeline or at all.

If the acquisition of GVT is consummated, we may be unable to successfully integrate GVT’s operations or to fully realize targeted synergies, revenues and other expected benefits of the acquisition of GVT.

Achieving the targeted synergies, such as operating and long-term strategic cost-savings, of the GVT acquisition will depend in part upon whether we can integrate GVT’s businesses in an efficient and effective manner. We may not be able to accomplish this integration process smoothly or successfully. We and GVT operate numerous systems, including those involving management information, accounting and finance, sales, billing, employee benefits, payroll and regulatory compliance. Moreover, the integration of our respective operations will require the dedication of significant management resources, which may distract management’s attention from day-to-day operations. Employee uncertainty and lack of focus during the integration process may also disrupt our business and result in undesired employee attrition. An inability of management to successfully integrate the operations of GVT into our business could have a material adverse effect on our business, results of operations and financial condition.

An inability to realize the full extent of, or any of, the anticipated benefits and synergies of the acquisition of GVT, as well as any delays encountered in the integration process, could have an adverse effect on our business, results of operations and financial condition.

The acquisition of GVT may expose us to liabilities and contingencies.

GVT is party to a number of lawsuits and other proceedings involving a significant amount. The indemnities that we may receive from the seller may be insufficient to protect or indemnify us for any liabilities and contingencies that we did not identify during the due diligence process or that were identified but were estimated to be lower than the actual amounts. If we incur significant costs as a result of such liabilities or contingencies, our business and results may be adversely affected.

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, and, with respect to quality of service, targets for the number of call completions. Our ability to satisfy these and other terms and conditions may

Table of Contents

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 the company 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. 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. The most recent net book value of our reversible assets reported to ANATEL is dated December 31, 2014 and estimated at R\$7.6 billion, which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

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.

We may be required to record impairment charges relating to goodwill and long-lived assets in the future.

For IFRS purposes, we are required to test our goodwill for impairment at least annually. The excess of the book value of a company over its market value may indicate that impairment exists. This impairment test is described in Note 3 to our audited consolidated financial statements. We have substantial goodwill with a carrying value of R\$10.2 billion as of December 31, 2014. It is possible that we may be required to record impairment charges relating to our goodwill in future periods, and this would have an adverse effect on our results of operations.

In addition, we are required to test for impairment on our long-lived assets, including property, plant and equipment and finite-lived intangible assets (including licenses) whenever there are indicators of impairment. If the carrying value of these assets exceeds the recoverable amount expected from their use, we are required to record an impairment charge. This impairment test is also described in Note 3 to our audited consolidated financial statements included in this annual report.

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, each with an average of over 30 years of 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 eventual liabilities resulting from our contracting structure for third party service providers. Such potential liabilities may involve claims by third party providers that are treated as direct employees as well as claims for secondary liability resulting from work place injury, wage parity and overtime pay complaints. If a significant portion of these liabilities are decided against us and for which we have not made 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.

Review of our concession agreements may have a materially adverse effect on us.

On June 27, 2014, as set forth in our concession agreement for fixed line services in the state of São Paulo, ANATEL opened a public comment period for the revision of the terms of our concession agreement. The comment period, which ended on December 26, 2014, was opened for comments on certain topics such as service universalization, rates and fees and quality of services, among others. We submitted our comments on time and according to the established rules. Depending on the evaluation made by ANATEL of the contributions and ANATEL's final decision regarding the terms of our concession agreement, it may impose universal service goals, with values that we are not able to predict, which may have a materially adverse effect on our financial condition and results of operations.

Table of Contents

Consolidation in the Brazilian telecommunications market may increase competition in the near future.

Some of the main telecommunication groups in Brazil have been going through a series of mergers and acquisitions since 2012. In December 2011, Sky Brasil (a Brazilian subsidiary of DirecTV), announced the purchase of Acom Comunicações, a Brazilian television and internet company, which was approved by regulators in 2012. Along with the acquisition of Acom, Sky Brasil also acquired grants to operate new 4G spectrum areas in June 2012.

In May 2012, entrepreneur George Soros acquired Sunrise Telecomunicações, a Brazilian Pay TV provider that is now expanding into mobile services. Sunrise Telecomunicações spent US\$9.3 million to acquire two 4G spectrum licenses covering 134 cities in the state of São Paulo.

On February 19, 2014, Oi S.A., or Oi, and Portugal Telecom SGPS, S.A., or Portugal Telecom, entered into a subscription agreement pursuant to which Portugal Telecom agreed to subscribe to Oi common and preferred shares as part of a capital increase by contributing all of the share capital of PT Portugal SGPS, S.A., or PT Portugal, to Oi. According to the valuation report, the shares of PT Portugal were valued at an amount between €1,623.3 million (R\$5,296.4 million) and €1,794.1 million (R\$5,853.9 million).

Furthermore, on December 8, 2014, Oi's board of directors approved the general terms and conditions for the sale of all of the shares of PT Portugal to Altice S.A., or Altice. The sale involves substantially all of PT Portugal's operations in Portugal and Hungary. The transaction was approved by the shareholders of Portugal Telecom on January 22, 2015. At closing, subject to regulatory approval, Oi will transfer to Altice all of the shares issued by PT Portugal for €7.4 billion, subject to certain adjustments.

On May 18, 2014, AT&T announced an agreement to acquire DirecTV (one of the shareholders of SKY Brasil) in a stock-and-cash transaction for US\$95 per share. The expected synergies are primarily driven by increased economies of scale in video. The two companies, DirecTV and AT&T, have more than 26 million video subscribers in the United States, and the merger is currently under review by U.S. Department of Justice and the Federal Communications Commission because their combined operations will have a significant impact on the U.S. Pay TV market. DirecTV currently has approximately 18.1 million customers in its Latin American operations, which include Brazil.

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

We face significant competition in the Brazilian market.

We face significant competition in the Brazilian market, the Brazilian telecommunication industry growth (measured in revenues) decelerated in 2014, mainly due to obligatory reductions in mobile termination rates mandated by Brazilian regulators, which directly affected revenues of telecommunications companies. Furthermore, customer demand for improvements in network quality and new customer service regulations have pressured companies' investments and margins.

Competition remains fierce, despite a weakening macroeconomic environment, and telecommunications companies are seeking to strengthen their competitive position through internal corporate restructurings as well as mergers and acquisitions. We expect that competition for customers will continue to drive us and our competitors to provide innovative and improved products and services. For example, the high level of participation by major Brazilian mobile operators in the Brazilian auction for the 700 MHz frequency, which was conducted in September 2014, confirms the relevance of 4G as a cornerstone of our competitors' long-term growth strategy. Future spectrum auctions by ANATEL

may allow new competitors to enter the market and may strengthen the competitive position of some of our current competitors. Bundled offers are also heightening their importance as a commercial driver, fostering companies to offer complete and superior solutions to consumers. To the extent we are unable to keep pace with our competitors, our market position and results of operations may be adversely affected. Moreover, the significant competition in the Brazilian market may adversely affect our margins if we are required to reduce prices or provide special offers to customers in order to maintain or increase market share.

Table of Contents

Our results of operations may be negatively affected by the application of the Personal Mobile Service (Serviço Móvel Pessoal), or SMP, rules relating to mobile services.

We receive payments for the termination of calls in our network. In 2014, ANATEL established gradual decreases in mobile interconnection fees, also known as mobile termination rates, or MTR. In 2014, the MTR net value in Region III was R\$0.25126 and it will be R\$0.16751 in 2015, R\$0.11218 in 2016, R\$0.06816 in 2017, R\$0.04141 in 2018 and R\$0.02517 in 2019.

In addition, SMP rules implemented number portability beginning in September 2008, which allow users to maintain the same number when switching operators within the same area code, and costs of such portability are borne by the operator. For fixed service operators, number portability is also available within the same area code. There can be no assurance that this regulation will not have material adverse effects on the results of our operations.

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.

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

ANATEL issues new regulations every year 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), 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.

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 (who 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.

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.

Table of Contents

In order to meet the coverage obligations and the schedule defined by ANATEL, we have made 4G services available to 140 metropolitan areas in Brazil including all cities with over 500,000 residents. To complete the coverage requirements, we will need to implement 4G coverage as follows:

- by December 31, 2015: cities with over 200,000 residents;
- by December 31, 2016: cities with over 100,000 residents;
- by December 31, 2017: cities with between 30,000 and 100,000 residents; and
- by December 31, 2019: cities with fewer than 30,000.

In 2012, ANATEL auctioned a 450 MHz frequency lot that is 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. The schedule for providing infrastructure in the rural areas requires that 100% of municipalities have infrastructure in place by December 2015, with a transmission rate of 256Kbps and by December 31, 2017, all of these municipalities will be expected to have 1Mbps.

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.

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. The beginning of the spectrum usage could be delayed, because it requires the completion of the band cleaning process. This may have an adverse effect on the 4G data package offerings and consequently on our revenues from mobile data services.

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.

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.

Table of Contents

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. Initiatives for the approval of a federal law that would establish new guidelines to create a consolidated plan for the installation of antennas have been taken and the plan is currently being reviewed by the Brazilian federal senate, after which it will be subject to presidential approval. However, despite the federal initiatives, 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. 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





Table of Contents

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, eight 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 depository, 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—Preemptive Rights.”

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

CMN Resolution No. 1,927 currently regulates foreign investments in depository receipts based on shares issued by Brazilian companies. Pursuant to this regulation, the ADSs benefit from the certificate of foreign capital registration, which permits Citibank N.A., as depository, 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 depository’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. 2,689, dated January 26, 2000, which entitles certain investors to buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration. CMN Resolution No. 4,373, of September 29, 2014, will replace 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 the Central Bank regulating 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. 2,689, they will generally be subject to less favorable tax treatment with respect to our preferred shares. There can be no assurance that the depository'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.

## Table of Contents

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. Brazilian tax authorities also do not provide clear guidance in this respect, and may treat such transaction as subject to this capital gain tax in Brazil at the rate of 15% (or 25% if the non-Brazilian holder is located in a tax haven jurisdiction), plus potential fines and interest. Therefore, if the income tax is deemed to be due, the gains may be subject to income tax in Brazil at a rate of 15.0% (general taxation) or 25.0% (if the nonresident seller is located in a tax haven, a country which does not impose any income tax, which imposes it at a maximum rate lower than 20.0%, or in which the laws impose restrictions on the disclosure of ownership composition or securities ownership or the identification of the effective beneficiary of income attributed to nonresident holders). 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 91.57% of our voting shares and 73.74% 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, 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

## Table of Contents

GVT acquisition or its value. In addition, ANATEL required that the subsequent swap transaction, which contemplates that Vivendi will exchange a portion of its stake in Telefônica Brasil for a portion of Telefónica S.A.'s indirect stake in Telecom Italia be subject to a distinct and specific approval process. Such additional approval request was filed on December 30, 2014 and approval is still pending. In addition, the transaction remains subject to CADE's approval, which we requested on November 17, 2014.

On February 13, 2015, CADE's superintendent board recommended the approval of 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. The GVT acquisition is under the review of CADE's administrative tribunal, which will issue a final decision.

We are registered with the CVM as a publicly held company and our stock is traded on the BM&FBOVESPA 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, 2014, we had 381,335,671 outstanding common shares (excluding treasury shares), with no par value per share, and 741,933,573 outstanding preferred shares, with no par value per share. Our shareholders' equity was in the amount of R\$44.9 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 Telefónica. 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.

In addition to the concentration of the equity ownership mentioned above, the purpose of the corporate restructuring was to simplify the organizational structure of the companies, both of which were publicly held, so as to: (i) focus all authorizations for the rendering of SMP services (originally held by Vivo Participações and Vivo), and (ii) simplify the current corporate structure, eliminating the structure of Vivo Participações, which due to the concentration of commitments, had become a holding company.

Moreover, the corporate restructuring provided for the rationalization of the cost structure of the two companies and facilitated the integration of the businesses and the generation of synergies, thus positively impacting both companies. 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.

## Table of Contents

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

The Italian company TELCO S.p.A. has a 22.4% interest with voting rights in Telecom Italia, and is its major shareholder. 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 is involved with or has decision-making powers over TIM's operations in Brazil, although Telefónica does hold an indirect interest with respect to TIM's operations in Brazil. They are also legally and contractually forbidden from exercising any voting rights in TIM's operations in Brazil. TIM and Telefônica Brasil compete in all markets in which they operate in Brazil and maintain usual and customary contractual relations with one another as well as with the other players in the telecommunications industry (many of which are regulated and reviewed by ANATEL), and notice is given to ANATEL and CADE, when required, concerning the commitments assumed pursuant to these contracts so as to ensure total independence of their operations.

On September 24, 2013, Telefónica entered into a shareholders' agreement with the other shareholders of TELCO S.p.A. whereby Telefónica subscribed and paid for shares (without voting rights) of TELCO S.p.A. in the amount of €324 million. As a result of this capital increase, the share capital of Telefónica with voting rights in TELCO S.p.A. remained unchanged at 46.18%, although its ownership interest increased to 66%. Thus, the governance of TELCO S.p.A., as well as the obligations of Telefónica to abstain from participating in or influencing the decisions that impact the industries where they both operate, remained unchanged.

On January 1, 2014, Italian shareholders of TELCO S.p.A. granted Telefónica an option to purchase all of their shares in TELCO S.p.A. The ability to exercise this call option is subject to approvals from the applicable antitrust authorities and telecommunications regulatory agencies as applicable (including in Brazil and Argentina). The call option has been available since January 1, 2014 and will remain available as long as the shareholders' agreement mentioned above remains in effect, except (i) during the period between January 15 and February 15, 2015 and (ii) during certain periods in the event that the Italian shareholders of TELCO S.p.A. request TELCO S.p.A.'s spin-off.

On December 4, 2013, CADE announced its decision to approve, subject to the limitations described below, the acquisition, by Telefónica, of the total interest held by Portugal Telecom in Brasilcel, which previously controlled Vivo Participações. The transaction had previously been approved by ANATEL and its completion (requiring no prior approval from CADE at the time) and took place immediately after approval from ANATEL, on September 27, 2010. Pursuant to CADE's decision of December 4, 2013, we are required to (1) obtain a new shareholder and share



control over Vivo Participações with Telefónica, under the same conditions applied to Portugal Telecom when it held an interest in Brasilcel or (2) Telefónica shall cease to have, either directly or indirectly, an equity interest in TIM.

Additionally, on December 4, 2013, CADE announced its decision to impose a R\$15 million fine on Telefónica for violating the intent and purpose of the agreement executed by and between Telefónica and CADE (as a requirement to approve the initial purchase transaction of Telecom Italia in 2007), due to the subscription and payment, by Telefónica, of non-voting shares of TELCO S.p.A. in the context of its recent capital increase. This decision also requires Telefónica to dispose of its non-voting shares held in TELCO S.p.A. The deadlines for compliance with the conditions and obligations imposed by CADE in both decisions were classified as confidential by CADE.

Table of Contents

In order to strengthen its firm commitment to the obligations previously assumed by Telefónica to not interfere with decisions that affect Telecom Italia and, consequently, TIM Brasil, Telecom Italia's business in Brazil, Telefónica pointed out, in a material communication, that Mr. César Alierta Izuel and Mr. Julio Linares López had decided to resign with immediate effect, from the position of Directors at Telecom Italia. Additionally, Mr. Julio Linares López decided to resign, with immediate effect, from his position on the list presented by TELCO S.p.A. for potential reelection to the board of directors of Telecom Italia.

Likewise, Telefónica, notwithstanding the rights defined in the TELCO S.p.A. shareholders' agreement, stated in a material communication that it decided not to exercise its right to appoint or nominate directors of Telecom Italia.

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 is subject to approval from ANATEL and CADE. When approved by ANATEL and CADE, the spin-off will consist of the shares held by Telecom Italia being spun-off to four new companies, each of which will be wholly owned by one of TELCO, S.p.A.'s shareholders and each of which will 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. will indirectly hold 14.77% of Telecom Italia S.p.A. of which 8.3% will be exchanged with Vivendi as consideration in the GVT acquisition and 6.47% will 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 required that the subsequent swap transaction which contemplates that Vivendi will exchange its voting stake in Telefônica Brasil for a corresponding amount of ordinary shares of Telecom Italia (currently held by Telefónica) be subject to a distinct and specific approval process. Such additional approval request was filed on December 30, 2014 and approval is still pending.

**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.

## Table of Contents

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 will be paid after the conclusion of (A) a capital increase, the proceeds of which are expected to be used to pay the cash consideration described in (1) above, and (B) the merger of shares of GVTPar into us. Immediately following Vivendi S.A.'s receipt of the stock consideration, Vivendi S.A. will swap 12% of our outstanding ordinary shares and 0.72% of our outstanding preferred shares for shares of Telecom Italia S.p.A. that are indirectly held by Telefónica representing 8.3% of the voting capital stock of Telecom Italia S.p.A. that are indirectly held by Telefónica.

In connection with the acquisition, the holders of our common shares and preferred shares (but not our ADSs) will be granted withdrawal rights. The amount per share to be paid as a result of the withdrawal rights will be determined at the shareholders' meeting that approves the GVT acquisition and the offering, which is expected to occur by mid-2015.

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, 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. In addition, ANATEL required that the subsequent swap transaction which contemplates that Vivendi will exchange a portion of its voting stake in Telefônica Brasil for part of Telefónica S.A.'s indirect stake in Telecom Italia be subject to a distinct and specific approval process. Such additional approval request was filed on December 30, 2014 and approval is still pending. In addition, the transaction remains subject to CADE's approval, which we requested on November 17, 2014.

On February 13, 2015, CADE's superintendent board recommended the approval of 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. The GVT acquisition is under the review of CADE's administrative tribunal, which will issue a final decision.

For a description of GVT's business, see “—B. Business Overview—GVT's Business Activities.”

## Capital Expenditures

### Year Ended December 31, 2014

In 2014, we invested R\$9,140.4 million, a 52% increase over the amount we invested in 2013, primarily due to the cost of acquiring the new 700MHz frequency spectrum, in an amount of R\$2,770 million; however, we also increased the capital expenditures for projects (14% in capital expenditures, excluding licenses). Investments in projects are strongly focused on network (which accounted for 87% of investments in 2014, excluding licenses) and include 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 help 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, mobile 3G/4G and dedicated corporate networks. We continue to invest in expanding our national data transmission backbone to meet the increase in mobile data traffic throughout Brazil.

Table of Contents

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2014.

Telefônica Brasil	Year ended December 31,		
	2014	2013	2012
	(in millions of reais)		
Network	5,517.0	4,683.3	3,845.8
Technology / Information Systems	590.4	569.5	562.3
Others(1)	3,033.0	780.5	1,709.0
<u>Total capital expenditures</u>	<u>9,140.4</u>	<u>6,033.3</u>	<u>6,117.1</u>

(1) Consists primarily of free handset sales made to corporate customers for the length of their contracts, furniture and fixtures, office equipment and store layouts and an amount of R\$2,770 million in 2014 related to the acquisition of the new 700MHz frequency spectrum, R\$451 million in 2013 related to the upgrade of the 1,900 MHz frequency for 3G usage, R\$1,050 million in 2012 related to acquisition of the new 2.500MHz/450MHz frequency spectrum and other costs of licenses.

## Year Ended December 31, 2013

In 2013, we invested R\$6,033.3 million, a similar amount to what was invested in 2012. However we increased the capital expenditures for projects and decreased our expenditures for spectrum licenses compared to 2012. Investments in projects in 2013 were strongly focused on network (which accounted for 84% of investments in 2013, excluding licenses) and helped sustain our commercial and revenue growth while maintaining the quality of the services provided.

## Year Ended December 31, 2012

In 2012, we invested R\$6,117.1 million, mainly in network-related investments to assure quality and increase our capacity to support growth in mobile data and voice and expand fiber services. The investments in mobile and fixed line networks and expanding our client base represented 87% of the total amount invested by us in 2012 (excluding the purchase of new licenses).

## B. Business Overview

We are the leading mobile telecommunications company in Brazil (28.5% market share as of December 31, 2014, based on accesses), with a particularly strong position in postpaid mobile services (41.8% market share as of December 31, 2014, 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 60% 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, 2014, our average revenue per mobile user, or ARPU, of R\$23.7 represented a significant premium relative to the market average of R\$16.8. In 2014, we captured 56.3% of the net additions of 8.3 million 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 infrastructure, or FTTH), Pay TV, information technology and digital services (such as e-health, cloud and financial services). We also have the most extensive distribution network among our competitors, with more than 300 of our own stores and approximately 1,800 physical distribution points of sale 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 are in the process of acquiring GVT, 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.

## Table of Contents

### 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.

#### 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 (including Value Added 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 WAP protocol, 3G and 4G as well as value-added services, including voice mail, voice mail translation in speech-to-text (“Vivo Torpedo Recado”), caller identification, voice minutes in unlimited bundles to other mobile phones of postpaid customers, ring tones (“Vivo Som de Chamada”), and innovative services such as multi-media backup, cloud based services to save texts (“Vivo Torpedo Center”) and our “MultiVivo” services, which allow the customer to share a 3G, 3G Plus and 4G connection with up to five mobile devices. All these services can be bought directly by the client at Vivo Service Stores (“Lojas de Serviços Vivo”).

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.

## Table of Contents

### Data Services

We provide fixed broadband through xDSL technologies, coaxial cable and FTTH. Under the brand Vivo Internet Fixa we offer internet with speeds ranging from 1Mbps to 10Mbps and under the brand Vivo Internet Fibra we offer the Ultra Broadband service with speeds of 50, 100 and 200Mbps.

In 2014, we covered 100% of the municipalities in our concession area in the state of São Paulo, reaching more than 3.9 million fixed broadband customers, and we expanded our fiber network in São Paulo to reach four million homes in 36 cities.

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.

In mobile broadband, we offer the HSPA+ technology, commercially known as 3G Plus. This technology is already being offered in 100% of our WCDMA coverage, allowing customers with compatible terminals to reach up to three times the speed of traditional 3G. We also offer the LTE system in a new spectrum (2.6 Ghz). Initially we covered the host and sub-host cities of the 2013 FIFA Confederations Cup and 2014 FIFA World Cup, in compliance with the schedule established by ANATEL, and subsequently expanded the coverage to other locations pursuant to the criteria established by ANATEL. By the end of 2014, 140 municipalities relied on our 4G coverage, including primarily the state capital cities, the Federal District and cities with a population of more than 500,000 inhabitants.

### Wireless Internet (SMP)

We use a variety of technologies to provide wireless internet services to our customers. Our 3G network is currently available nationwide. In addition, we provide 3G Plus technology to customers with compatible handsets, offering higher speeds and transmission rates than the traditional 3G network. We also provide LTE or 4G technology, which as of December 31, 2014 was available in 140 municipalities, reaching 40.6% of Brazil’s population. As of December 31, 2014, our 3G network was available in 3,245 municipalities, reaching 87.18% of Brazil’s population, and our 2G network was available in 3,758 municipalities, reaching 91.1% of Brazil’s population.

### 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, 2014, had 771,000 Pay TV customers, including 95,000 IPTV customers. We currently offer DTH to the entire state of São Paulo and offer IPTV and cable in the metropolitan area of the city of São Paulo.

### Network Services

Our network management technology ensures comprehensive management and supervision of all our network processes and network performance for our wholesale clients. Our network management centers are located in São Paulo, Brasilia and Minas Gerais. 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 and broadband networks. The network management center in Brasília monitors

the critical operational parameters of core networks and services platforms. The network management center in Minas Gerais monitors the critical operational parameters of the radio access network and infrastructure. 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.

## Table of Contents

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. Such improvements reach 43.3% of fixed traffic, modernization of switches and adaptation of the infrastructure of datacenters, 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 without broadband internet, 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.

The fixed-wireless services, or FWT, is a fixed voice service provided using mobile infrastructure. It is aimed at lower income customers mainly outside São Paulo. It grew more than 87% in 2014.

### Network and Facilities

We provide industrial exploration of dedicated lines (Exploração Industrial de Linha Dedicada), or 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.

The EILD are used to meet the demands of other carriers. 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. In 2015 we expect to meet demand for more than 10,000 circuits of 2Mbps EILD, totaling 38Gbps of bandwidth.

Our network consists of an access layer that connects our clients through our metal 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 this 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 2014, we had 233 local and long-distance interconnection agreements and 106 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.

## Table of Contents

### Digital Services

We have made strides in 2014 in the process of becoming a digital telecommunications company in areas such as financial services, machine-to-machine operations, e-health solutions, safety, video and advertising. In the e-health area, for example, we have over 2.5 million clients as well as a wide portfolio of products directed towards the B2C segment. With these new developments, we aim to democratize access to health services and ensure quality and innovation levels in self-service related to healthcare.

### 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 only GSM and WCDMA devices such as handsets, 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, Nokia, Sony, Alcatel, ZTE, Apple, BlackBerry and Huawei.

### GVT's Business Activities

GVT is a high-growth Brazilian telecommunications company that offers high-speed broadband, fixed telephone and Pay-TV services to high income customers across its target market. GVT began operating as an alternative operator, which functions similarly to a competitive local exchange carrier in the United States, to the local incumbent in Region II (Center and Southeast Brazil) in late 2000, initially servicing 24 cities. Since 2006, GVT has held licenses to operate all types of fixed-line telecommunications services throughout Brazil. As of December 31, 2014, GVT operated in 156 Brazilian cities and in 21 Brazilian states as well as in the Federal District. GVT has historically pursued its growth strategy by expanding its network coverage in cities in which it is already present and expanding its territorial reach to additional key markets located outside Region II, aiming to build a national presence across targeted markets throughout Brazil. In 2013, GVT launched operations in 14 cities in five states having almost 16 million inhabitants. GVT also began serving the São Paulo retail market, which is the largest such market in Brazil. In 2014, GVT launched operations in six additional cities across three states, including Araraquara in São Paulo, the first GVT city with 100% of its network based on Gigabit Passive Optical Network, or GPON.

GVT is one of the leading players in high-speed broadband in Brazil and is the leading high-speed broadband provider in 91% of the cities in which it is present, reaching 10.7 million homes in 156 cities. It has a dense and high quality strong transmission backhaul in key regions of Brazil such as the South, Southeast, Center West and a large part of the Northeast with over 33,000 kilometers of fiber deployed as of December 31, 2014. GVT's last mile architecture is

based on FTTC (Fiber to the Cabinet) technology, with broadband commercial speeds of up to 150 mbps. Leveraging its high quality offerings and competitive pricing, GVT successfully captured nearly 67% of broadband net additions of high-speed broadband in the segment between 12 Mbps and 34 Mbps in 2014. GVT provides services that are complementary to our own, with limited overlap with the services we provide. Such complementary services include 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. GVT has more than 2.9 million high-speed broadband clients, of which almost 91% are located outside the state of São Paulo.

## Table of Contents

GVT offers innovative bundles combining high quality and performance at competitive prices for all market sectors (retail, small to medium enterprises and corporate). GVT has delivered broadband speeds to the retail market with differentiated value-added services such as Freedom (an application that simulates a fixed telephone call on a smartphone) and GVT Music and an innovative Pay TV service that is integrated with its other services since the end of 2011. In the first quarter of 2013, GVT improved its broadband portfolio by offering a service speed of 25 Mbps and by increasing the highest available speed to up to 150 Mbps. These new speeds are available with “Power Combo GVT,” a “triple-play offer” of products combining broadband internet, Pay TV and fixed-line telephone. In 2014, GVT increased the GPON technology penetration in the network architecture, preparing the infrastructure for the next generation of broadband that will allow speeds of up to 500 Mbps. This triple-play offer addresses customers’ desire for constant connectivity with quick access to internet content across devices (such as personal computers, tablet computers, smartphones and TVs). In 2013, triple-play bundles accounted for approximately 37% of sales. By year-end 2014, Pay TV achieved a 29% penetration rate across GVT’s broadband customer base. We believe GVT offers a differentiated value proposition for its Pay TV customers given the leading combination of standard channel line-ups with interactive services like Video on Demand, or VoD. GVT’s platform also combines pure direct to the home, or DTH products, and hybrid ones that combine DTH and internet protocol, including internet protocol television, or IPTV, creating superior overall quality and perceived value.

The quality of GVT’s services is superior to that of its main competitors in terms of upload and download speeds. GVT boasts the latest technology broadband networks with an average speed of 13 Mbps, which is three times faster than the average speeds of its competitors. As a result of its quality and performance leadership, GVT has a 63% market share of all lines with speeds between 12 Mbps and 34 Mbps with leadership in new additions of 67% in 2014, boasting a 63% share in the main cities where it operates, which include Brasilia, Curitiba, Fortaleza, Goiânia and Salvador, which is almost three times higher than its principal competitor.

As part of its strategy to achieve market-leading ARPU, GVT has historically focused its operations and growth in cities that have higher average GDP per capita. Given that GVT is a relatively new entrant to the market and operates under authorization agreements, and is not subject to the requirements of concession contracts, it has been able to selectively enter markets that offer higher profit and return potential rather than restrict its operations to specific markets bound by concession agreements. As a result of this flexibility and GVT’s ability to selectively invest in targeted markets, 56% of the cities in which GVT operates have a higher average GDP per capita than the average of cities where its competitors operate.

## 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 or 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
- Individual Special Class Access (Acesso Individual Class Especial or AICE): a plan created specifically for families enrolled in the Brazilian government's social program.

Table of Contents

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:

Characteristics of Plan	Local Basic Plan	Mandatory Alternative Service Plan
Monthly Basic Assignment		
Allowance (minutes included in the residential assignment)	200 minutes	400 minutes
Commercial Assignment Allowance (minutes included in the commercial assignment)	150 minutes	360 minutes
Local Call Charges		
Regular Hours		
Completing the call (minutes deducted from the allotment)	–	4 minutes
Completing the call after the terms of the allotment Sector 31	–	R\$0.16176
Local Minutes—charges in excess use of the allotment Sector 31	R\$0.10549	R\$0.04018
Minimum time billing	30 seconds	–
Reduced Hours		
Charge per answered call (minutes deducted from allotment)	2 minutes	4 minutes
Charge per answered call after the allotted duration Sector 31	R\$0.21101	R\$0.16176

As of the date of this annual report, the subscription to the AICE plan costs R\$9.85 (excluding taxes) 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.

We may offer alternative plans with any pricing structure. However, we must notify ANATEL of any alternative plan before the publication and implementation of any such 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, or 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. Therefore, we are free to negotiate our fees for international calls based on the international telecommunications market, where our main competitor is Embratel.

We have developed alternative rate plans for our residential and corporate customers with respect to long-distance calls.

Table of Contents

## 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; however, 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. The latest price adjustment of the Local Basic Plan took place in November 2014 and averaged a 5.04% increase throughout the different states in Brazil.

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 permitted free negotiations for mobile interconnection fees, or MTR.

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

Year	Reduction in %	MTR in reais
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 in compliance with the regulations established by ANATEL, which includes 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.

#### TV Rates

Pay TV rates are not regulated. Multimedia services operators are able to freely set the rates for alternative service plans.

## Table of Contents

### 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.

Table of Contents

## 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 and fixed customers, as a general rule, if payment is more than 30 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.

For Pay TV customers, as a general rule, if payment is overdue, service can be fully suspended 15 days after the customer is notified of the overdue invoice. If payment is more than 15 days overdue, after this initial suspension, service 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, direct customer interaction (telephone contact), followed by a late payment notice, and finally reporting customer information to an external credit bureau. 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. Write-offs are made in accordance with Brazilian regulations, which permits a bad debt write-off 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. Write-offs of late payments of over R\$30,001 that are open for more than 365 days require the commencement of a lawsuit.

In the year ended December 31, 2014, the monthly average of partial suspensions, for mobile and fixed services, was 2.5 million lines and the monthly average of total suspensions was 519,000 lines. For Pay TV services, the monthly average of suspension was 44,800 terminals. Provisions for doubtful accounts in the year ended December 31, 2014 were 1.70% 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 telephone, data and Pay TV services throughout Brazil pursuant to licenses and authorization.

The following table sets forth population, gross domestic product, or GDP, and per capita income statistics for each state in our service regions at the dates and for the years indicated:

Area	Frequency Range (MHz)	On December 31, 2014		Last Available IBGE Data from 2012		
		Population (in thousands)(1)	Percent of Brazil's population(1)	GDP (in millions of reais) (2)	Percent of Brazil's GDP (2)	Per capita income (in reais) (2)
São Paulo State	450, 700, 850, 1800, 1900, 2100 and 2500	41,262	21.63 %	1,408,904	32.08 %	34,145
Rio de Janeiro State		15,990	8.38 %	504,221	11.48 %	31,534



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	700, 850, 900, 1800, 2100 and 2500							
Minas Gerais State	450, 700, 850, 900, 1800, 2100 and 2500	19,597	10.27	%	403,551	9.19	%	20,592
Rio Grande do Sul State	700, 850, 900, 1800, 1900, 2100 and 2500	10,694	5.61	%	277,658	6.32	%	25,964
Paraná State	700, 850, 900, 1800, 2100 and 2500	10,445	5.48	%	255,927	5.83	%	24,503
Santa Catarina State	700, 850, 900, 1800, 2100 and 2500	6,248	3.28	%	177,276	4.04	%	28,371
Federal District	700, 850, 900, 1800, 2100 and 2500	2,570	1.35	%	171,236	3.90	%	66,624
Bahia State	700, 850, 900, 1800, 2100 and 2500	14,017	7.35	%	167,727	3.82	%	11,966
Goiás State	700, 850, 900, 1800, 1900, 2100 and 2500	6,004	3.15	%	123,926	2.82	%	20,641
Pernambuco State	450, 700, 1800, 1900, 2100 and 2500	8,796	4.61	%	117,340	2.67	%	13,339
Espírito Santo State	700, 850, 900, 1800, 2100 and 2500	3,515	1.84	%	107,329	2.44	%	30,535

Table of Contents

Area	Frequency Range (MHz)	On December 31, 2014			Last Available IBGE Data from 2012		
		Population (in thousands)(1)	Percent of Brazil's population(1)		GDP (in millions of reais) (2)	Percent of Brazil's GDP (2)	Per capita income (in reais) (2)
Pará State	700, 850, 900, 1800, 2100 and 2500	7,581	3.97	%	91,009	2.07	% 12,005
Ceará State	450, 700, 1800, 1900, 2100 and 2500	8,452	4.43	%	90,132	2.05	% 10,663
Mato Grosso State	700, 850, 900, 1800, 2100 and 2500	3,035	1.59	%	80,830	1.84	% 26,632
Amazonas State	700, 850, 900, 1800, 2100 and 2500	3,484	1.83	%	64,120	1.46	% 18,404
Maranhão State	700, 850, 900, 1800, 2100 and 2500	6,575	3.45	%	58,820	1.34	% 8,946
Mato Grosso do Sul State	700, 850, 900, 1800, 1900, 2100 and 2500	2,449	1.28	%	54,471	1.24	% 22,242
Rio Grande do Norte State	450, 700, 1800, 1900, 2100 and 2500	3,168	1.66	%	39,544	0.90	% 12,482
Paraíba State	450, 700, 1800, 1900, 2100 and 2500	3,767	1.97	%	38,731	0.88	% 10,283
Alagoas State	450, 700, 1800, 1900, 2100 and 2500	3,120	1.64	%	29,545	0.67	% 9,468
Rondônia State	700, 850, 900, 1800, 2100 and 2500	1,562	0.82	%	29,362	0.67	% 18,793
Sergipe State	450, 700, 850, 900, 1800, 2100 and 2500	2,068	1.08	%	27,823	0.63	% 13,454
Piauí State	450, 700, 1800, 1900, 2100 and 2500	3,118	1.63	%	25,721	0.59	% 8,248
Tocantins State	700, 850, 900, 1800, 2100 and 2500	1,383	0.73	%	19,530	0.44	% 14,117
Amapá State	700, 850, 900, 1800, 2100 and 2500	670	0.35	%	10,420	0.24	% 15,563
Acre State	700, 850, 900, 1800, 2100 and 2500	734	0.38	%	9,629	0.22	% 13,127
Roraima State	700, 850, 900, 1800, 2100 and 2500	450	0.24	%	7,314	0.17	% 16,236
<b>Total</b>		<b>190,756</b>	<b>100.00</b>	<b>%</b>	<b>4,392,094</b>	<b>100.00</b>	<b>% 23,025</b>

(1) According to the 2010 Census published by IBGE in 2011 (latest data available).

(2) According to the most recent IBGE data (2012). Nominal Brazilian GDP was R\$4,392,094 million as of December 2012 calculated by IBGE, subject to revision.

## Industry Overview

## Macroeconomic Backdrop

Brazil is the largest and most important Latin American nation and one of the largest countries in the world in terms of area, population and GDP. Brazilian GDP in 2013 was roughly \$2.2 trillion. According to the World Bank, Brazilian nominal GDP per capita increased from US\$4,451 to US\$5,823 from 2004 to 2014 and is projected to reach approximately \$20,564 by 2020 according to Business Monitor, suggesting significant upside potential from continued income per capita growth and associated improvements in disposable income and purchasing power. According to IBGE (Brazilian Institute of Geography and Statistics), the Brazilian population reached 203 million in 2014.

Brazilian macroeconomic policy has remained relatively consistent since 1994 with the creation of the Plano Real, or the “Real Plan”, when sweeping measures were implemented to stabilize the economy, control inflation and promote growth. This plan centered around three critical policy pillars: explicit inflation targets, floating exchange rate regime and primary budget surplus targets. Against this macroeconomic policy backdrop, the Brazilian economy performed well: from 2004 to 2014, Brazil’s GDP grew at an average annual rate of approximately 15.1%. These policies, coupled with favorable global trends, led to the substantial growth of Brazil’s middle class, with a large population migrating from lower income classes to “Class C” (a social group that includes families with monthly incomes between R\$2,004 and R\$8,640), which represented 118 million people in 2013.

Table of Contents

This growth trend in the middle class along with a strong increase in consumer spending favors the expansion of the subscriber base, growth in the use of services and the increase in the sales volume of services, which are clear opportunities for the telecommunications sector.

Mobile

According to the “Global Wireless Matrix,” released in the third quarter of 2014, Brazil is the fourth largest market in terms of mobile service revenues and mobile subscriber bases.

In December 2014, based on ANATEL data, the country had approximately 280 million mobile users, of which 24% were users of postpaid services and 76% were users of prepaid services. Since 2011, the total number of mobile subscribers grew 16%, a compound average growth rate of 5.0%.

Source: ANATEL

We are the market leader in terms of total mobile subscribers. Our base of 80 million subscribers represents a 29% market share. In the postpaid segment, we have an even stronger competitive position, leading the market with 42% of total subscribers. As this market is more profitable and poised to continue growing faster than the prepaid market, we intend to continue consolidating the market and gaining share, particularly in light of our superior product offering and coverage quality. We highlight that our ARPU for this segment is four times higher than prepaid and consist of 1/3 of the prepaid churn. From 2010 to 2014, the postpaid market grew by 89%, increasing from 36 million to 68 million users. Of this total increase, we captured the highest share of net additions, adding 15 million postpaid subscribers, the highest share of any player in the industry. Over the same period, the prepaid market grew 27%.

Table of Contents

Source: ANATEL, as of December 2014

Source: ANATEL, from January 2010 to  
December 2014

We believe that there is significant room for expansion of the Brazilian telecommunication industry as the market remains in a relatively early stage compared to developed markets. For instance, Brazil was only the 13th country in terms of penetration of subscribers in the 2013, according to “Global Wireless Matrix”.

The stronger potential growth in postpaid subscribers in Brazil also contributes to a relevant increase in mobile data adoption. In the last two years, postpaid mobile subscribers in Brazil grew on average 15% against an average growth of 4% of total mobile subscribers. This superior performance should be sustained in the next years driven by larger coverage, new services in 4G technology and increasing migration of customers from the prepaid segment.

Table of Contents

Smartphone penetration highlights even larger potential for future expansion, with Brazil ranking 30th globally with only 27% penetration compared to the United States, for instance, with roughly 55% penetration.

This low penetration, particularly of smartphones, underscores the significant untapped potential in the Brazilian market, both in terms of number of subscribers and the number of services utilized by each subscriber.

We are making targeted investments to maintain our leading quality positioning and actively monitor global telecommunications trends to ensure that we are always ahead of the technology curve.

Source: Global Wireless Matrix

In addition to the favorable demographic and penetration trends, the government has created favorable tax incentives that are positively impacting growth of smartphone penetration, mobile broadband networks development and investments in the deployment of new technologies.

We possess a complete portfolio of spectrum to provide best-in-class 3G and 4G services, including the largest available slots of spectrum in the 2.5 GHz and 700 MHz spectrum frequencies. With this enhanced portfolio of spectrum, we believe that we will be able to offer our clients unparalleled, high quality mobile broadband services, allowing us to increase market share and the sale of data value-added services.

Table of Contents

Broadband

Brazil is the 8th largest market for fixed Broadband, according to Teleco. As of December, 2014, the Brazilian fixed broadband segment had 24 million subscribers, which represents a total penetration of 11% and a 12.1% CAGR since 2011, according to ANATEL.

We offer this service through ADSL, cable and FTTH technologies in the state of São Paulo. We differentiate our services with this technology by currently providing bundles with broadband of up to 200 Mbps combined with the Pay TV service, which uses IPTV solutions, and fixed voice services. We believe that the acquisition of GVT will reinforce our positioning in the segment as we will be able to combine our subscriber base and take advantage of complementary services.

Source: ANATEL

As a result of the GVT acquisition, we will be the second largest player in terms of broadband accesses with 29% of market share, compared with 31% for the first player. In addition to our strong share, we expect to be able to leverage GVT's superior network technology and unmatched quality to speed our growth and drive share gains.

Source: ANATEL as of December 2014

Table of Contents

GVT's last mile network architecture is based on FTTC (Fiber to the Cabinet) technology, with broadband commercial offers of up to 100 Mbps. Leveraging its high quality offering and competitive pricing, GVT successfully captured nearly 48% of last twelve months net additions in the 12 Mbps+ segment. In addition, approximately 70% of GVT broadband base has download speeds of 12 Mbps+, compared to only 11% and 3% for our closest competitors in terms of high speed (12 Mbps+) subscribers.

In terms of broadband penetration, in 2013 Brazil had 10 subscribers per 100 inhabitants according to ITU, significantly below levels in the United States, China and the United Kingdom with 29, 14 and 36 subscribers per 100 inhabitants, respectively. We believe that strong demand drivers coupled with low relative penetration will create significant growth in the coming years.

In addition to broad demand drivers, geographical concentration of existing broadband infrastructure provides significant untapped opportunities in currently unserved and underserved areas. According to ANATEL, the Southeast, South and Northeast regions have the highest number of accesses, with 60%, 17% and 12%, respectively, of the Brazilian market. Given our strong positioning in the Southeast region, with 29% market share, the GVT acquisition will position us to take advantage of targeted growth opportunities in the South and Northeast regions, where GVT has roughly 25% and 24% of market share, respectively, according to ANATEL.

Pay TV

Brazil is the 13th largest market for Pay TV subscribers. As of December 2014, the Brazilian Pay TV segment had 20 million subscribers, which represents a total penetration of 9% and a 15.4% CAGR since 2011, according to ANATEL.

Source: ANATEL

We are currently the third largest player in the Pay TV segment, with roughly 8% market share, pro-forma for the acquisition of GVT. We believe that this acquisition will accelerate our consolidation of the segment as we will be able to combine our subscriber bases and take advantage of complementary positioning. Through GVT, we will begin expanding our Pay TV presence in the South and Northeast regions by capitalizing on GVT's solid presence, as the fourth and third largest player in these regions, with 9% and 8% market share, respectively, as of September 2014.



Table of Contents

Source: ANATEL

Pay TV market share and conversion is highly correlated to quality, technology, and breadth of offering. We believe that GVT has a differentiated value proposition from its 100% HD Pay TV penetration since it combines standard channel line ups, as well as interactive services like VoD. GVT's platform also combines pure DTH products and hybrid ones, including IP-based interactive content, creating superior overall quality and perceived value.

We believe that combining GVT's superior Pay TV product with our existing platform will allow us to create customized and differentiated product offerings that will improve our profitability and minimize churn.

Seasonality

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

Marketing and Sales

As of December 31, 2014, we maintained 305 of our own sales outlets throughout Brazil, which also provide customer support for our existing customers. In addition, we also have 11,929 sales outlets run by authorized dealers.

We aim to increase our services in strategic cities and locations where there are currently no sales outlets for our services. As of December 31, 2014, we worked with 88 third-party companies, including telesales and door-to-door services, with approximately 1,832 salespeople reaching out to potential customers, in particular for Vivo fixed-line, postpaid and data services. We also have an on-line store and an e-commerce operation, authorized by us to sell services over the internet. During 2014, we integrated sales channels to offer standardized solutions and customer service in connection with the sale of fixed and mobile services.

In 2014, we had approximately 600,000 points of sale where prepaid mobile service customers could purchase credit, including our own stores, authorized agents, lottery stores, post offices, bank branches and small retailers, such as pharmacies, newspaper stands, libraries, bakeries, gas stations, bars and restaurants. 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.

Table of Contents

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

- **Vivo stores:** focused on individual clients and located in strategic points, our own stores provide a highly trained team built to guarantee the best sales experience for the customer. The main focus of this channel is innovation. As a result, most stores also offer self-service terminals for value added services and purchases of pre-paid credit. We also offer special treatment for premium clients with scheduled appointments via the internet to assure that they are not required to wait in line.
- **Exclusive dealers:** The exclusive dealers 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.
- **Retail channel:** Working closely with the main retailers in Brazil, the retail channel is focused on prepaid credit and data services.
- **Telesales:** sales through active and passive telemarketing call centers, employing highly trained sales associates, focused on fixed lines, data services and migration from prepaid to postpaid plans.
- **E-commerce:** As a key component of our transformation process to become a digital telecommunications company and to deliver more value to our customers, we focused strongly on online channels in 2014. At our website, customers can obtain up-to-date information about the company's products and services, including specific sections for corporate customers and online self-service. A total of more than 300 different services and requests can be managed online. We also have an on-line store and an authorized e-commerce operation for the sale of services over the internet. The e-commerce processes are also being improved on a continual basis to leverage the recent strong e-commerce growth in Brazil. Current e-commerce capabilities include but are not limited to the sales of mobile handsets and plans, the entire portfolio of services for fixed and mobile businesses, prepaid credit purchases and value added services. Some highlights of this strategy in 2014 were:
  - 150% sales increase in residential fixed products as a result of strong focus on building and improving online channels for premium residential services such as fiber and broadband;
  - Sales increase of 118% in the mobile business compared to 2013, helped by new channels focused on plans upgrade;
  - Increase of 113% in customer care transactions, supported mainly by a strong focus on "Meu Vivo," our self-service option that is available on the web and also on applications;
  - Strong sales results on 2014's Black Friday, which achieved a 135% increase comparing to the previous year, have established it as a major event on Vivo's retail calendar; and
  - Development of new Online channels for top-ups, including a new exclusive app for Android and IOS, that helped to leverage the results on Online top-ups in 22%.
- **Door-to-door sales:** aiming to approach corporate and individual clients, we use physical channels of assistance, such as door-to-door sales of services by outsourced small companies and our own team of consultants. Our main focus is on fixed and data services.
-

Person-to-person sales: Our business management team offers customized sales services, ensuring high customer loyalty and a strong customer relationship resulting from customized consulting telecommunication and IT services and technical and commercial support.

#### Customer Service

In 2014, we advanced the unification of our fixed and mobile services in order to simplify management and improve customer service. We are working to combine existing systems and unify operations. The new service model provides for the migration from a product-focused service to a customer-focused service. Customers will be served by a single representative regardless of the number of products and services they use. This will increase

## Table of Contents

flexibility and efficiency in fulfilling customers' requests. In addition, we will be able to increasingly differentiate the most profitable customers as well as continually seek greater efficiency in those that bring less revenue. These actions will improve the quality of our competitive model, dedicating the best resources to high-value customers.

We are also working towards the improvement and expansion of virtual channels, including SMS, chat and online assistance, trying to stay ahead of our competitors in digital technologies, given the increased access to the internet and the growing use of smartphones in Brazil. Thus, we are working to enrich content and features available on channels like Meu Vivo (Web and Applications), SMS Chat and interactive voice response, or IVR, which provide simpler, quicker and more standardized interactions. We are also investing in the development of new channels such as Virtual Chat, Online Forum and Social Networks. The success of this strategy is evidenced by the rate of use of electronic channels, which today is over 79% of received contacts. As an example, automated SMS, which provides human-machine interaction by the SMS, increased by 30% from 2013 to 2014. By contrast, the average number of hits for The Meu Vivo relationship portal and online transactions increased by 82% for the same period. Virtual channels are more efficient and provide an improved customer experience. We will continue to develop these channels and encourage our customers to use them.

With regard to quality, we focus heavily in transforming the customer experience. We had a continued reduction in the rate of contacts in 2014, reaching positive results in reducing demands for questions and complaints. We also ranked highly in the index of resolved complaints and we have the best position in relation to the performance index of care (índice de atendimento ao cliente), or IDA, measured by ANATEL, among the four major national players that provide mobile telecommunications services. We were ahead of other competitors in 66 of the 67 months measured, with data up to June 2014, the most recent month of disclosure by ANATEL.

## 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.

Voice network is being modernized with the use of new generation technology that improves redundancy and reliability. In addition, we are deploying IMS Core, a framework to standardize the use of internet protocol, or IP, platforms for voice services.

We are preparing the network to support enterprise inbound and outbound call center services. An example of this evolution is a new service called "Hosted Voice," in which customers will have basic features and advanced PBX and also unified communication through the data network (IP/VPN). This solution reduces the amount of equipment in the customer environment by centralizing control and intelligence service.

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 the launch of new products like video on demand. At the same time, the expansion of fiber to customer homes 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 this goal, the integration of mobile and fixed IP backbones is essential. We have designed a robust architecture, using two distinct backbones to provide fixed and mobile services using both mobile and fixed multi-protocol networks infrastructures, to guarantee service reliability to our clients. Moreover, by absorbing other

existing networks obtained by means of earlier acquisitions into both backbones, we have been able to simplify the network and reduce operational costs.

To cope with greater traffic, core network topology has been revised, introducing more 100 gigabyte ethernet interfaces and reducing aggregate layers, resulting in a simpler yet more scalable network. At the metropolitan level, high bandwidth interfaces (40 gigabyte and 100 gigabyte) were also part of our network growth strategy, marked with increased capillarity to offer services in more locations.

Nonetheless, robust and reliable networks are not enough to meet customers' expectations. As content gains importance in the data world, quality of experience becomes a key concept to improve revenue without

## Table of Contents

compromising costs. Local content and distribution networks, or CDNs, are important for this objective as they improve user experience and save bandwidth at the same time by using video offloads.

In 2014, Latin America faced IP exhaustion, which is the depletion of the pool of unallocated IP addresses. This IP exhaustion could potentially interrupt all new sales of IP based services. Through the deployment of carrier grade network address translation, or CGNAT, which is used for translating the address range between two networks, we were able to translate several IP addresses into a few public addresses and maintain growth of IP addresses until the migration to the new version of IP (IPv6).

With regards to the local area network, or LAN, as there is an increase in IP services, we have aimed to create a design that can absorb an exponential port growth for services without increasing operational costs. The result was the adoption of a new network implementation, using top of rack, or TOR, and end of row, or EOR, architecture. The technology reduces the amount of equipment on site and drastically decreases the use of cables, by placing small switches inside server racks, where cables are kept confined. From the rack to the site's core switches, only one pair of fiber is sufficient. The result is a significant savings in operating expenditures, as well as space, energy and air conditioning, despite the significant increase of network ports on site. Recently, the deployment of Fabric technology, which helps avoid LAN interruptions, increases the reliability of service in our local networks without losing flexibility and quick service deployment to customers.

During the course of 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 focused on automation. Periodic tasks such as analyzing attacks notifications, auditing firewalls rules and evaluating security elements performance were the main areas subject to automation, freeing security professionals to focus on problems that are more complex. In addition, these actions improve network performance, extending the lifespan and reducing costs related to the network.

We offer the IPTV service through the FTTH network using a new platform that is well recognized in the world (Global Video Platform). This platform consists of Pay TV with video broadcasting offered through the use of the IP protocol. We made several improvements in the platform, such as the inclusion of Instant Channel Change (ICC), Picture in Picture (PiP), Live Pause, applications (Social Networks, Weather, Health, Multi-view, News, Kids and others) providing a better user experience. Additional services, such as pay-per-view and video on demand (VOD), are also available.

In 2015, we plan to continue the improvements in global video platforms aiming to increase competitiveness in the ITS market. New features like Timeshift and Catchup TV will be implemented and we will expand all the services to other cities in the state of São Paulo.

The IPTV platform also offers games, interaction and connectivity services through third party content, as well as OTT, content for the broadband users, through the applications developed for smart TVs, smart phones with Google's Android and Apple's iOS, and STBs and PCs. A new service, OTT Live, will deliver broadcast channels to those devices.

We also offer digital television service via satellite (DTH) to the subscribers in the state of São Paulo 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.

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 retransmittal technologies of TV over IP protocol (IPTV), satellite (DTH), and the continuous evolution of TV services.

We currently offer HSPA+ technology, commercially known as 3G Plus. This technology was first commercially launched in November, 2011 in the city of São Paulo (and its extended metropolitan area with area code 11) but now is offered across 100% of our WCDMA coverage, allowing customers who have compatible terminals to achieve up to three times the traditional 3G rate.

## Table of Contents

We also offer the LTE system in a new spectrum (2600 MHz). At the end of 2014, 140 Brazilian cities had 4G availability, including those that hosted World Cup games in 2014. Over the coming years, we expect our 4G coverage to fulfill the requirements of ANATEL, reaching approximately 545 cities.

### Fraud Detection and Prevention

During 2014, 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 an increase in subscription fraud-related losses, from R\$9.4 million in 2013 to R\$14.2 million in 2014. The main cause of this increase was the review of old accounts receivables to detect instances of fraud that had not been identified earlier.
- **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 had R\$199 thousand in identity fraud losses in 2014 compared to expenses of R\$7 thousand in 2013. The main reason for this increase was a new identity fraud technique, pursuant to which perpetrators obtain a dealer password and charge for irregular services. We are not expecting significant losses in 2015 with regards to identity fraud.

### 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.

#### Mobile Virtual Network Operating Agreements

Mobile virtual network operating, or MVNO, agreements allow other companies to provide SMP services using our network. These agreements also allow such companies to cross sell services with their own core business. MVNO agreements are also beneficial because they serve as source of revenue of telecommunications operators and they optimize investments in IT and network infrastructure. Under a full MVNO model, or authorized model, operators use their own name to act in the entirety of the operating chain, including sales, distributions, billing, interconnection agreements, and client phone numbers. Under the brand reseller model, or accredited model, the operator is responsible for marketing, distributions of SIM cards and other value added services, but the original operator is responsible for all other aspects of operations.



Full MVNO model (authorized)

In 2014, we signed two MVNO agreements, the first one with Sisteer and the second one with Virgin Mobile. Sisteer has experience as a Mobile Virtual Network Enabler, or MVNE in Europe and in Brazil and is planning to run a mobile operation. Virgin Mobile is a worldwide pioneer in the MVNO model and is already running three MVNO operations in Latin America, all of which are with sister company, Movistar, in Chile, Colombia and Mexico.

## Table of Contents

### Brand Reseller model (accredited)

In December 2014, we signed the first Brand Reseller MVNO agreement in Brazil with Alô AD Mobile, or Alô. Alô is planning to launch a prepaid operation in 2015.

### Network Sharing Agreement

In December 2013, we signed a networking sharing agreement with Nextel to provide mobile services coverage (voice, data and SMS) through our 2G and 3G network to 67 area codes. The contract has a term of five years, 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. Term and payments are subject to the fulfillment of the contractual obligations assumed by the parties.

### Competition

In 2014, competition remained strong in the Brazilian telecommunications market. This year was highlighted by constant rumors and strategic analysis for future consolidation. The telecommunications sector in 2014 continued to grow, driven mainly by mobile broadband. Through November 2014, we were leaders in the 4G technology in terms of accesses, in addition to coverage and percentage of population served, according to ANATEL.

We face intense competition in all the businesses in which we operate, primarily from other mobile service providers and also fixed-line operators. Many of these competitors are part of large, national or multinational groups and therefore have access to financing, new technologies and other benefits that are derived from being a part of such a group.

We lead mobile market share, measured in terms of the number of mobile accesses in 11 states: São Paulo, Espírito Santo, Amazonas, Acre, Roraima, Amapá, Sergipe, Mato Grosso, Mato Grosso do Sul, Rio Grande do Sul and Minas Gerais. Our main mobile service competitor in the states of Pará, Santa Catarina, Paraná, Alagoas, Pernambuco, Paraíba, Rio Grande do Norte and Ceará is TIM Celular or TIM, a Brazilian telephone company and subsidiary of Telecom Italia.

In the state of Maranhão the principal mobile competitor is Oi. The group has a concession of fixed telephone in all states to offer fixed services.

Rio de Janeiro, Bahia, Goiás, Rondônia, Distrito Federal, Tocantins and Piauí are states where Claro is our main competitor. Claro is a mobile operator that is controlled by a Mexican company, America Movil Group.

Our main competitors for the provision of fixed telecommunications services are: America Móvil/Telmex group (which includes NET, Claro and Embratel), TIM (which offers broadband services under the Live TIM brand) and SKY. Our competitors employ various strategies to gain market share. For instance, prior to entering into the Stock Purchase Agreement with us in September 2014, GVT expanded its operations to four additional cities, three of which are in the state of São Paulo, with special offers of broadband such as 15Mbps for R\$10/month for three months (in triple-play plans). GVT also focused on high-quality customer service and launched GTV Freedom, an application which allows users to use the fixed line through smartphone VoIP technology.

NET restructured its fixed broadband portfolio offering new speeds: 30, 60 and 120Mbps in addition to launching the 500Mbps speed. In partnership with Claro, NET increased its quad-play plans, including free smartphone offers in the

“combo.” Similar to NET and Claro, Oi is stronger in the fixed segment outside the state of São Paulo and remains focused on the convergence strategy between fixed and mobile services.

Live TIM experienced significant growth and reached 130,000 customers by the end of 2014 and has positioned itself as providing the best quality experience in broadband rankings released by Netflix in Brazil (in terms of average representation of streaming speed). Live TIM launched new speeds in its portfolio including 1Gbps for R\$1,499/month. SKY provides satellite Pay TV service and offers from low to high price packages to its target customers and in 2014 significantly expanded its broadband operations through TDD-4G technology (long term evolution-division duplex time).

## Table of Contents

### 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), or PGMU, and the General Quality Targets Plan (Plano Geral de Metas de Qualidade), or 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 that are 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 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 certain 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, CTBC Telecom, Sercomtel and Embratel (Embratel 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 generally 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 Embratel, 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.

## Table of Contents

### 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), or PGO, and special obligations regarding network expansion and modernization contained in the PGMQ.

In 2008, 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.

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), in the state of São Paulo, pursuant to the Serviço de Telefonia Fixa Comutada, or our concession agreement, granted in 1998 by the Brazilian Government, which was renewed in December 2005 for an additional 20-year term beginning on January 1, 2006. The concession 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;
- Mobile voice and broadband services, in all 26 states and the Federal District, under the personal mobile service (Serviço Móvel Pessoal), or SMP authorization. We operate under SMP authorizations with 15-year terms, expiring between 2020 and 2029;
- Multimedia communication services, such as audio, data, voice and other sounds, images, texts and other information throughout the state of São Paulo, under multimedia communication service (Serviço de Comunicação Multimídia), or SCM authorization. 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 under SeAC authorizations, which are valid for indefinite terms; 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), or 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.

### 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, dated from December 22, 2005, was renewed on January 1, 2006, and will be valid through December 31, 2025. On December 27, 2010, ANATEL approved Resolution No. 559, which established new revisions for the concession agreement on May 2, 2011, December 31, 2015, and December 31, 2020.

## Table of Contents

Since the renewal of our concession agreements, several new regulations are undergoing discussions or have been adopted to revise certain aspects of our concession. On June 30, 2011, we revised our concession agreement to determine the new basis of calculation of the biannual concession fees.

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), or 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 Class Especial), or AICE. On June 27, 2014, ANATEL opened two public comment periods; the first, Consulta Publica No. 25 aims to revise the PGMU, and the second, Consulta Publica No. 26, aims to revise the fixed line concession agreements. We have submitted our comments and ANATEL is reviewing all comments submitted. The revised version of the agreement should be published by the end of 2015.

Pursuant to the concession agreement, all assets owned by us which are indispensable to the provision of the services described in the concession are considered reversible assets and are deemed to be part of the concession assets. These assets will be automatically returned to ANATEL upon termination of the concession agreement, and as a result we may not encumber such assets.

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 30, 2013, based on 2012 revenue. The next payment is scheduled for 2015 based on 2014 revenue. See Note 1 to our Consolidated Financial Statements.

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.

On October 23, 2012, ANATEL published Resolution No. 598, which addresses population density, setting deadlines to meet access requests and benchmarks for use of the public telephone plant and the establishment of a list of agencies that can request access to its location, review of deadline for proposing service plans and the establishment of universal obligations disclosure.

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 other concessionaires are subject to the General Universal Service Targets Plan (Plano Geral de Metas de Universalização), or PGMU, and the General Quality Targets Plan (Plano Geral de Metas de Qualidade), or PGMQ, each of which respectively requires that concessionaires undertake certain network expansion activities with respect to our fixed-line services and meet specified quality of service targets. The timing for network expansion and benchmarks for quality of service are revised by ANATEL from time to time. If any given concessionaire does not fulfill its obligations under the PGMU and the PGMQ, 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 two General Plans.



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 in any other concessionaire, unless previously approved by ANATEL, according to ANATEL Resolution No. 101; and
  - a prohibition on concessionaires to provide similar services through related companies.

Table of Contents

## 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.

## Mobile Services

## 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, during the last year of each license and every two years for the duration of the extension period.

In order to transfer our services to SMP, we were required to comply with several technical and operational conditions, including, among other things, the adoption of a carrier selection code for long-distance calls originating from our network.

Our renewed 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 old authorizations. The table below sets forth our current SMP authorizations, their locations, band and spectrums, date of issuance or renewal and date of expiration:

## Band Expiration Date

Authorization	800 MHz	900 MHz	1800 MHz	1900 MHz	2100 MHz (3)
Rio de Janeiro	Band A November 2020	Extension 1 April 2023	Extensions 9&10 April 2023	Band L April 2023	Band J April 2023
Espírito Santo	Band A November 2023	Extension 1 April 2023	Extensions 9&10 April 2023	Band L April 2023	Band J 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	Band L April 2023	Band J April 2023
Minas Gerais (“Triângulo Mineiro” region)	—	Band E April 2020	Band E April 2020	Band L April 2023	Band J April 2023

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Bahia	Band A June 2023	Extension 1 April 2023	Extensions 9&10 April 2023	Band L April 2023	Band J April 2023
Sergipe	Band A December 2023	Extension 1 April 2023	Extensions 9&10 April 2023	Band L April 2023	Band J 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

Table of Contents

Authorization	Band Expiration Date				
	800 MHz	900 MHz	1800 MHz	1900 MHz	2100 MHz (3)
Paraná (except for Londrina and Tamarana) and Santa Catarina	Band B April 2028	Extension 1 April 2023	Band M April 2023	Band L April 2023	Band J 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	Band L April 2023	Band J 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	Band L April 2023	Band J April 2023
Goiás and Tocantins	Band A October 2023	Extension 1 April 2023	Band M April 2023	Band L April 2023	Band J April 2023
Goiás (Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão)	—	—	Extensions 7 to 10 April 2023 Band M April 2023	Band L December 2022	Band J April 2023
Mato Grosso	Band A March 2024	Extension 1 April 2023	Band M April 2023	Band L April 2023	Band J April 2023
Mato Grosso do Sul (except for Paranaíba)	Band A September 2024	Extension 1 April 2023	Band M April 2023	Band L April 2023	Band J April 2023
Mato Grosso do Sul (Paranaíba)	—	—	Extensions 7, 9&10 April 2023 Band M	Band L December 2022	Band J April 2023

April 2023

Rondônia	Band A July 2024	Extension 1 April 2023	Band M - April/23	Band L April 2023	Band J April 2023
Acre	Band A July 2024	Extension 1 April 2023	Band M April 2023	Band L April 2023	Band J April 2023
São Paulo	Band A August 2023	—	Extensions 9&10 April 2023	Band L April 2023	Band J April 2023
São Paulo (Ribeirão Preto, Guatapar and Bonfim Paulista)	Band A January 2024	—	Extensions 5, 9&10 April 2023	Band L April 2023	Band J April 2023
So Paulo (Franca region)	Band A August 2023	—	Extensions 5, 9&10 April 2023	Band L April 2023	Band J April 2023
So Paulo (Altinopolis, Aramina, Batatais, Brodosqui, Buritizal, Cajuru, Cassia dos Coqueiros, Colombia, Franca, Guaira, Guara, Ipua, Ituverava, Jardinopolis, Miguelopolis, Morro Agudo, Nuporanga, Orlandia, Ribeiro Corrente, Sales de Oliveira, Santa Cruz da Esperana, Santo Antonio da Alegria and Sao Joaquim da Barra)	—	—	Extensions 9&10 April 2023	Band L December 2022	Band J April 2023

Table of Contents

In 2013, we changed the terms of our authorization regarding Band “G” (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 Turuçú, in Rio Grande do Sul; Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in Goiás; and Paranaíba in Mato Grosso do Sul. This change is foreseen in the bidding document No 001/2007. We do not have band “G” in the northeast region and in Londrina and Tamarana, Paraná.

On June 12 and 13, 2012, ANATEL held a public bidding for 273 4G lots in the 2,500 to 2,690 MHz frequencies. We acquired the “X” band, with a nationwide coverage, for R\$1.05 billion. Given the rules of the public bidding process, which limited the total spectrum each service provider could hold within this frequency, we agreed to relinquish bands “P,” “T” and “U” used for MMDS services within 18 months of obtaining the “X” band.

In order to meet the coverage obligations and the schedule defined by ANATEL, we have made 4G services available to 140 metropolitan areas in Brazil including all cities with over 500,000 residents. To complete the coverage requirements, we will need to implement 4G coverage as follows:

- by December 31, 2015: cities with over 200,000 residents;
- by December 31, 2016: cities with over 100,000 residents;
- by December 31, 2017: cities with between 30,000 and 100,000 residents; and
- by December 31, 2019: cities with fewer than 30,000 residents.

ANATEL auctioned a 450 MHz frequency lot that is 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. The timetable for providing infrastructure in the rural areas requires that 100% of municipalities have infrastructure set up by December 2015, with a transmission rate of 256Kbps and by December 31, 2017, all of these municipalities will be expected to have 1Mbps.

On July 18, 2012, ANATEL notified us that we would be required to present an improvement plan for SMP services. We presented our plan and it was approved by ANATEL on September 10, 2012. We have since been required by ANATEL to meet certain quality and service targets. ANATEL evaluates such quality and service improvements every three months.

In September 2014 we won one of the three lots offered for auction by ANATEL for the sale of 700 MHz national frequency bands. The value of the frequency range was the minimum price of R\$1.9 billion plus R\$903.9 million related to cost payment obligations relating to the redistribution of TV and RTV in order to avoid harmful interference problems in radio communication systems. Therefore, we will increase our service delivery capacity with 4G technology throughout Brazil and will operate in the 700 MHz frequency range, with a band of 10 + 10 MHz, plus the 2.5 GHz frequency band with 20 + 20 Mhz acquired in the 2012 public bid.



## Table of Contents

### Mobile Services Obligations

The mobile service authorizations of Telefônica Brasil involve obligations, established by ANATEL, to meet quality of service standards relating to the system's ability to make and receive calls, call failure rates, the network's capacity to handle peak periods, failed interconnection of calls and customer complaints.

To restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to check the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (Regulamento de Gestão da Qualidade da Prestação de Serviço Móvel Pessoal), or SMP-RGQ.

The SMP-RGQ provides for the assessment of the network connection and their respective data transmission rate, assessing aspects of availability, stability and connection speed for the data network. In addition, the rule established the formation of a Quality Measurement Process Deployment Group (Grupo de Implantação de Processos de Aferição da Qualidade), or GIPAQ, which is responsible for implementing the processes on the quality indicators for the "Instant Transmission Rate Guarantee" and "Average Transmission Rate Guarantee."

The methodology and procedures regarding the collection of data connection indicators has been defined by a group composed of providers, ANATEL and the entity responsible for the measurement of the rate of data transmission indicators (Entidade Aferidora da Qualidade), or EAQ, which shall be responsible for implementing these processes and which has been hired by the mobile operators, as a group, starting with February 29, 2012. All costs associated with implementing the new procedures for measuring quality are borne by the providers of SMP services.

Initially, targets were defined by at least 60% of the speed hired by users and 20% of the instant speed. In November 2013 and November 2014, ANATEL raised the target values to 80% of speed hired by users and 40% of the instant speed, according to the definitions of the Resolution 575/2011.

In July 2012, ANATEL suspended the sale and activation of the mobile lines of three major Brazilian operators. We were not affected by this measure. Since then, ANATEL has requested the submission of an Action Plan for Quality Improvement of the Mobile Telephone from operators. We had our plan approved on September 10, 2012. The measurement results of the indicators defined on the PMQ were published in August 2012 and are under an ongoing monitoring process set forth by ANATEL.

### Multimedia Communication Services (SCM)

Our multimedia services include broadband and wireless internet services as well as fiber UBB services.

#### Authorization to Provide Multimedia Services

On January 29, 2003, ANATEL granted our multimedia communication license nationwide, allowing A. TELECOM S.A. (formerly Assist Telefônica), our wholly owned subsidiary at that time, to provide voice and data services through points-of-presence (POPs), which are comprised of private telecommunications networks and circuits. In addition to A. TELECOM S.A., ANATEL granted multimedia communication licenses to T-Data (formerly T-Empresas) and Emergia.

As a result of our merger with and into Vivo S.A. and pursuant to the concession agreement, we are not able to provide services other than telecommunications. Consequently, we submitted a request to ANATEL for the



cancellation of T-Data's multimedia communication license and the unification of our multimedia communication licenses under Telefônica Brasil. On September 3, 2014, ANATEL granted Telefônica Brasil a nationwide multimedia communication license.

## Table of Contents

### Obligation to provide fixed broadband access

As a telecommunications concessionaire, we have the obligation to provide free Internet access to public schools in our concession area during the term of the agreement (until 2025). The number of schools for which we should provide broadband is determined by the National Education Ministry school census. Currently our obligations include 10,149 schools, of which 9,739 were met.

### Pay TV services

#### Authorization to provide Pay TV Services – SeAC

On March 14, 2007, ANATEL granted A. TELECOM S.A. authorization to provide services of Pay TV via satellite (Direct to Home – DTH). DTH is one of the special types of subscription TV services that utilize satellites for the direct distribution of television and audio signals for subscribers. The launching of the commercial transaction occurred on August 12, 2007.

On October 31, 2007, the board of ANATEL concluded its regulatory review of the agreement between us and Grupo Abril, which included a special license that allows us to offer Pay TV and broadband services. In November 2012, ANATEL approved the adoption of service licenses for subscription television by the Telefónica group to the conditional access service.

Following the merger of Telefônica Brasil S.A. and Vivo S.A., the company requested the adjustment of the Multimedia Multipoint Distribution Service (MMDS), the Pay TV via satellite Direct to Home – DTH, and the Cable TV service licenses, to the SeAC single license. On January 25, 2013 it was issued by ANATEL.

#### Regulations for 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), or 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 yearly by March 31 of each year.

As a result of Law No. 12,485/2011, the National Cinema Agency (Agência Nacional do Cinema), or 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.

## Table of Contents

### 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. It determined that:

- 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%
  - The partial Bill & Keep by December 31, 2013 and full Bill & Keep by December 31, 2014.

### 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. 7272 was published. It established 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. 7310 was published, replacing the reference values previously set out in Act no. 7272.

In addition, the General Competition Plan (“Plano Geral de Metas de Competição – PGMC) determined that 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; 60% of the total traffic exchanged from February 24, 2015 to February 23, 2016. And from February 24, 2016, the MTR will be owed to the mobile service provider when its network is used to originate or

## Table of Contents

terminate calls (full billing). However, on December 18, 2014 ANATEL opened a comment period for a proposal that sets the following schedule for the MTR reductions:

- 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: Full Billing.

### 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, the decision of ANATEL established values for 2018 based on a bottom-up cost model. For 2016 and 2017 intermediate values will be 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 will be 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. We have signed agreements with companies authorized to operate as an MVNO in Brazil.

### 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. The Brazilian House of Representatives is considering a law that would penalize Internet service providers for knowingly providing services that allow illegal goods or services to be sold on the Internet, and would impose confidentiality requirements on Internet service providers regarding nonpublic information transmitted or stored on their networks.

### Exemptions for telecommunications infrastructure

In connection with “Plano Brasil Maior,” a policy 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). 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, established exemptions for machine-to-machine services. It sets reductions on both rates that compose 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. 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.

## Table of Contents

### General Regulation of Consumer Rights - RGC

On March 10, 2014, ANATEL published Resolution 632, which approved the General Regulation of Consumer Rights. This regulation brings important changes in service, billing and supply of all telecommunications services. It also establishes a period ranging from 120 days to 24 months from the date of publication for entering into compliance with the new rules. Most of the new rules that expand the rights of those who use the telecommunications services entered into force on July 8, 2014.

### Civil Rights Framework for Internet

On April 23, 2014, at the opening of NetMundial, President Dilma Rousseff approved the Civil Rights Framework for Internet, which was enacted as Law 12,965/2014. The final text has highlighted Net Neutrality, guarantying equality of treatment for packages. Moreover, it preserves the business model of Brazilian broadband that offers packages with different speeds. Certain parts of the law went into effect on June 23, 2014 and others depend on further regulation to be valid.

### Agreement for mobile interconnection

On January 13, 2014, Telefonica announced an agreement with Nextel to supply, wholesale, voice and data services through 2G and 3G networks in Brazil. The contract will run for five years. The agreement went into effect in 2014 and is now fully functional.

ANATEL approved the agreement and the execution of the operation in March 2014.

### 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 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.

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, 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. In addition, ANATEL required that the subsequent swap transaction which contemplates that Vivendi will exchange its voting stake in Telefônica Brasil for a corresponding amount of ordinary shares of Telecom Italia (currently held by Telefónica) be subject to a distinct and specific approval process. Such additional approval request was filed on December 30, 2014 and approval is still pending. In addition, the transaction remains subject to CADE's approval, which we requested on November 17, 2014.

On February 13, 2015, CADE's superintendent board recommended the approval of 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. The GVT acquisition is under the review of CADE's administrative tribunal, which will issue a final decision.



#### Methodology for fines calculation

On August 21, 2014, ANATEL approved the methodology for calculating fines. Methodologies have been defined for eight different types of infractions. The calculations are based on references values plus a number of variables, depending on the infraction. The new rules will apply in cases where there were no further sanctions.

#### 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.

## Table of Contents

### Utility Pole Sharing

On December 2014, ANATEL and the Brazilian Electricity Regulatory Agency (Agência Nacional de Energia Elétrica – ANEEL) approved a joint resolution establishing the reference value for sharing utility poles between electricity distributors and telecommunications providers. The resolution aims to solve conflicts and define rules for the use and occupation of utility poles.

The resolution establishes a reference value of R\$3.19 as the price to be paid by telecommunications providers to energy companies for each attachment point. The posts of electricity companies are used by telecom operators for fixing wiring services like fixed telephone, cable TV and broadband.

The resolution also provides that an adjustment schedule should be agreed between the parties addressing cases of pole occupation that do not comply with standards. All the regularization costs should be funded by telecommunications services providers.

### Resolutions Published

A series of new regulations, published by ANATEL as well as other regulatory bodies in Brazil, became effective in 2014. The most relevant among these regulations were:

- Resolution No. 630/2014: Approves weighted average cost of capital (WACC) methodology;
- Resolution No. 632/2014: Approves the Consumers Rights General Regulation (Regulamento Geral de Direitos do Consumidor de Serviços de Telecomunicações), or RGC;
  - Resolution No. 635/2014: Approves the Radiofrequency Temporary Use Regulation;
  - Resolution No. 638/2014: Approves the Public Telephone Regulation;
- Resolution No. 639/2014: Approves the norm that sets the maximum rates for the use of PSTN and the reference value for the use of the mobile network of the PCS and Wholesale of dedicated line, based on Cost Model;
- Resolution No. 640/2014: Approves the Regulation on living conditions among the Broadcasting Services and Television Retransmission that operates on the 698 MHz to 806 MHz frequencies; and
- Joint Resolution No. 4/2014: Establishes the reference value for the sharing of light posts among electricity distributors and telecommunications providers.

### Other Regulatory Matters

On August 1st, 2013, the Brazilian Government published Law No. 12,846, or the Brazilian Anti-Corruption Law. The Brazilian Anti-Corruption Law extends existing anti-corruption legislation, previously applicable only to individuals, to corporations and other business entities, such as us. Our management has no reason to believe that we are not in compliance with the Brazilian Anti-Corruption Law; however, in November 2014 our board of directors approved the “Guidelines on Preventing and Combating Corruption,” which aims to compile and clarify all measures adopted by us to prevent and combat acts of corruption by our employees and suppliers. We will continue to evaluate the need to implement new measures to ensure compliance with the Brazilian Anti-Corruption Law.

C. Organizational Structure

On December 31, 2014, 91.57% of our voting shares were controlled by three major shareholders: SP Telecomunicações Participações Ltda. with 50.47%, Telefónica with 25.68% and Telefônica Internacional S.A. with 15.43%. Telefónica Internacional S.A., or Telefónica Internacional, is the controlling shareholder of SP Telecomunicações S.A., or SP Telecomunicações. Telefónica Internacional is a wholly owned subsidiary of Telefónica of Spain. Therefore, Telefónica was the beneficial owner of 91.57% of our voting shares. See “Item 7. Major Shareholders and Related Party Transactions—A. Major Shareholders.”

## Table of Contents

Our current general corporate and shareholder structure is as follows:

### Significant Subsidiaries

Our only subsidiary is Telefonica Data S.A., or TData, a wholly owned subsidiary 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.

Table of Contents

Roaming Agreements

Various subsidiaries of our controlling shareholder, Telefónica, have entered into roaming agreements with Iranian telecommunication companies, certain of which are or may be owned or controlled by the government of Iran. 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 Irancell. In 2014, we recorded US\$0.90 in roaming revenues under this agreement in 2014. 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 2014:

- (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 2014, TME recorded the following revenues related to these roaming agreements: (i) 20,337.27 euros from MTCI, (ii) 3,290.74 euros from Irancell, (iii) none from Taliya and (iv) none from TKC.

TME also holds a Roaming Hub agreement through its 55% directly-owned subsidiary, Link2One, A.E.I.E. ("L2O"). Under this 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. Under this roaming hub service, for 2014, L2O has billed Irancell 114,428.69 euros.

- (2) Telefónica Germany GmbH & Co. OHG ("TG"), Telefónica's German 62.37% indirectly-owned subsidiary, has a roaming agreement with MTCI. TG recorded 156,966.00 euros in roaming revenues under this agreement in 2014.
- (3) Telefónica UK Ltd ("TUK"), Telefónica's English directly wholly-owned subsidiary, has a roaming agreement with Irancell. TUK recorded 1,558.34 euros in roaming revenues under this agreement in 2013.
- (4) Pegaso Comunicaciones y Sistemas, S.A. de C.V. ("PCS"), Telefónica's Mexican directly wholly-owned subsidiary, has a roaming agreement with Irancell. PCS recorded no revenues under this agreement in 2014.
- (5) Telefónica Argentina, S.A. and Telefónica Móviles Argentina, S.A. (together TA), Telefónica's Argentinean directly wholly-owned subsidiaries, have a roaming agreement with Irancell. TA recorded 43.96 U.S. dollars in roaming revenues under this agreement in 2014.
- (6) Telefónica Celular de Nicaragua, S.A. ("TCN"), Telefónica's Nicaraguan 60% indirectly-owned subsidiary, has a roaming agreement with Irancell. TCN recorded no revenues under this agreement in 2014.
- (7) E-Plus Mobilfunk GmbH & Co. KG ("E-Plus"), Telefónica's German 100% indirectly-owned subsidiary, has respective roaming agreements with MTCI, Irancell and Taliya. During 2014, E-Plus recorded the following revenues related to these roaming agreements; 1,415 euros from Irancell and none from Taliya.

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.

Table of Contents

International Carrier Agreement

Telefónica de España has an international carrier agreement with Telecommunication Company of Iran (“TCI”).

Pursuant to this agreement, both companies interconnect their networks to allow international exchange of telephone traffic. Telefónica de España recorded 10,594 euros in revenues under this agreement in 2014. 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

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.

At December 31, 2014, we had operations in 2,187 properties, 1,400 of which we own, and we have entered into standard leasing agreements to rent the remaining properties.

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.

Our principal 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.

As of December 31, 2014, we had 183 switches for our mobile network and other equipment installed in 136 owned spaces, and 47 leased spaces. We lease most of the sites in which our cellular telecommunications network equipment is installed. The average term of these leases is five years (subject to renewal for additional five-year terms) and ten years in the Northeast. Our 36,000 base stations and other network equipment are installed in cellular sites, administrative buildings and administrative facilities. In addition, we own 21 administrative buildings and we lease 38 administrative areas, 12 kiosks and 305 retail stores.

We are constantly making improvements to our facilities and network to meet new customer demand and to improve the level of services we offer our clients. At December 31, 2014 the net book value of our property, plant and equipment amounted R\$20.5 billion (R\$18.4 billion at December 31, 2013), which included reversible assets in the amount of R\$7.6 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



Table of Contents

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. 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 also offer collection points at our stores for old mobile phones, accessories and batteries, where customers and other individuals can dispose of their used equipment. We properly dispose of these hazardous materials. Lastly, we have implemented an environmentally friendly data center, which includes intelligent air conditioning, water reuse, bicycles and bike racks, water taps with flow control and dual flush discharge, among other measures.

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) Santa Efigênia; (iv) Santo Amaro; (v) Paraíso; and (vi) Itaquera.

ITEM 4A.

UNRESOLVED STAFF COMMENTS

None.

58

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Table of Contents

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 market data, the Brazilian GDP increased by approximately 0.1% in 2014 compared to 2.3% in 2013.

Consumer prices, as measured by the IPCA, increased 6.41% in 2014. Accordingly, growth in consumer prices was higher than the inflation target established by the Central Bank of 4.5%. In 2012 and 2013, the increases in IPCA were 5.8% and 5.9%, 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 8.1% and 5.5% in 2012 and 2013, respectively. In 2014, the IGP-DI increased 3.78%.

As inflation rates measured by IPCA still remain above the inflation target, the Central Bank increased the basic interest rate (Sistema Especial de Liquidação e de Custódia), or SELIC rate, to 11.75% by the end of 2014, from 10.0% as of the end of 2013.

Brazil closed 2014 with a trade balance deficit of US\$3.9 billion, compared to a surplus of US\$2.6 billion at the end of 2013. Exports fell by 7% to US\$225 billion, and imports decreased 4%, to US\$229 billion. Foreign Direct Investments inflows into the country decreased slightly, reaching US\$62 billion, compared to US\$64 billion in 2013. On the other hand, portfolio investments increased to US\$30 billion in 2014, in comparison to US\$25.8 billion in 2013. As a consequence of this performance of external accounts, international reserves at the end of 2014 were US\$374 billion, a decrease of US\$1.7 billion compared to December 31, 2013.

This worsening in domestic economic data, such as inflation, external accounts, and interest rates, in addition to increased risk aversion in the international capital markets, led to a higher country risk in 2014. The J.P. Morgan Emerging Markets Bond Index Plus (EMBI + Brazil), which tracks total returns for traded external debt instruments in emerging markets, reached 259 basis points by the end of 2014, up from 224 basis points at the end of 2013 and 142 basis points at the end of 2012.

As a consequence, the real depreciated against the U.S. dollar in 2014 by 13.4%. The exchange rate on December 31, 2014 was R\$2.66 per US\$1.00, from R\$2.34 per US\$1.00 on December 31, 2013.

Our business is directly affected by the external environment and the Brazilian economy. If the Brazilian economy enters a period of prolonged recession, then demand for some telecommunications services is likely to decline. Similarly, depreciation of the Brazilian real against the U.S. dollar may reduce the purchasing power of Brazilian

consumers and, as a consequence, negatively affect 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 2014 was 5.9% according to the most recent data published by ANATEL.

Table of Contents

The table below shows the Brazilian general price inflation (according to the IGP-DI, IPCA and the IST) for the years ended December 31, 2010 through 2014:

	Inflation Rate (%) as Measured by IGP-DI(1)	Inflation Rate (%) as Measured by IPCA(2)	Inflation Rate (%) as Measured by IST(3)
December 31, 2014	3.8	6.4	5.9
December 31, 2013	5.5	5.9	5.0
December 31, 2012	8.1	5.8	4.9
December 31, 2011	5.0	6.5	4.9
December 31, 2010	11.3	5.9	5.6

(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 of the assets over which they are to be depreciated or amortized as well as their residual value. Asset 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

## Table of Contents

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 19 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 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 at December 31, 2014, which is the key financial assumption used to measure the obligation as well as the sensitivity of our pension liability at December 31, 2014 and of the income statement charge in 2014/15 to changes in these assumptions, is disclosed in Note 32 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), (l) and (m) and 33 to our consolidated financial statements.

### Taxes

There are 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 possible auditing by 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 to recover less than the assets recognized.



## Table of Contents

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 taxable profits, 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 for 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.

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.

#### Provision for doubtful debts

We provide services to consumer and business customers, mainly on credit terms. We know that certain debts due to us will not be paid through the default of a small number of our customers. Estimates, based on our historical experience, are used to determine the level of debts that we believe will not be collected. These estimates include such factors as the current state of the economy and particular industry issues.

Additional information on provision for doubtful debts is disclosed in Notes 3(b) and 5 to our consolidated financial statements.

Table of Contents

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 Call Sound, Vivo Online Security, List Assistance, E-Health messages, and P2A Interactivity Services (Kantoo, Vivo Gol de Placa, Vivo Ligue Bebe, Vivo Futebol, Vivo Nutrição); and
- Data Transmission: Fixed and mobile data including FTTH, xDSL, cable on the fixed side and 3G and 4G on the mobile side.

- 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.

Table of Contents

## Results of Operations

The following table sets forth certain components of our net income for each year ended December 31, 2014, December 31, 2013 and December 31, 2012 as well as the percentage change of each component.

	Year ended December 31,			Percent change		Percent change	
	2014	2013	2012	2014-2013		2013-2012	
	(in millions of reais)						
Net operating revenue	35,000.0	34,721.9	33,919.7	0.8	%	2.4	%
Cost of services and goods	(17,222.7)	(17,542.2)	(16,557.5)	(1.8	%)	5.9	%
Gross profit	17,777.3	17,179.7	17,362.2	3.5	%	(1.1	%)
Operating expenses:							
Selling	(10,466.7)	(9,686.1 )	(8,693.7 )	8.1	%	11.4	%
General and administrative	(1,803.9 )	(2,177.9 )	(2,145.3 )	(17.2	%)	1.5	%
Other operating revenues, net	(397.7 )	(383.4 )	687.7	3.7	%		
Total operating expenses, net	(12,668.3)	(12,247.4)	(10,151.3)	3.4	%	20.6	%
Equity in earnings (losses) of associates	6.9	(55.1 )	0.6	(112.5	%)	(155.8	%)
Operating income before financial expense, net	5,115.9	4,877.2	7,211.5	4.9	%	(32.4	%)
Financial expenses, net	(362.0 )	(214.8 )	(291.2 )	68.5	%	(26.2	%)
Net income before tax and social contribution	4,753.9	4,662.4	6,920.3	2.0	%	(32.6	%)
Income tax and social contribution	182.7	(946.5 )	(2,468.1 )			(61.7	%)
Net income	4,936.6	3,715.9	4,452.2	32.9	%	(16.5	%)
Net income attributable to:							
Controlling shareholding	4,936.6	3,715.9	4,453.6	32.9	%	(16.6	%)
Non-controlling shareholders			(1.4 )				
Net income	4,936.6	3,715.9	4,452.2	32.9	%	(16.5	%)

## Results of Operations for the Year Ended December 31, 2014 Compared to the Year Ended December 31, 2013

## Net Operating Revenue

Net operating revenue increased by 0.8% to R\$35,000.0 million in 2014 from R\$34,721.9 million in 2013 mainly due to the variations in our gross operating revenue discussed below.

## Gross Operating Revenue

Our gross operating revenue increased by 1.3% to R\$52,602.9 million in 2014 from R\$51,908.0 million in 2013, primarily as a result of the increases in revenues from fixed and mobile data services, data transmission and value added services and Pay TV services. The table and descriptions below set forth explanations for these variations:

	Year ended December 31,		Percent change	
	2014	2013	2014-2013	
	(in millions of reais)			
Telephone services	26,151.0	26,428.6	(1.1	%)

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Data transmission and value added services	18,355.3	16,294.9	12.6	%
Interconnection fees charged	2,784.6	3,820.0	(27.1)	%
Pay TV	684.6	587.4	16.5	%
Sale of goods and equipment	3,424.9	3,479.8	(1.6)	%
Other services	1,202.5	1,297.3	(7.3)	%
Gross operating revenue	52,602.9	51,908.0	1.3	%
Value-added and other indirect taxes	(17,602.9)	(17,186.1)	2.4	%
Net operating revenues	35,000.0	34,721.9	0.8	%

Table of Contents

Telephone services: Revenue from telephone services decreased by R\$277.6 million in 2014, or 1.1%, compared to 2013, primarily as a result of the 25% decrease in mobile termination rates mandated by ANATEL, which became effective in February 2014, as described in “Item 4. Information On The Company—B. Business Overview—Regulation of the Brazilian Telecommunications Industry—Mobile Services—Interconnection Fees—Mobile service.” This decrease was partially offset by an increase in our postpaid customer base.

Data transmission and value added services: Revenues from data transmission and value added services increased by R\$2,060.4 million, or 12.6%, compared to 2013, primarily as a result of (1) increased sales of data services, (2) higher penetration of smartphones within our customer base and (3) migration of fixed broadband clients to higher speeds, increasing ARPU.

Interconnection fees: Revenues from interconnection fees decreased by R\$1,035.4 million, a 27.1% decrease in relation to 2013, primarily a result of the 25% decrease in mobile termination rates mandated by ANATEL, which became effective in February 2014.

Pay TV: Revenues from Pay TV totaled R\$684.6 million in 2014, a 16.5% increase compared to 2013, primarily as a result of (1) increases in our DTH and IPTV customer base and (2) increased adoption of high definition television services, which have higher ARPU.

Sale of goods and equipment: Revenues from the sale of goods and equipment in 2014 decreased by R\$54.9 million or 1.6% compared to 2013, primarily as a result of the decline in the number of handsets sold due to the restrictive subsidy policy to which we are subject and which is currently granted only on sales of handsets to postpaid users with 4G data plans.

Others services: Revenues from other services decreased by R\$94.8 million, or 7.3% compared to 2013, primarily as a result of the volatility in the sale of equipment linked to contracts with large clients.

#### Cost of Services and Goods

Cost of services and goods decreased by R\$319.5 million, or 1.8%, to R\$17,222.7 million in 2014 from R\$17,542.2 million in 2013. The table and descriptions below set forth explanations for these variations:

	Year ended December 31,		Percent change	
	2014	2013	2014-2013	
	(in millions of reais)			
Cost of goods sold	(2,107.1 )	(2,117.9 )	(0.5	%)
Depreciation and amortization	(4,067.3 )	(4,265.1 )	(4.6	%)
Outside services and other	(4,074.1 )	(3,645.4 )	11.8	%)
Interconnection fees	(3,176.3 )	(3,842.3 )	(17.3	%)
Rent, insurance, condominium fees, and leased lines	(1,556.4 )	(1,428.0 )	9.0	%)
Personnel	(549.4 )	(522.1 )	5.2	%)
Taxes, fees and contributions	(1,692.1 )	(1,721.4 )	(1.7	%)
Cost of services and goods	(17,222.7)	(17,542.2)	(1.8	%)

Cost of goods sold: Our cost of goods sold decreased by R\$10.8 million, or 0.5%, to R\$2,107.1 million in 2014 from R\$2,117.9 million in 2013, primarily as a result of a decline in the number of handsets sold as a result of the more restrictive subsidy policy, focused on handsets with 4G plans.

Depreciation and amortization: Costs related to depreciation and amortization decreased by R\$197.8 million, or 4.6%, to R\$4,067.3 million in 2014 from R\$4,265.1 million in 2013, primarily as a result of the gain from the periodical review of the useful life of our fixed assets, which resulted in an increase in the average useful life for certain of our fixed assets. The total decrease in depreciation resulting from this review was R\$528.4 million in 2014.

Outside services and other: Costs related to outside services and other increased by R\$428.7 million, or 11.8%, to R\$4,074.1 million in 2014 from R\$3,645.4 million in 2013, primarily as a result of increases in (1) expenses related to plant maintenance and (2) the purchase of TV and mobile content.



Table of Contents

Interconnection fees: Costs related to interconnection fees decreased by R\$666.0 million, or 17.3%, to R\$3,176.3 million in 2014, from R\$3,842.3 million in 2013, primarily as a result of the 25% decrease in mobile termination rates mandated by ANATEL, which became effective in February 2014.

Rent, insurance, condominium fees and leased lines: Costs related to rent, insurance, condominium fees and leased lines increased by R\$128.4 million, or 9.0%, to R\$1,556.4 million in 2014, from R\$1,428.0 million in 2013, primarily as a result of higher rental expenses in connection with sites where we install our antennas, which we increased as part of our continuing efforts to improve quality and increase capacity and coverage.

Personnel: Personnel expenses increased by R\$27.3 million, or 5.2%, to R\$549.4 million in 2014 from R\$522.1 million in 2013, primarily as a result of our collective bargaining agreement, which was revised in January 2014 and renewed in September 2014.

Taxes, fees and contributions: Taxes, fees and contributions decreased by R\$29.3 million, or 1.7%, to R\$1,692.1 million in 2014, from R\$1,721.4 million in 2013, primarily as a result of a reduction in the costs related to tax inefficiencies we had prior to our corporate restructuring, which was completed on July 1, 2013.

## Operating Expenses

Operating expenses increased by R\$420.9 million, or 3.4%, to R\$12,668.3 million in 2014, from R\$12,247.4 million in 2013, primarily as result of an increase in selling expenses, which was partially offset by a reduction in general and administrative expenses. The table and descriptions below set forth explanations for these variations:

	Year ended December 31,		Percent change	
	2014	2013	2014-2013	
	(in millions of reais)			
Selling expenses	(10,466.7)	(9,686.1 )	8.1	%
General and administrative expenses	(1,803.9 )	(2,177.9 )	(17.2	%)
Other net operating income (expense)	(397.7 )	(383.4 )	3.7	%
Total	(12,668.3)	(12,247.4)	3.4	%

Selling expenses: Our selling expenses increased by R\$780.6 million, or 8.1%, to R\$10,466.7 million in 2014 from R\$9,686.1 million in 2013, primarily as a result of our focused sales efforts to increase the higher-value services that we provide, particularly in postpaid mobile voice and data as well as fiber.

General and administrative expenses: Our general and administrative expenses decreased by R\$374.0 million, or 17.2%, to R\$1,803.9 million in 2014, from R\$2,177.9 million in 2013, primarily as a result of stricter cost controls with savings primarily concentrated in rental costs and the effects of the review of the useful life of our fixed assets, which resulted in an increase in the average useful life for certain of our fixed assets.

Other net operating income (expense): Other net operating expenses increased by R\$14.3 million, or 3.7%, to R\$397.7 million in 2014, from R\$383.4 million in 2013. This increase is a result of the proceeds received from the sale of assets in 2013, which did not recur in 2014.

## Financial Expenses, Net

For the year ended December 31, 2014, net financial expenses reached R\$362.0 million, increasing by R\$147.2 million or 68.5% when compared to the period ended December 31, 2013, mainly due to higher average indebtedness in 2014.

#### Income Tax and Social Contribution

We recorded income from income tax and social contribution in the amount of R\$182.7 million in 2014, compared to an expense of R\$946.5 million in 2013. This variation was a result of Law No. 12,973, which became effective in 2014. Law No. 12,973 caused us to revise our tax basis of certain intangible assets resulting from business combinations, which resulted in a positive impact of R\$1,195 million. For additional information, see “Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations” and Note 27 to our financial statements.

Table of Contents

The effective rate of income tax and social contribution decreased to 3.84% in 2014 compared with 20.3% in 2013, which is a result of the revisions described above as well as an increase in the distribution of interest on shareholders' equity during 2014, which is deductible for purposes of calculating income tax and social contributions based on income.

## Results of Operations for the Year Ended December 31, 2013 Compared to the Year Ended December 31, 2012

## Net Operating Revenue

Net operating revenue increased by 2.4% to R\$34,721.9 million in 2013 from R\$33,919.7 million in 2012, mainly due to the variations in our gross operating revenue discussed below.

## Gross Operating Revenue

Our gross operating revenue increased 3.3% to R\$51,908.0 million in 2013 from R\$50,264.6 million in 2012, impacted by increases in revenue from (1) fixed and mobile telephone services, (2) mobile value added services and sales of goods and equipment, primarily from an increase in smartphone sales. The variations are explained as follows:

	Year ended December 31,		Percent change	
	2013	2012	2013-2012	
	(in millions of reais)			
Telephone services	26,428.6	26,555.1	(0.5	%)
Data transmission and value added services	16,294.9	14,389.8	13.2	%)
Interconnection fees charged	3,820.0	4,453.4	(14.2	%)
Pay TV	587.4	805.3	(27.1	%)
Sale of goods and equipment	3,479.8	2,792.6	24.6	%)
Other services	1,297.3	1,268.4	2.3	%)
Gross operating revenue	51,908.0	50,264.6	3.3	%)
Value-added and other indirect taxes	(17,186.1)	(16,344.9)	5.1	%)
Net operating revenues	34,721.9	33,919.7	2.4	%)

Telephone services: There was a decrease of R\$126.5 million in revenue from telephone services, or 0.5%, primarily as a result of a decrease in the fixed-to-mobile tariff (VC) in April 2013. This decrease was partially offset by the increase in prepaid plans called "Vivo ilimitado."

Data transmission and value added services: Revenue from data transmission and value added services increased by R\$1,905.1 million, or 13.2%, compared to 2012, primarily as a result of (1) the growth in sales of 3G, 3G Plus and 4G postpaid data packages tied to smartphones and (2) an increase in sales of data packages to prepaid customers.

Interconnection fees: Revenue from interconnection fees decreased by R\$633.4 million, a 14.2% decrease in relation to 2012, primarily as a result of the decrease in mobile termination rates that occurred in April 2013.

Pay TV: Revenue from Pay TV totaled R\$587.4 million in 2013, a decrease of 27.1% in relation to 2012, primarily as a result of the disconnection of MMDS customers due to the occupation of the spectrum by 4G operators. It was partially offset by an increase in DTH sales since June 2013, reflecting the selective relaunching of DTH TV services in some regions of São Paulo.

**Sale of goods and equipment:** Revenue from the sale of goods and equipment in 2013 totaled R\$3,479.8 million, an increase of 24.6% compared to 2012. The variation in 2013 is mainly explained by increases in smartphone sales and postpaid customers, and by the change in our sales model for SME customers.

**Others services:** Revenues from other services totaled R\$1,297.3 million, an increase of 2.3% compared to 2012. This increase is mainly a result of higher hardware sales for corporate SME customers.

Table of Contents

## Cost of Services and Goods

The following table sets forth the components of our costs of services and goods sold for 2013 and 2012, as well as the percentage change from the previous year.

	Year ended December 31,		Percent change	
	2013	2012	2013-2012	
(in millions of reais)				
Cost of goods sold	(2,117.9 )	(1,801.9 )	17.5	%
Depreciation and amortization	(4,265.1 )	(4,131.8 )	3.2	%
Outside services and other	(3,645.4 )	(3,373.1 )	8.1	%
Interconnection fees	(3,842.3 )	(4,012.1 )	(4.2)	%
Rent, insurance, condominium fees, and leased lines	(1,428.0 )	(969.3 )	47.3	%
Personnel	(522.1 )	(459.7 )	13.6	%
Taxes, fees and contributions	(1,721.4 )	(1,809.6 )	(4.9)	%
Cost of services and goods	(17,542.2)	(16,557.5)	5.9	%

Cost of services and goods increased by 5.9% to R\$17,542.2 million in 2013 from R\$16,557.5 million in 2012. The variations are explained as follows:

**Cost of goods sold:** Cost of wireless devices and accessories increased by 17.5% to R\$2,117.9 million in 2013, from R\$1,801.9 million in 2012, primarily as a result of (1) an increase in smartphone sales, which is a result of higher sales of postpaid and data plans, (2) a change in our sales model for SME customers, and (3) an increase in hardware sales for corporate customers.

**Depreciation and amortization:** Depreciation and amortization expenses increased by 3.2% to R\$4,265.1 million in 2013, from R\$4,131.8 million in 2012, primarily as a result of investments in transmission infrastructure and network.

**Outside services and other:** Cost of outside services and other increased by 8.1% to R\$3,645.4 million in 2013, from R\$3,373.1 million in 2012, primarily as a result of (1) an increase in mobile content as a result of a higher number of applications offered to our customer base and (2) an increase in Pay TV content.

**Interconnection fees:** Interconnection fees decreased by 4.2% to R\$3,842.3 million in 2013, from R\$4,012.1 million in 2012, primarily as a result of the reduction of mobile termination rates beginning in April 2013.

**Rent, insurance, condominium fees, and leased lines:** Rent, insurance, condominium fees, and leased lines increased by 47.3% to R\$1,428.0 million in 2013, from R\$969.3 million in 2012, primarily as a result of (1) the leaseback of sold tower spaces and (2) the expansion of 3G and 4G coverage.

**Personnel:** Personnel expenses increased by 13.6% to R\$522.1 million in 2013, from R\$459.7 million in 2012, primarily as a result of (1) the organizational restructuring action carried out in 2012 and (2) the collective bargaining agreement implemented in January 2013.

**Taxes:** Taxes decreased by 4.9% to R\$1,721.4 million in 2013, from R\$1,809.6 million in 2012, primarily as a result of a reduction in the FISTEL fee mainly due to a restructured policy in prepaid disconnections and costs associated with the renewal of concession licenses and authorization, which is based upon a percentage of revenues, explained by

lower fixed revenue.

68

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Table of Contents

## Operating Expenses

The following table sets forth the components of our operating expenses for each of the years ended December 31, 2013 and 2012, as well as the percentage change from the prior year.

	Year ended December 31,		Percent change	
	2013	2012	2013-2012	
	(in millions of reais)			
Selling expenses	(9,686.1 )	(8,693.7 )	11.4	%
General and administrative expenses	(2,177.9 )	(2,145.3 )	1.5	%
Other net operating income (expense)	(383.4 )	687.7	(155.8	)%
Total	(12,247.4)	(10,151.3)	20.6	%

Operating expenses increased by 20.6% to R\$12,247.4 million in 2013, from R\$10,151.3 million in 2012, primarily as a result of an increase in selling expenses.

**Selling expenses:** Selling expenses increased by 11.4% to R\$9,686.1 million in 2013, from R\$8,693.7 million in 2012, primarily as a result of (1) our focused selling efforts to improve fixed services and (2) an increase in our base of postpaid mobile customers, which was supported by a sales policy focused on adding value. The most relevant drivers of selling expenses were: commissions, which are tied to increased sales of data packages, call center and advertising related to the fixed services turnaround.

**General and administrative expenses:** General and administrative expenses increased by 1.5% to R\$2,177.9 million in 2013, from R\$2,145.3 million in 2012. The lower increase (compared to the increase in 2012 as compared to 2011) was primarily due to cost cutting measures implemented by us during the year.

**Other net operating income (expense):** The net amount of other operating income (expense) decreased to an expense of R\$383.4 million in 2013, from income of R\$687.7 million in 2012. The net disposal proceeds from the sale of towers in 2012 in the amount of R\$1,114 million explains the decrease of 155.8% in 2013 as compared to 2012.

## Financial Expenses, Net

For the year ended December 31, 2013, net financial expenses reached R\$214.8 million, decreasing by R\$76.4 million or 26.2% when compared to the period ended December 31, 2012, mainly due to lower average indebtedness in 2013.

## Income Tax and Social Contribution

We recorded expenses from income tax and social contribution in the amount of R\$946.5 million in 2013, a decrease of 61.7% from an expense of R\$2,468.1 million in 2012. The decrease in 2013 was due to lower income before income tax and social contribution. The effective rate of income tax and social contribution decreased to 20.3% in 2013 compared with 35.7% in 2012, mainly due to interest on shareholders' equity payments made in 2013, which is deductible for income tax purposes, and also to recognition of tax losses carry forwards in our subsidiary TData not recognized in previous years.





Table of Contents

B. Liquidity and Capital Resources

General

We fund our operations and capital expenditures primarily from operating cash flows, loans obtained from financial institutions or development banks, and debentures. As of December 31, 2014, we had R\$4.7 billion in cash and cash equivalents. We do not have any material unused sources of liquidity.

Our principal cash requirements include:

- the servicing of our indebtedness;
- capital expenditures; and
- the payment of dividends.

In addition, we have agreed to pay a portion of the price for the acquisition of GVT in cash and a portion in kind, in the form of our common and preferred shares, as further described in “Item 4. Information on the Company—A. History and Development of the Company—Historical Background—Acquisition of GVT.” We expect to fund the payment of the cash portion with a capital increase.

Our management believes that our sources of liquidity and capital resources, including working capital, are adequate for our present requirements.

Sources of Funds

Our cash flow from operations was R\$9.4 billion in 2014, a decrease of 2% compared to R\$9.6 billion in 2013. The decrease in cash flow from operations was a result of higher costs during the year, particularly with (1) expenses with third party services, due to network expansion and maintenance efforts in our fixed and mobile networks and (2) selling expenses, due to higher commercial activity, mainly in the mobile postpaid and fixed broadband and Pay TV businesses. Extraordinary tax benefits and organizational restructuring events have also impacted cash flow from operations, positiv