INTERNATIONAL BUSINESS MACHINES CORP
Form 4
April 01, 2015

# FORM 4

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

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

**STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES**

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

| OMB APPROVAL | |
|---|---|
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(Print or Type Responses)

1. Name and Address of Reporting Person *
LIVERIS ANDREW N

(Last) (First) (Middle)

THE DOW CHEMICAL COMPANY, 2030 DOW CENTER

(Street)

MIDLAND, MI 48674

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
INTERNATIONAL BUSINESS MACHINES CORP [IBM]

3. Date of Earliest Transaction (Month/Day/Year)
03/31/2015

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

**Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned**

| 1.Title of Security (Instr. 3) | 2. Transaction Date (Month/Day/Year) | 2A. Deemed Execution Date, if any (Month/Day/Year) | 3. Transaction Code (Instr. 8) | | 4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5) | | | 5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4) | 6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4) | 7. Nature of Indirect Beneficial Ownership (Instr. 4) |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Code | V | Amount | (A) or (D) | Price | | | |

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

**Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned**
**(*e.g.*, puts, calls, warrants, options, convertible securities)**

| 1. Title of Derivative | 2. Conversion | 3. Transaction Date (Month/Day/Year) | 3A. Deemed Execution Date, if | 4. Transaction | 5. Number of | 6. Date Exercisable and Expiration Date | 7. Title and Amount of Underlying Securities | 8. Price Derivati |
|---|---|---|---|---|---|---|---|---|

| Security (Instr. 3) | or Exercise Price of Derivative Security | | any (Month/Day/Year) | Code (Instr. 8) | | Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5) | | (Month/Day/Year) | | (Instr. 3 and 4) | | Security (Instr. 5 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Code | V | (A) | (D) | Date Exercisable | Expiration Date | Title | Amount or Number of Shares | |
| Promised Fee Share | $ 0 (1) | 03/31/2015 | | A (2) | | 468 | | (3) | (3) | Common Stock | 468 | $ 160 |

## Reporting Owners

| Reporting Owner Name / Address | Relationships | | | |
|---|---|---|---|---|
| | Director | 10% Owner | Officer | Other |
| LIVERIS ANDREW N<br>THE DOW CHEMICAL COMPANY<br>2030 DOW CENTER<br>MIDLAND, MI 48674 | X | | | |

## Signatures

| | |
|---|---|
| M. Clemens on behalf of A. N. Liveris | 04/01/2015 |
| **Signature of Reporting Person | Date |

## Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

**(1)** Promised Fee Shares under the IBM Board of Directors Deferred Compensation and Equity Award Plan are paid out after retirement in the company's common stock or cash.

**(2)** Deferral of fees into Promised Fee Shares under the terms of the IBM Board of Directors Deferred Compensation and Equity Award Plan.

**(3)** Distribution of Promised Fee Shares under the IBM Board of Directors Deferred Compensation and Equity Award Plan is deferred until retirement.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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| | |
|---|---|
| | Total |
| Loans and financing | |
| | **55,876** |

| | |
|---|---|
| | **(1,781,261)** |
| | **(244,702)** |
| | **(2,025,963)** |
| BNDES | |
| | 15,998 |
| | (825,256) |
| | (213,752) |
| | (1,039,008) |
| BNB | |
| | 39,878 |
| | (11,808) |
| | (4,073) |
| | (15,881) |
| Resolution 4131 - Scotiabank and Bank of America | |
| | - |
| | (944,197) |

(26,877)

(971,074)

**Debêntures**

**3,000,000**

**(2,000,000)**

**(513,937)**

**(2,513,937)**

4th issue – Series 3

-

-

(1,522)

(1,522)

3rd issue

-

(2,000,000)

(246,817)

(2,246,817)

4th issue

-

-

(151,152)

(151,152)

5th issue

2,000,000

-

(114,446)

(114,446)

6th issue

1,000,000

-

-

-

**Suppliers**

Explanation of Responses:

| | |
|---|---|
| | **571,444** |
| | **(668,512)** |
| | **(88,974)** |
| | **(757,486)** |
| **Finance lease** | |
| | **13,462** |
| | **(35,722)** |
| | **(11,973)** |
| | **(47,695)** |
| **Total** | |
| | **3,640,782** |
| | **(4,485,495)** |
| | **(859,586)** |
| | **(5,345,081)** |

**Additions**

Loans and Financing

*Banco do Nordeste ("BNB")*

On May 12, 2017, draw-downs were made related to the agreement signed on August 18, 2014 in the total amount of R$39,878. The rates of this contract are 7.06% p.a. to 10.0% p.a., total term of 8 years, with interest payments and principal repayments in 72 monthly and successive installments. These resources were destined to investment and expansion projects for the Brazil's Northeast region.

*BNDES FINEM*

Contract 14.2.1192.1: On December 30, 2014, a financing line of R$1,000,293 was contracted, with rates of: (i) TJLP + 0 to 3.12% p.a; (ii) 4% p.a; (iii ) Selic + 2.32% p.a, total term of 8 years, with a grace period ending on January 15, 2018. After the grace period, interest and principal repayments will be paid in 60 monthly and successive installments; and (iv) 6% a.a. total term of 7 years, with a grace period ending on January 15, 2017. After the grace period, interest and principal repayments will be paid in 60 monthly and successive installments.

During 2017, three disbursements related to this agreement were made in the amount of R$15,998.

These disbursements refer to a financial support plan linked to projects carried out in the 2014-2016 triennium, aiming at expansion in the areas of operation.

Debentures

*5th Issue*

At a meeting held on January 26, 2017, the Company's Board of Directors approved the 5th issue of simple debentures, non-convertible into shares of the Company, in a single series, unsecured, in the total amount of R$2,000,000, which were subject to public placement with restricted efforts, under a firm guarantee regime, in the terms of ICVM 476/09.

On February 8, 2017, the Company issued 200,000 debentures, with a par value equivalent to R$10. The debentures have a maturity of five years and the nominal unit value of each of the debentures will not be monetarily restated.

Remuneration interest corresponds to 108.25% of the accumulated variation of the average daily rates of one-day Interbank Deposits ("DI").

*6th Issue*

At a meeting held on November 13, 2017, the Company's Board of Directors approved the 6th issue of simple debentures, non-convertible into shares of the Company, in a single series, unsecured, in the total amount of R$1,000,000, which were subject to public placement with restricted efforts, under a firm guarantee regime, in the terms of ICVM 476/09.

On November 27, 2017, the Company issued 100,000 debentures, with a par value equivalent to R$10. The debentures have a maturity of three years and the nominal unit value of each of the debentures will not be monetarily restated.

Remuneration interest corresponds to 100.00% of the accumulated variation of the average daily rates of one-day Interbank Deposits ("DI"), plus a spread equivalent to 0.24%.

**21) OTHER LIABILITIES**

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| | 12/31/17 | 12/31/16 |
|---|---|---|
| Authorization licenses (1) | 258,742 | 1,048,523 |
| Liabilities with related parties (Note 28) | 125,987 | 112,358 |
| Payment for license renewal (2) | 167,536 | 215,154 |
| Third-party withholdings (3) | 144,593 | 227,685 |
| Surplus from post-employment benefit plans (Note 30) | 531,938 | 327,670 |
| Amounts to be refunded to subscribers | 189,380 | 168,708 |
| Other liabilities | 72,893 | 92,447 |
| **Total** | **1,491,069** | **2,192,545** |
| Current | 718,468 | 1,640,757 |
| Noncurrent | 772,601 | 551,788 |

(1) Includes a portion of the Company's liability arising from an agreement entered into with ANATEL, whereby the operators that won the auction of the 4G licenses organized Entidade Administradora do Processo de Redistribuição e Digitalização de Canais de TV e RTV ("EAD"), which will be responsible for equally performing all TV and RTV channel redistribution procedures and solutions to harmful interference in radio communication systems, in addition to other operations in which the winning operators have obligations, as defined in the agreement. On January 31, 2017, the Company paid R$858,991 to EAD, referring to the 2nd and 3rd installments of the auction of 700 MHz national frequency bands for the provision of SMP, performed by ANATEL on September 30, 2014.
(2) This refers to the cost of renewing STFC and SMP licenses.
(3) This refers to payroll withholdings and taxes withheld from pay-outs of interest on equity and on provision of services.

## 22) EQUITY

### a) Capital

According to its Articles of Incorporation, the Company is authorized to increase its share capital up to 1,850,000,000 common and preferred shares. The Board of Directors is the competent body to decide on any increase and consequent issue of new shares within the authorized capital limit.

Nevertheless, Brazil’s Corporation Law (Law nº 6404/76, Article 166, item IV) - establishes that capital may be increased by means of a Special Shareholders’ Meeting resolution to decide about amendments to the Articles of Incorporation, if authorized capital increase limit has been reached.

Capital increases do not necessarily observe the proportion between the number of shares of each class to be maintained, however the number of non-voting or restricted-voting preferred shares must not exceed 2/3 of total shares issued.

Preferred shares are non-voting, except for cases set forth in Articles 9 and 10 of the Articles of Incorporation, but have priority in the event of reimbursement of capital, without premium, and are entitled to dividends 10% higher than those paid on common shares, as per article 7 of the Company's Articles of Incorporation and item II, paragraph 1, article 17 of Law No. 6404/76.

Preferred shares are also entitled to full voting rights if the Company fails to pay the minimum dividend to which they are entitled for three consecutive financial years and this right will be kept until payment of said dividend.

Subscribed and paid-in capital at December 31, 2017 and 2016 amounted to R$63,571,416, divided into shares without par value, held as follows:

At December 31, 2017

| | Common Shares | | Preferred Shares | | Grand Total | |
|---|---|---|---|---|---|---|
| **Shareholders** | **Number** | **%** | **Number** | **%** | **Number** | |
| **Controlling Group** | **540,033,264** | **94.47%** | **704,207,855** | **62.91%** | **1,244,241,119** | **73.5** |
| Telefónica Latinoamérica Holding, S.L. | 46,746,635 | 8.18% | 360,532,578 | 32.21% | 407,279,213 | 24.0 |
| Telefónica S.A. | 198,207,608 | 34.67% | 305,122,195 | 27.26% | 503,329,803 | 29.7 |
| SP Telecomunicações Participações Ltda | 294,158,155 | 51.46% | 38,537,435 | 3.44% | 332,695,590 | 19.6 |
| Telefónica Chile S.A. | 920,866 | 0.16% | 15,647 | 0.00% | 936,513 | 0.0 |
| **Other shareholders** | **29,320,789** | **5.13%** | **415,131,868** | **37.09%** | **444,452,657** | **26.2** |
| **Treasury Shares** | **2,290,164** | **0.40%** | **983** | **0.00%** | **2,291,147** | **0.1** |
| **Total shares** | **571,644,217** | **100.00%** | **1,119,340,706** | **100.00%** | **1,690,984,923** | **100.0** |
| Treasury Shares | (2,290,164) | | (983) | | (2,291,147) | |
| **Total shares outstanding** | **569,354,053** | | **1,119,339,723** | | **1,688,693,776** | |

At December 31, 2016

| | Common Shares | | Preferred Shares | | Grand Total | |
|---|---|---|---|---|---|---|
| **Shareholders** | **Number** | **%** | **Number** | **%** | **Number** | |
| **Controlling Group** | **540,033,264** | **94.47%** | **704,207,855** | **62.91%** | **1,244,241,119** | **73.5** |
| Telefónica Latinoamérica Holding, S.L. | 46,746,635 | 8.18% | 360,532,578 | 32.21% | 407,279,213 | 24.0 |
| Telefónica S.A. | 198,207,608 | 34.67% | 305,122,195 | 27.26% | 503,329,803 | 29.7 |
| SP Telecomunicações Participações Ltda | 294,158,155 | 51.46% | 38,537,435 | 3.44% | 332,695,590 | 19.6 |
| Telefónica Chile S.A. | 920,866 | 0.16% | 15,647 | 0.00% | 936,513 | 0.0 |
| **Other shareholders** | **29,320,789** | **5.13%** | **415,132,512** | **37.09%** | **444,453,301** | **26.2** |
| **Treasury Shares** | **2,290,164** | **0.40%** | **339** | **0.00%** | **2,290,503** | **0.1** |
| **Total shares** | **571,644,217** | **100.00%** | **1,119,340,706** | **100.00%** | **1,690,984,923** | **100.0** |
| Treasury Shares | (2,290,164) | | (339) | | (2,290,503) | |
| **Total shares outstanding** | **569,354,053** | | **1,119,340,367** | | **1,688,694,420** | |

**b) Capital reserves**

b.1) Special goodwill reserve

This represents the tax benefit generated by the merger of Telefonica Data do Brasil Ltda. which will be capitalized in favor of the controlling shareholders (SPTE Participações Ltda) after the tax credits are realized under the terms of CVM Ruling No. 319/99. The balance of this account at December 31, 2017 and 2016 was R$63,074.

b.2) Other capital reserves

The breakdown as of December 31, 2017 and 2016 is as follows.

| | 12.31.17 | 12.31.16 |
|---|---|---|
| Excess of the value in the issue or capitalization, in relation to the basic value of the share on the issue date (1) | 2,735,930 | 2,735,930 |
| Cancelation of treasury shares according to the Special Shareholders' Meeting (SGM) of 3/12/15 (2) | (112,107) | (112,107) |
| Direct costs of capital increases (3) | (62,433) | (62,433) |
| Incorporation of shares of GVTPart. (4) | (1,188,707) | (1,188,707) |
| Effects of the acquisition of Lemontree and GTR by Company and Tglog by TData (5) | (75,388) | (75,388) |
| Preferred shares delivered referring to the judicial process of expansion plan (6) | 2 | 2 |
| Effects of the acquisition of Terra Networks Brasil by TData (7) | (59,029) | - |
| **Total** | **1,238,268** | **1,297,297** |

(1) Refers to the excess of the value in the issue or capitalization, in relation to the basic value of the share on the issue date.

(2) The cancellation of 2,332,686 shares issued by the Company, held in treasury, approved at the Special Shareholders' Meeting held on March 12, 2015.

(3) Refers to direct costs (net of taxes) of Company capital increases on April 28, 2015 and April 30, 2015, arising from the Primary Offering of Shares.

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(4) Refers to the difference between the economic values of the merger of shares of GVTPart. and market value of shares, issued on the transaction closing date.

(5) Regarding the effects of the acquisition of shares of non-controlling shareholders that, with the adoption of IFRS 10, would be recorded in equity when there is no change in the shareholding control.

(6) Refers to the effects of write-offs due to the transfer of 62 preferred shares in treasury to outstanding shares, for compliance with judicial process decisions in which the Company is involved regarding rights to the complementary receipt of shares calculated in relation to network expansion plans after 1996.

(7) Refers to the effects of TData's acquisition of Terra Networks, related to the difference between the consideration given in exchange for the equity interest obtained and the value of the net assets acquired (note 1 c.1).

b.3) Treasury shares

The Company's shares held in treasury whose balance is resulting: (i) of the exercise of the right to withdraw from the Company's common and preferred shareholders, who expressed their dissent regarding the acquisition of GVTPart (see Note 1.c3); (ii) the acquisition of preferred shares in the financial market in accordance with the share buyback program in effect at the time of the transaction (see Note 22.f); and (iii) transfers of preferred shares, related to compliance with court decisions in which the Company is involved, which deals with rights to the complementary receipt of shares calculated in relation to network expansion plans after 1996.

The table below shows the changes in this caption for the year ended December 31, 2017 and 2016.

| | | Shares | | |
|---|---|---|---|---|
| Treasury stock | Common shares | Preferred shares | Total | In thousands of reais |
| **At 12.31.15** | **2,290,164** | **734** | **2,290,898** | **(87,805)** |
| Transfer of lawsuits concerning judicial proceedings (1) | - | (395) | (395) | 15 |

| | | | | |
|---|---|---|---|---|
| **At 12.31.16** | **2,290,164** | **339** | **2,290,503** | **(87,790)** |
| Acquisition of shares in the financial market (2) | **-** | 706 | 706 | **(32)** |
| Transfer of lawsuits concerning judicial proceedings (1) | **-** | (62) | (62) | **2** |
| **At 12.31.17** | **2,290,164** | **983** | **2,291,147** | **(87,820)** |

(1) Refers to the transfer of preferred shares in treasury to outstanding shares to comply with decisions of lawsuits in which the Company is involved that deals with rights to the complementary receipt of shares calculated in relation to plans to expand the network after 1996.

(2) The Company acquired preferred shares issued by the Company in the financial market: (i) on June 1, 2017, 45 shares at a unit price of R$ 47.31, totaling R$ 2; and (ii) on July 5, 2017, 661 shares at a unit price of R$45.26, totaling R$32.

**c) <u>Income reserves</u>**

The amounts of the income reserves are distributed as follows:

| | Legal reserve (1) | Expansion and Modernization Reserve (2) | Tax incentives (3) | Total |
|---|---|---|---|---|
| **At 12.31.15** | **1,703,643** | **700,000** | **6,928** | **2,410,571** |
| Reversal of reserves | - | (700,000) | - | (700,000) |
| Recording of reserves | 204,262 | 550,000 | 10,141 | 764,403 |
| **At 12.31.16** | **1,907,905** | **550,000** | **17,069** | **2,474,974** |
| Reversal of reserves | - | (550,000) | - | (550,000) |
| Recording of reserves | 230,439 | 297,000 | 10,815 | 538,254 |
| **At 12.31.17** | **2,138,344** | **297,000** | **27,884** | **2,463,228** |

(1) This reserve is set up by allocation of 5% of the net income for the year, up to the limit of 20% of the paid-up capital. Legal reserve will only be used to increase capital and offset accumulated losses.

(2) This reserve is constituted based on the capital budget, whose purpose is to guarantee the expansion of the network capacity to meet the Company's increasing demand and guarantee the quality of service rendering. In accordance with Article 196 of Law No. 6404/76, the capital budget will be submitted for appreciation and approval by the Shareholders' Meeting.

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(3) The Company has State VAT (ICMS) tax benefits in the states of Minas Gerais and Espírito Santo, relating to tax credits approved by the relevant bodies of said states, in connection with investments in the installation of SMP support equipment, fully operational, in accordance with the rules in force, ensuring that the localities listed in the call for bid be included in the SMP coverage area. The portion of profit subject to the incentive was excluded from dividend calculation, and may be used only in the event of capital increase or loss absorption.

**d) Dividend and interest on equity**

d.1) Additional dividends proposed for 2016

On April 26, 2017, the Company's Ordinary General Meeting approved the allocation of proposed additional dividends for 2016, not yet distributed, amounting of R$1,913,987, equivalent to R$1.06295487663 and R$1.16925036430 for common and preferred shares, respectively, to the holders of common and preferred shares that were registered in the Company's records at the end of the day of the Ordinary General Meeting. The amount will be paid as of December 13, 2017.

d.2) Remuneration to shareholders

The dividends are calculated in accordance with the Company Articles of Incorporation and the Corporation Law. The table below shows the calculation of dividends and interest on equity for 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Net income for the year | 4,608,790 | 4,085,242 |
| Allocation to legal reserve | (230,439) | (204,262) |
| **Total** | **4,378,351** | **3,880,980** |
| (-) Tax incentives - not distributable | (10,815) | (10,141) |
| **Adjusted net income** | **4,367,536** | **3,870,839** |
| **IOE distributed for the year:** | **2,416,639** | **2,172,145** |
| Interest on equity (gross) | 2,416,639 | 2,172,145 |
| **Balance of unallocated net income** | **1,950,897** | **1,698,694** |

| | | |
|---|---|---|
| (+) Reversal special reserve for modernization and expansion | 550,000 | 700,000 |
| (+) Expired equity instruments | 101,778 | 221,559 |
| (+-) Actuarial gains (losses) recognized and effect of limitation of surplus plan assets, net of taxes and other changes | (113,811) | (156,266) |
| **Income available to be distributed** | **2,488,864** | **2,463,987** |
| **Proposal for Distributions:** | | |
| Special reserve for modernization and expansion | 297,000 | 550,000 |
| Additional proposed dividends | 2,191,864 | 1,913,987 |
| **Total** | **2,488,864** | **2,463,987** |
| **Mandatory minimum dividend - 25% of adjusted net income** | **1,091,884** | **967,710** |

The manner proposed by management for payment of dividends was:

For 2017: The remaining unallocated balance of net income for the year ended December 31, 2017, amounting to R$1,950,897, plus equity instruments lapsed in 2017 amounting to R$101,778 and reversal special reserve for expansion and modernization of 2016 amounting to R$550,000 and less other comprehensive income amounting to R$113,811, totaling R$2,488,864. The amount of R$297,000 was classified as "Special Reserve for Expansion and Modernization" and R$2,191,864 was classified as additional proposed dividends in accordance with the management proposal for allocation of income for the year, submitted and approved at the General Shareholders' Meeting.

For 2016: The remaining unallocated balance of net income for the year ended December 31, 2016, amounting to R$1,698,694, plus equity instruments lapsed in 2016 amounting to R$221,559 and reversal special reserve for expansion and modernization of 2016 amounting to R$700,000 and less other comprehensive income amounting to R$156,266, totaling R$2,463,987. The amount of R$550,000 was classified as "Special Reserve for Expansion and Modernization" and R$1,913,987 was classified as additional proposed dividends in accordance with the management proposal for allocation of income for the year, submitted and approved at the General Shareholders' Meeting at April 27, 2017.

| **Total proposed dividend for deliberation - per share** | **2017** | **2016** |
|---|---|---|
| Common shares | 1.217277 | 1.062955 |
| Preferred shares (1) | 1.339005 | 1.169250 |

(1) 10% higher than the amount allocated to each common share, under article 7 of the Company Articles of Incorporation.

In 2017 and 2016, the Company allocated interim dividends and interest on equity, which were allocated to mandatory minimum dividends, as follows:

2017

| Dates | | | Gross Amount | | | Net Value | | |
|---|---|---|---|---|---|---|---|---|
| Approval | Credit | Beginning of Payment | Common | Preferred (2) | Total | Common | Preferred (2) | Tota |
| 02/13/17 | 02/24/17 | Until 12/31/18 | 56,916 | 123,084 | 180,000 | 48,379 | 104,621 | 153,000 |
| 03/20/17 | 03/31/17 | Until 12/31/18 | 110,669 | 239,331 | 350,000 | 94,069 | 203,431 | 297,500 |
| 06/19/17 | 06/30/17 | Until 12/31/18 | 30,039 | 64,961 | 95,000 | 25,533 | 55,217 | 80,750 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 09/18/17 | 09/29/17 | Until 12/31/18 | 96,440 | 208,560 | 305,000 | 81,974 | 177,276 | 259,250 |
| 12/14/17 | 12/26/17 | Until 12/31/18 | 470,072 | 1,016,567 | 1,486,639 | 399,561 | 864,082 | 1,263,643 |
| | **Total** | | **764,136** | **1,652,503** | **2,416,639** | **649,516** | **1,404,627** | **2,054,143** |

2016

| Dates | | | Gross Amount | | | Net Value | | | A |
|---|---|---|---|---|---|---|---|---|---|
| Approval | Credit | Beginning of Payment | Common | Preferred (2) | Total | Common | Preferred (2) | Total | C |
| 02/19/16 | 02/29/16 | 08/22/17 | 63,239 | 136,761 | 200,000 | 53,753 | 116,247 | 170,000 | 0. |
| 03/18/16 | 03/31/16 | 08/22/17 | 106,559 | 230,441 | 337,000 | 90,575 | 195,875 | 286,450 | 0. |
| 04/18/16 | 04/29/16 | 08/22/17 | 69,563 | 150,437 | 220,000 | 59,129 | 127,871 | 187,000 | 0. |
| 06/17/16 | 06/30/16 | 08/22/17 | 50,908 | 110,092 | 161,000 | 43,272 | 93,578 | 136,850 | 0. |
| 09/19/16 | 09/30/16 | 08/22/17 | 205,528 | 444,472 | 650,000 | 174,699 | 377,801 | 552,500 | 0. |
| 12/19/16 | 12/30/16 | 12/13/17 | 191,029 | 413,116 | 604,145 | 162,374 | 351,149 | 513,523 | 0. |
| | **Total** | | **686,826** | **1,485,319** | **2,172,145** | **583,802** | **1,262,521** | **1,846,323** | |

(1) The amounts of IOE are calculated and stated net of Withholding Income Tax (IRRF). The immune shareholders received the full IOE amount, without withholding income tax at source.

(2) The gross and net values for the preferred shares are 10% higher than those attributed to each common share, as per article 7 of the Company's Articles of Incorporation.

d.3) Unclaimed dividends and interest on equity

Pursuant to article 287, paragraph II, item “a” of Law No. 6404, of December 15, 1976, the dividends and interest on equity unclaimed by shareholders expire in 3 (three) years, as from the initial payment date. The Company reverses the amount of unclaimed dividends and IOE to equity upon expiry.

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For the years ended December 31, 2017 and 2016, the Company reversed unclaimed dividends and interest on equity amounting to R$101,778 and R$189,471, respectively, which were included in calculations for decisions on Company dividends.

**e) Other comprehensive income**

Financial instruments available for sale: These refer to changes in fair value of financial assets available for sale.

Derivative financial instruments: These refer to the effective part of cash flow hedges up to the balance sheet date.

Currency translation effects for foreign investments: This refers to currency translation differences arising from the translation of financial statements of Aliança (jointly-controlled entity).

Changes in other comprehensive income are as follows:

| | Financial instruments available for sale | Derivative transactions | Currency translation effects - foreign investments | Total |
|---|---|---|---|---|
| **Balances at 12/31/15** | **(8,936)** | **379** | **34,025** | **25,468** |
| Exchange variation | - | - | (17,232) | (17,232) |
| Gains from future contracts | - | 42 | - | 42 |
| Reclassification of gains cash flow hedge for capex | - | 3,128 | - | 3,128 |
| Gains on financial assets available for sale | 55 | - | - | 55 |
| **Balances at 12/31/16** | **(8,881)** | **3,549** | **16,793** | **11,461** |
| Exchange variation | | | | |

| | | | | |
|---|---|---|---|---|
| | - | - | 11,239 | 11,239 |
| Losses from future contracts | - | (1,595) | - | (1,595) |
| Gains on financial assets available for sale | 223 | - | - | 223 |
| **Balances at 12/31/17** | **(8,658)** | **1,954** | **28,032** | **21,328** |

**f) <u>Company Share Repurchase Program</u>**

In a meeting held on June 9, 2017, the Company's Board of Directors, in accordance with article 17, item XV, of the Articles of Incorporation, approved the repurchase of common and preferred shares issued by the Company, under CVM Ruling No. 567, of September 17, 2015, for acquisition of common and preferred shares issued by the Company for subsequent cancellation, disposal or to be held in treasury, without decreasing capital, to increase shareholder value through the efficient application of available cash resources and optimize the Company's capital allocation.

The repurchase shall be made through the use of the capital reserve balance included in the balance sheet as of March 31, 2017, excluding the reserves referred to in article 7, paragraph 1, of CVM Instruction 567, of September 17, 2015.

This program is effective until December 8, 2018, with the acquisitions made at B3, at market prices, observing the legal and regulatory limits, being the maximum amounts to be acquired of 870,781 common shares and 41,510,761 preferred shares.

On June 1, 2017 and July 5, 2017, the Company acquired 45 and 661 preferred shares issued by the Company at an average unit price of R$47.31 and R$45.26, repectively, totaling R$32.

**g) <u>Earnings per share</u>**

Basic and diluted earnings per share were calculated by dividing profit attributed to the Company’s shareholders by the weighted average number of outstanding common and preferred shares for the year.

The table below sets out the calculation of earnings per share for the years ended December 31, 2017, 2016 and 2015:

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| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Net income for the year attributable to shareholders: | 4,608,790 | 4,085,242 | 3,420,249 |
| Common shares | 1,457,288 | 1,291,743 | 1,083,911 |
| Preferred shares | 3,151,502 | 2,793,499 | 2,336,338 |
| Number of shares: | 1,688,694 | 1,688,694 | 1,491,131 |
| Weighted average number of outstanding common shares for the year | 569,354 | 569,354 | 503,842 |
| Weighted average number of outstanding preferred shares for the year | 1,119,340 | 1,119,340 | 987,289 |
| Basic and diluted earnings per share: | | | |
| Common shares (in R$) | 2.56 | 2.27 | 2.15 |
| Preferred shares (in R$) | 2.82 | 2.50 | 2.37 |

## 23) NET OPERATING REVENUE

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Gross operating revenue (1)** | **66,243,174** | **65,006,728** | **60,997,496** |
| **Deductions from gross operating revenue** | **(23,036,342)** | **(22,498,269)** | **(20,710,681)** |
| Taxes | (16,058,584) | (15,388,784) | (14,163,869) |
| Discounts granted and return of goods | (6,977,758) | (7,109,485) | (6,546,812) |
| **Net operating revenue** | **43,206,832** | **42,508,459** | **40,286,815** |

(1) These include telephone services, use of interconnection network, data and SVA services, cable TV and other services.

No one customer contributed more than 10% of gross operating revenue for the years ended December 31, 2017, 2016 and 2015.

All amounts in net income are included in income and social contribution tax bases.

**24) OPERATING COSTS AND EXPENSES**

| | 2017 | | | |
|---|---|---|---|---|
| | Cost of sales | Selling expenses | General and administrative expenses | Total |
| Personnel | (845,358) | (2,387,314) | (493,095) | (3,725,767) |
| Third-party services | (5,591,284) | (6,423,523) | (1,232,379) | (13,247,186) |
| Interconnection and network use | (1,440,968) | - | - | (1,440,968) |
| Advertising and publicity | - | (1,015,414) | - | (1,015,414) |
| Rental, insurance, condominium and connection means | (2,624,405) | (151,455) | (204,701) | (2,980,561) |
| Taxes, charges and contributions | (1,792,764) | (39,050) | (34,779) | (1,866,593) |
| Estimated impairment losses on accounts receivable | - | (1,481,015) | - | (1,481,015) |
| Depreciation and amortization (1) | (5,963,153) | (1,433,297) | (457,284) | (7,853,734) |
| Cost of goods sold | (1,955,890) | - | - | (1,955,890) |
| Materials and other operating costs and expenses | (58,708) | (205,406) | (20,867) | (284,981) |
| **Total** | **(20,272,530)** | **(13,136,474)** | **(2,443,105)** | **(35,852,109)** |

| | 2016 | | | |
|---|---|---|---|---|
| | Cost of sales | Selling expenses | General and administrative expenses | Total |
| Personnel | (976,233) | (2,136,399) | (747,156) | (3,859,788) |
| Third-party services | (5,705,098) | (6,151,012) | (1,254,187) | (13,110,297) |
| Interconnection and network use | (1,924,148) | - | - | (1,924,148) |
| Advertising and publicity | - | (1,065,882) | - | (1,065,882) |
| Rental, insurance, condominium and connection means | (2,326,219) | (141,135) | (220,655) | (2,688,009) |
| Taxes, charges and contributions | (1,861,237) | (5,933) | (92,394) | (1,959,564) |
| Estimated impairment losses on accounts receivable | - | (1,348,221) | - | (1,348,221) |
| Depreciation and amortization (1) | (5,821,620) | (1,408,866) | (423,920) | (7,654,406) |
| Cost of goods sold | (2,118,940) | - | - | (2,118,940) |
| Materials and other operating costs and expenses | (89,519) | (197,918) | (55,074) | (342,511) |
| **Total** | **(20,823,014)** | **(12,455,366)** | **(2,793,386)** | **(36,071,766)** |

| | 2015 | | | |
|---|---|---|---|---|
| | Cost of sales | Selling expenses | General and administrative expenses | Total |
| Personnel | (813,612) | (1,939,493) | (468,557) | (3,221,662) |
| Third-party services | (5,300,820) | (6,183,609) | (1,044,272) | (12,528,701) |
| Interconnection and network use | (2,595,894) | - | - | (2,595,894) |
| Advertising and publicity | - | (1,102,458) | - | (1,102,458) |
| Rental, insurance, condominium and connection means | (2,051,055) | (156,663) | (186,691) | (2,394,409) |
| Taxes, charges and contributions | (1,616,920) | (5,264) | (65,599) | (1,687,783) |

| | | | | |
|---|---|---|---|---|
| Estimated impairment losses on accounts receivable | - | (1,230,675) | - | (1,230,675) |
| Depreciation and amortization (1) | (5,269,588) | (1,181,216) | (364,147) | (6,814,951) |
| Cost of goods sold | (2,597,088) | - | - | (2,597,088) |
| Materials and other operating costs and expenses | (100,099) | (206,099) | (13,193) | (319,391) |
| **Total** | **(20,345,076)** | **(12,005,477)** | **(2,142,459)** | **(34,493,012)** |

(1) Includes R$1,267, R$46,647 and R$37,626, related to non-cumulative PIS and COFINS tax credits in 2017, 2016 and 2015, respectively.

**25) OTHER OPERATING INCOME (EXPENSES)**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Recovered expenses and fines | 355,415 | 504,877 | 538,239 |
| Provisions for labor, tax and civil contingencies | (999,419) | (985,176) | (1,014,080) |
| Net gain (loss) on asset disposal/loss (1) | 108,767 | 463,602 | (4,512) |
| Other operating income (expenses) (2) | (187,249) | (51,977) | (73,852) |
| **Total** | **(722,486)** | **(68,674)** | **(554,205)** |
| Other operating income | 464,182 | 968,479 | 538,239 |
| Other operating expenses | (1,186,668) | (1,037,153) | (1,092,444) |
| **Total** | **(722,486)** | **(68,674)** | **(554,205)** |

(1) The amount shown for 2016 includes R$476,371 (net of residual values) from the Company's sale of 1,655 of transmission towers to Telxius Torres Brasil Ltda. After the sale of these assets, a lease agreement for part of the towers sold was entered into, thus ensuring continued transmission of data for mobile services.

The transaction was recognized as sale and leaseback as provided under IAS 17. Management analyzed each asset leased back and classified them as operating or finance leases in accordance with IAS 17 qualitative and quantitative criteria.

Risks and benefits relating to these towers have been transferred to their purchasers, with the exception of several towers for which transfer of risks and benefits was not possible. For these items, the amount was recognized as deferred revenue (Note 19).

(2) In the same transaction, performed in 2016 and described in item (1), the Company transferred assignment of current lease agreements for sites and sold sharing agreements (customer portfolio) for R$40,899.

**26) FINANCIAL INCOME (EXPENSES)**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Financial Income** | | | |
| Interest income | 655,474 | 719,399 | 832,872 |
| Interest receivable (customers, taxes and other) | 124,391 | 104,837 | 87,023 |
| Gain on derivative financial instruments | 373,971 | 994,801 | 2,910,914 |
| Foreign exchange variations on loans and financing | 113,203 | 487,747 | 203,754 |
| Other revenues from foreign exchange and monetary variation | 406,013 | 374,169 | 569,698 |
| Other financial income | 82,906 | 100,406 | 124,404 |
| **Total** | **1,755,958** | **2,781,359** | **4,728,665** |
| **Financial Expenses** | | | |
| Loan, financing, debenture and finance lease charges | (932,727) | (1,061,098) | (921,019) |
| Foreign exchange variation on loans and financing | (129,049) | (214,952) | (1,365,133) |
| Loss on derivative financial instruments | (415,956) | (1,342,671) | (2,011,855) |
| Interest payable (financial institutions, provisions, trade accounts payable, taxes and other) | (136,425) | (278,175) | (216,729) |
| Other expenses with foreign exchange and monetary variation | (876,948) | (830,466) | (704,438) |
| IOF, Pis, Cofins and other financial expenses | (167,897) | (288,538) | (357,669) |
| **Total** | **(2,659,002)** | **(4,015,900)** | **(5,576,843)** |
| **Financial Expenses, net** | | | |

| | | |
|---|---|---|
| **(903,044)** | **(1,234,541)** | **(848,178)** |

**27) INCOME AND SOCIAL CONTRIBUTION TAXES**

The Company recognize income and social contribution taxes on a monthly basis, on an accrual basis, and pay the taxes based on estimates, in accordance with the trial balances for tax-reduction/tax-suspension purposes. Taxes calculated on profits until the month of the financial statements are recorded in liabilities or assets, as applicable.

Reconciliation of the reported tax expense and the amounts calculated by applying the statutory tax rate of 34% (income tax of 25% and social contribution tax of 9%) is shown in the table below for the years ended December 31, 2017, 2016 and 2015.

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Income before taxes | 5,730,773 | 5,134,722 | 4,393,456 |
| Income and social contribution tax expenses, at the tax rate of 34% | (1,948,463) | (1,745,805) | (1,493,775) |
| <u>Permanent differences</u> | | | |
| Equity pickup, net of effects from interest on equity received and surplus value of the assets purchased attributed to the Company (Note 11) | 537 | 423 | 692 |
| Unclaimed interest on equity | (21,843) | (11,432) | (6,552) |
| Temporary differences in subsidiaries | 2,007 | - | - |
| Non-deductible expenses, gifts, incentives | (94,413) | (88,916) | (139,752) |
| Deferred taxes recognized in subsidiaries on tax loss carryforwards, negative basis and temporary differences referring to prior years | 132,080 | - | - |
| Tax benefit related to interest on equity allocated | 821,657 | 738,529 | 593,615 |
| Other (additions) exclusions | (13,545) | 57,721 | 72,565 |
| **Tax** | **(1,121,983)** | **(1,049,480)** | **(973,207)** |
| Effective rate | 19.6% | 20.4% | 22.2% |
| Current income and social contribution taxes | (580,578) | (288,063) | (939,500) |
| Deferred income and social contribution taxes | (541,405) | (761,417) | (33,707) |

Breakdown of gains and losses of deferred income and social contribution taxes on temporary differences is shown in Note 7.b).

**28) BALANCES AND TRANSACTIONS WITH RELATED PARTIES**

**a) <u>Balances and transactions with related parties</u>**

The main balances of assets and liabilities with related parties arises from transactions with companies related to the controlling group carried out at the prices and other commercial conditions agreed in contracts between the parties as follows:

a) Fixed and mobile telephony services provided by Telefónica Group companies;

b) Digital TV services provided by Media Networks Latino America;

c) Lease and maintenance of safety equipment provided by Telefônica Inteligência e Segurança Brasil;

d) Corporate services passed through at the cost effectively incurred for these services;

e) Right to use certain software licenses, including maintenance and support, provided by Telefónica Global Technology

f) International transmission infrastructure for several data circuits and roaming services provided by Telxius Cable Brasil, Telefónica International Wholesale Services Espanha, Telefónica USA; and Media Net Br;

g) Transactions with Terra Group companies based abroad, relating to the purchase of internet content, advertising and auditing services. On July 3, 2017, TData (a wholly-owned subsidiary of the Company) acquired the controlling interest in Terra Networks Brasil, note 1.c.1). Therefore, the balances presented in the result table refer to the period from January to June 2017;

h) Marketing services provided by Terra Group companies;

i) Advertising services, sale of postal solutions and development and sale of content provided by Terra Networks Brasil. On July 3, 2017, TData (a wholly-owned subsidiary of the Company) acquired the controlling interest in Terra Networks Brasil, note 1.c.1). Therefore, the balances presented in the result table refer to the period from January to June 2017;

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j) Data communication services and integrated solutions provided by Telefónica International Wholesale Services Espanha and Telefónica USA;

k) Long distance call and international roaming services provided by companies of Telefónica Group;

l) Sundry expenses and costs to be reimbursed by companies of Telefónica Group;

m) Brand Fee for assignment of rights to use the brand paid to Telefónica;

n) Stock option plan for employees of the Company related to acquisition of Telefónica shares;

o) Cost Sharing Agreement (CSA) for digital-business related expenses reimbursed to Telefónica Digital;

p) Leases/rentals of Telefónica Group companies' buildings;

q) Financial Clearing House roaming, inflows of funds for payments and receipts arising from roaming operation between group companies operated by Telfisa;

r) Integrated e-learning, online education and training solutions provided by T.Learning Services Brasil;

s) Factoring transactions, credit facilities for services provided by the Group's suppliers;

t) Social investment in Fundação Telefônica, innovative use of technology to enhance learning and knowledge, contributing to personal and social development;

u) Contracts or agreements assigning user rights for cable ducts, optical fiber duct rental services, and right-of-way related occupancy agreements with several highway concessionaires provided by Companhia

AIX;

v) Adquira Sourcing platform - online solution provided by Telefónica Compras Electrónicas to transact purchase and sale of all types of goods and services;

w) Digital media; marketing and sales, in-store and outdoor digital marketing services provided by Telefônica On The Spot Soluções Digitais Brasil;

x) Sale/transfer of the Company's towers and customer portfolio to Telxius Torres Brasil; and

y) Logistics operator, messenger and motorcycle courier services provided by Telefônica Transportes e Logística. The amounts for the year of 2015 refer to the period from January to October 2015, the month in which this company was acquired by TData.

As described in note 30, the Company sponsor pension plans and other post-employment benefits to its employees with Visão Prev e Sistel.

The following table summarizes the consolidated balances with related parties:

| | | Balance Sheet - Assets | | | | | |
|---|---|---|---|---|---|---|---|
| | | At 12/31/17 | | | At 12/31/16 | | |
| **Companies** | Type of transaction | Cash and cash equivalents | Accounts receivable, net | Other assets | Cash and cash equivalents | Accounts receivable, net | Other assets |
| **Parent Companies** | | | | | | | |
| SP Telecomunicações Participações | d) / l) | - | 531 | 46 | - | 94 | 9,618 |
| Telefónica LatinoAmerica Holding | l) | - | - | 135,486 | - | - | 206,619 |
| Telefónica | l) | - | 492 | 158 | - | - | 633 |
| | | **-** | **1,023** | **135,690** | **-** | **94** | **216,870** |
| **Other Group companies** | | | | | | | |
| Colombia Telecomunicaciones ESP | k) | - | 1,210 | 4,505 | - | 2,641 | 3,900 |
| Media Networks Brasil Soluções Digitais | a) / d) | - | 1,017 | 2,106 | - | 81 | 59 |
| Pegaso PCS | k) | - | 2,757 | - | - | 6,163 | - |
| T.O2 Germany GMBH CO. OHG | k) | - | 22,315 | - | - | 9,849 | - |
| Telcel Telecom. Celulares C. A. | k) | - | 6,067 | - | - | 6,180 | - |
| Telefônica Digital España | l) | - | 1,929 | - | - | - | - |
| Telefônica Factoring do Brasil | a) / d) / l) | - | 12,337 | 93 | - | 4,927 | 22 |
| Telefónica Global Technology | l) | - | - | 13,600 | - | 1,614 | 11,244 |
| Telefônica Inteligência e Segurança Brasil | a) / d) / l) | - | 271 | 1,013 | - | 868 | 945 |
| Telefónica International Wholesale Services Espanha | j) | - | 69,087 | - | - | 82,613 | - |
| Telefônica Learning Services Brasil | a) | - | 175 | - | - | 64 | - |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Telefónica Moviles Argentina | k) | - | 7,194 | - | - | 6,288 | - |
| Telefónica Moviles Del Chile | k) | - | 539 | 387 | - | 10,207 | 337 |
| Telefónica Moviles Del Espanha | k) | - | 8,918 | - | - | 9,220 | - |
| Telefônica Serviços Empresariais do Brasil | a) / d) / p) | - | 2,938 | 2,355 | - | 2,518 | 2,410 |
| Telefonica UK LTD.(O2 UK LTD) | k) | - | 1,350 | - | - | 8,809 | - |
| Telefónica USA | j) | - | 6,248 | - | - | 3,550 | - |
| Telfisa | q) | 9,523 | - | - | 78,070 | - | - |
| Telxius Cable Brasil | a) / d) / p) | - | 28,981 | 819 | - | 11,513 | 2,678 |
| Telxius Torres Brasil (1) | d) / l) / p) / x) | - | 14,666 | 5,106 | - | 13,842 | 3,709 |
| Terra Networks Chile, Terra Networks México, Terra Networks Perú e Terra Networks Operation | g) / h) | - | 8,159 | - | - | - | - |
| Terra Networks Brasil | a) / d) / l) | - | - | - | - | 5,499 | 7,596 |
| Other | a) / d) / g) / h) / k) / l) / p) | - | 3,840 | 1,059 | - | 4,366 | 909 |
| | | **9,523** | **199,998** | **31,043** | **78,070** | **190,812** | **33,809** |
| **Total** | | **9,523** | **201,021** | **166,733** | **78,070** | **190,906** | **250,679** |
| **Current assets** | | **9,523** | **201,021** | **164,249** | **78,070** | **190,906** | **247,863** |
| **Noncurrent assets** | | **-** | **-** | **2,484** | **-** | **-** | **2,816** |

| | | Balance Sheet - Liabilities | | | |
|---|---|---|---|---|---|
| | | At 12/31/17 | | At 12/31/16 | |
| **Companies** | Type of transaction | Trade accounts payable and other payables | Other liabilities | Trade accounts payable and other payables | Other liabilities |
| **Parent Companies** | | | | | |
| SP Telecomunicações  Participações | l) | 6,656 | 15,000 | - | 533 |
| Telefónica LatinoAmerica Holding | l) | 86 | - | 109 | - |
| Telefónica | l) / m) / n) | 1,205 | 99,950 | 2,236 | 84,759 |
| | | **7,947** | **114,950** | **2,345** | **85,292** |
| **Other Group companies** | | | | | |
| Colombia Telecomunicaciones S.A. ESP | k) | 471 | - | 2,675 | - |
| Companhia AIX de Participações | u) | 1,915 | - | 1,835 | - |
| Fundação Telefônica | t) | - | 137 | - | 52 |
| Media Networks Latina America SAC | b) | 4,248 | - | 32,398 | - |
| Media Networks Brasil Soluções Digitais | f) | 33,751 | 318 | 11,821 | 318 |
| Pegaso PCS | k) | 388 | - | 2,452 | - |
| T.O2 Germany GMBH CO. OHG | k) | 5,477 | - | 4,409 | - |
| Telcel Telecom. Celulares C. A. | k) | 5,240 | - | 4,721 | - |
| Telefónica Compras Electrónicas | v) | 24,311 | - | 24,196 | - |
| Telefônica Digital España | l) / o) | 46,645 | - | 35,347 | - |
| Telefônica Factoring do Brasil | l) / s) | - | 146 | - | 6,154 |
| Telefónica Global Technology | e) / l) | 15,671 | - | 15,169 | - |
| Telefônica Inteligência e Segurança Brasil | c) / l) | 15,336 | 27 | 26,516 | 27 |
| Telefónica International Wholesale Services Espanha | f) | 44,240 | 8 | 50,121 | 8 |

| | | | | | |
|---|---|---|---|---|---|
| Telefônica Learning Services Brasil | r) | 37,931 | - | 16,328 | - |
| Telefónica Moviles Argentina | k) | 3,865 | - | 13,997 | - |
| Telefónica Moviles Del Chile | k) | 963 | - | 10,673 | - |
| Telefónica Moviles Del Espanha | k) | 3,589 | - | 4,671 | - |
| Telefônica Serviços Empresariais do Brasil | d) | - | 376 | 112 | 1,042 |
| Telefonica UK LTD.(O2 UK LTD) | k) | 89 | - | 3,868 | - |
| Telefónica USA | f) | - | 171 | 14,283 | 168 |
| Telxius Cable Brasil | f) | 44,037 | 2,068 | 52,210 | 2,068 |
| Telxius Torres Brasil (1) | x) / l) | 37,718 | 7,757 | 33,178 | 15,991 |
| Terra Networks México, Terra Networks Perú e Terra Networks Operation | h) | 7,633 | - | - | - |
| Terra Networks Brasil | i) | - | - | 3,360 | 1,209 |
| Other | g) / h) / k) / l) / w) | 9,379 | 29 | 14,555 | 29 |
| | | **342,897** | **11,037** | **378,895** | **27,066** |
| **Total** | | **350,844** | **125,987** | **381,240** | **112,358** |
| **Current liabilities** | | **350,844** | **124,749** | **381,240** | **110,449** |
| **Noncurrent liabilities** | | **-** | **1,238** | **-** | **1,909** |

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| | | | | | Income sta | |
|---|---|---|---|---|---|---|
| | | | 2017 | | | 201 |
| **Companies** | Type of transaction | Operating revenues | Cost, despesas and other expenses (revenues) operating | Financial result | Operating revenues | desp and expe (rever oper |
| **Parent Companies** | | | | | | |
| SP Telecomunicações Participações | d) / l) | - | 268 | - | - | |
| Telefónica LatinoAmerica Holding | l) | - | 36,523 | 11,030 | - | 87 |
| Telefónica | l) / m) / n) | - | (331,684) | (996) | - | (319 |
| | | **-** | **(294,893)** | **10,034** | **-** | **(232** |
| **Other Group companies** | | | | | | |
| Colombia Telecomunicaciones S.A. ESP | k) | 349 | (10) | 604 | 217 | (2 |
| Companhia AIX de Participações | a) / u) | 36 | (22,738) | - | 67 | (21 |
| Fundação Telefônica | a) / t) | - | (11,395) | - | - | (10 |
| Media Networks Brasil Soluções Digitais | a) / d) / f) | 600 | (57,176) | - | 572 | (3 |
| Media Networks Latina America SAC | b) | - | (33,133) | (516) | - | (17 |
| Pegaso PCS | k) | 170 | 536 | - | 86 | (5 |
| T. Learning Services Brasil | a) / r) | 292 | (54,782) | - | 2 | (47 |
| T.O2 Germany GMBH CO. OHG | k) | 75 | (1,409) | - | 45 | (4 |
| Telefónica Compras Electrónicas | v) | - | (29,062) | - | - | (42 |
| Telefônica Digital España | l) / o) | - | (81,893) | (2,600) | - | (44 |
| Telefônica Factoring do Brasil | a) / d) / l) / s) | 69 | 828 | 61 | 41 | |
| Telefónica Global Technology, S.A.U. | e) / l) | - | (36,395) | 40 | - | (28 |
| Telefônica Inteligência e Segurança Brasil | a) / c) / d) / l) | 706 | (40,918) | - | 1,041 | (39 |
| | f) / j) | | | | | |

Explanation of Responses:

| | | | | | | |
|---|---|---|---|---|---|---|
| Telefónica International Wholesale Services Espanha | | 56,728 | (49,960) | (2,564) | 72,520 | (56 |
| Telefónica Moviles Argentina | k) | 3,746 | 6,147 | - | 3,072 | (9 |
| Telefónica Moviles Del Chile | k) | 1,586 | (2,196) | 52 | 1,074 | (1 |
| Telefónica Moviles Del Espanha | k) | 1,048 | (1,969) | - | (836) | (2 |
| Telefônica Serviços Empresariais do Brasil | a) / d) / p) | 286 | (989) | - | 118 | |
| Telefonica UK LTD.(O2 UK LTD) | k) | 1,163 | (1,374) | - | 5 | |
| Telefónica USA | f) / j) | 2,392 | (2,322) | (2,035) | 2,998 | (14 |
| Telxius Cable Brasil | a) / d) / f) / p) | 15,044 | (200,536) | 787 | 17,624 | (246 |
| Telefônica Transportes e Logística | a) / d) / l) / q) / z) | - | - | - | - | |
| Telxius Torres Brasil (1) | d) / l) / p) / x) | - | (107,373) | - | 31 | (72 |
| Terra Networks Chile, Terra Networks México, Terra Networks Perú e Terra Networks Operation | g) / h) | - | (9,782) | (120) | - | |
| Terra Networks Brasil | a) / d) / l) / i) | 2,485 | (10,719) | - | 16,483 | (17 |
| Other | a) / d) / g) / h) / k) / l) / p) / w) / x) | 3,537 | (14,608) | 41 | 1,683 | (23 |
| | | **90,312** | **(763,228)** | **(6,250)** | **116,843** | **(713** |
| **Total** | | **90,312** | **(1,058,121)** | **3,784** | **116,843** | **(946** |

(1) In March 2016, the Company entered into a purchase and sale agreements for infrastructure and assignment of leases, pooling and other covenants ("Agreement") with Telxius Torres Brasil Ltda (a Telefónica subsidiary). The subject matter of the agreement is the purchase and sale of 1,655 tower structures, assignment of current rental agreements for their sites and shared-use/ pooling agreements. The total amount involved was R$760,000, comprising R$719,101 relating to the tower infrastructures and R$40,899 relating to the customer portfolio.

The agreement's conditions were established taking into consideration: (i) prior transactions of the same nature performed by the Company and other companies in the industry; (ii) a valuation report for the assets subject matter of the agreement, prepared by an independent appraiser; and (iii) internal business plan showing that the operation is profitable for the Company.

The following table summarizes the aforementioned transaction:

**Impacts on the Balance Sheet**

| **Description** | **Balance Sheet Group** | **R$ thousands** |
|---|---|---|
| Amounts receivable from Telxius Torres Brasil Ltda | Related-party receivables (1) | 760,000 |
| Amount of write-offs of residual values of towers | Property, plan and equipment (note 12) | (99,210) |
| Value of towers classified as finance lease | Finance lease (Note 20) | 2,674 |
| Value of towers awaiting for contractual conditions for transfer | Deferred revenues (Note 19) | 140,846 |

(1) On April 8, 2016, Telxius Torres Brasil Ltda settled the amount of R$760,000 in favor of the Company relating to this transaction, which is classified in the statement of cash flows as cash received from sale of PP&E items.

**Impacts on the Statement of Income**

| **Description** | **DRE Group** |
|---|---|
| Value of disposal of towers (except retention and financial lease) | Other operating revenues (expenses), net (Note |
| Value of write-off of residual amount | Other operating revenues (expenses), net (Note |
| Value of customer portfolio | Other operating revenues (expenses), net (Note |
| Amount of PIS and Cofins charged on customer portfolio | Other operating revenues (expenses), net (Note |
| **Effect on operating income** | |
| Amount of IR and CS levied on towers and customer portfolio | Income and social contribution taxes (Note 27) |
| **Net effect on transaction income** | **Net effect on transaction income** |

**b) Management compensation**

Consolidated key management personnel compensation paid by the Company to its Board of Directors and Statutory Officers for the years ended December 31, 2017 and 2016 totaled R$21,684 and R$109,314, respectively. Of this amount, R$14,439 (R$39,822 at December 31, 2016) corresponds to salaries, benefits and social charges and R$7,245 (R$69,492 at December 31, 2016) to variable compensation.

These amounts were recorded as expenses with personnel under the General and administrative expenses group of accounts (Note 24).

For the years ended December 31, 2017 and 2016, the Company’s Directors and Officers did not receive any pension, retirement pension or other similar benefits.

## 29) SHARE-BASED PAYMENT PLANS

Telefónica, as the Company's parent company, has different share-based payment plans based on the share quotes, which were also offered to management and employees of its subsidiaries, including Telefônica Brasil.

The fair value of these options is estimated on the grant date, based on a binomial pricing model reflecting terms and conditions of instruments granted.

The Company reimburse Telefónica for the amount of the fair value of the benefits granted to management and employees on the grant date.

The main plans in effect at December 31, 2017 and 2016 are detailed below:

**a) <u>Performance & Investment Plan (“PIP</u>”)**

Telefónica's General Shareholders’ Meeting held on May 18, 2011 approved a long-term program for using Telefónica stock options to reward senior management's global commitment, outstanding performance and high potential by awarding Telefónica S.A. shares.

Participants are not required to pay for their initial stock options and may increase the number of shares to be received at the end of the plan if they decide to make a joint investment in their PIP, which requires a participant to buy the equivalent of 25% of the initial shares awarded by Telefónica and hold them until the end of the cycle, when Telefónica will add another 25% in addition to the initial amount of shares in their co-investment.

Initially, the plan is expected to remain effective for 3 years. The cycles are independent of each other. The number of shares is reported at the beginning of each cycle and will be transferred to participants 3 years after the grant date assuming these professionals have met their targets.

The granting of shares is conditional on: (i) maintenance of an active employment relationship within the Telefónica Group on the cycle consolidation date; and (ii) achievement, by Telefónica, of results representing fulfillment of the objectives established for the plan.

The level of success is based on a comparison of the growth in shareholder earnings, considering stock quotations and dividends (Total Shareholder Return - TSR) with the growth in TSR for companies of the Group in an established basis of comparison.

In 2014, the Company approved the extension of this program for another 3 cycles of 3 years each, beginning October 1, 2014 until September 30, 2017. The number of shares is stated at the beginning of the cycle and three years after grant date, and shares are transferred to participants as long as TSR targets are met.

The 2013-2016 cycle takes place in June 2016 and the TSR was not achieved, therefore Telefónica shares were not awarded to the Company's executives.

The 2014-2017 cycle takes place in September 2017 and the TSR was not achieved, therefore Telefónica shares were not awarded to the Company's executives.

The 2015-2018 (October 1, 2015 the September 30, 2018): with 84 active Company executives (including 2 executives appointed under the Articles of Incorporation of the Company), hold the right to potentially receive 471,654 Telefónica shares (includes initial amounts and co-investment).

At December 31, 2017, the value of Telefónica’ share price was Eur 8.1950.

**b) <u>Talent for the Future Share Plan (“TFSP</u>”)**

Telefónica's 2014 General Shareholders’ Meeting approved a long-term program to reward the global commitment, outstanding performance and high potential of its executives by awarding Telefónica shares.

Participants are not required to pay for their initial options. Initially, the plan is expected to remain effective for 3 years. The cycle began on October 1, 2014 until September 30, 2017. The number of shares is reported at the beginning of the cycle and shares will be transferred to participants 3 years after grant date if their targets have been met.

The granting of shares is conditional upon: (i) maintenance of an active employment relationship within the Telefónica Group on the cycle consolidation date; and (ii) achievement, by Telefónica, of results representing fulfillment of the objectives established for the plan. The level of success is based on a comparison of growth in Telefónica shareholder earnings, including their quotations and dividends (Total Shareholder Return - TSR) compared with the growth in TSR for Companies of the Group in an established basis of comparison.

The 2014-2017 cycle takes place in September 2017 and the TSR was not achieved, therefore Telefónica shares were not awarded to the Company’s executives.

The 2015-2018 cycle (October 1, 2015 to September 30, 2018): with the right to potentially receive 83,500 Telefónica shares (includes initial amounts).

At December 31, 2017, the value of Telefónica’ share price was Eur 8.1950.

**c) Global Employee Share Plan (“GESP”)**

At the Telefónica General Shareholders’ Meeting held on May 30, 2014, a share purchase plan under tax incentive was approved, intended for employees of Telefónica Group at the international level, including the employees of the Company. This plan offers the possibility of acquiring Telefónica shares with the commitment of the later to deliver free of charge to participants a given number of its shares, whenever certain requirements are met.

Initially, the plan was expected to remain effective for 2 years. Employees enrolled in the plan were able to acquire Telefónica shares by making monthly contributions of 25 to 150 euros (or the equivalent in local currency) totaling at most 1,800 euros over 12 months (acquisition period).

The delivery of shares occurred after the vesting period of the plan, as of July 31, 2017, and was conditional on: (i) the permanence in the Company during the 2-year program period (vesting period), subject to certain special conditions related to terminations; and (ii) the exact number of shares to be granted at the end of the vesting period depends on the number of shares acquired and held by employees. Thus, employees enrolled with the plan, who remained in the Telefónica Group and who have held the shares acquired for an additional period of over 12 months after the end of the purchase period, will be entitled to receive one free share for each share they have acquired and held until the end of the vesting period.

The cycle was finalized on July 31, 2017, with the delivery of the net shares of withholding income tax.

The expenses of the Company with the share-based compensation plans described above, where applicable, are recorded as personnel expenses, divided into the groups Cost of Services, Selling expenses and General and Administrative Expenses (Note 24), corresponding to R$7,013 and R$21,952 for the years ended December 31, 2017 and 2016.

## 30) PENSION PLANS AND OTHER POST-EMPLOYMENT BENEFITS

The plans sponsored by the Company and related benefit types are as follows:

| **Plan** | **Type** | **Entity** | **Sponsor** |
|---|---|---|---|
| PBS-A | Defined benefit (DB) | Sistel | Telefônica Brasil, jointly with other telecoms resulting from privatization of the Sistema Telebrás |
| PAMA / PCE | Defined benefit (DB) | Sistel | Telefônica Brasil, jointly with other telecoms resulting from privatization of the Sistema Telebrás |
| Healthcare - Law No. 9656/98 | Defined benefit (DB) | Telefônica Brasil | Telefônica Brasil, TData, Terra Networks and TGLog |
| CTB | Defined benefit (DB) | Telefônica Brasil | Telefônica Brasil |
| Telefônica BD | Defined benefit (DB) | VisãoPrev | Telefônica Brasil |
| TCOPREV | Hybrid | VisãoPrev | Telefônica Brasil |
| VISÃO | Defined contribution (DC) / Hybrid | VisãoPrev | Telefônica Brasil, TData, Terra Networks and TGLog |

The actuarial valuation of the plans was made in December 2017 and 2016, based on the registration of the participants held on the following dates:

• <u>Post-Employment Health Benefits Plans</u>

The actuarial valuation made for the PAMA health plan used the registration of the participants with a base date of October 31, 2017, projected for December 31, 2017 and the registration of the participants with a base date of July 31, 2016, projected for 31 of December 2016.

The actuarial valuation carried out for the health plan Law No. 9,656 / 98 used the register of the participants with a base date of October 31, 2017, projected for December 31, 2017 and the registration of the participants with a base date of August 31, 2016 , projected for December 31, 2016.

• Post-employment Social Security Plans

The actuarial valuation made for the CTB pension plan used the registration of the participants with a base date of August 31, 2017, projected for December 31, 2017 and the registration of the participants with a base date of July 31, 2016, projected for 31 of December 2016.

The actuarial valuation made for all other pension plans (PBS-A, Telefônica BD, Tcoprev and Visão plans) used the register of the participants with a base date of July 31, 2017, projected for December 31, 2017 and the with a base date of July 31, 2016, projected for December 31, 2016.

The Company has participation in the decisions that directly affect the governance of the plans, with members nominated for both the Deliberative Council and the Fiscal Council of the administrators Sistel and VisãoPrev.

The defined benefit obligation is made up of different components, according to the pension characteristic of each plan, and may include the actuarial liabilities of supplementary pension liabilities, health care benefits to retirees and dependents or compensation for death or disability of members. This liability is exposed to economic and demographic risks, such as: (i) increases in medical costs that could impact the cost of health care plans; (ii) salary growth; (iii) long-term inflation rate; (iv) nominal discount rate; and (v) life expectancy of members and pensioners.

The fair value of plan assets is primarily comprised of fixed income investments (NTN's, LFT’s, LTN's, repurchase agreements, CDBs, debentures, letters of guarantee and FIDC shares) and equity investments (highly liquid, well regarded, large company shares and investments in market indices). Due to the concentration of fixed income and floating rate investments plan assets are mainly exposed to the risks inherent in the financial market and economic environment such as: (i) market risk in the economic sectors where variable income investments are concentrated; (ii) risk events that impact the economic environment and market indices where variable income investments are concentrated; and (iii) the long-term inflation rate that may erode the profitability of fixed-income investments at fixed rates.

The companies that administer post-employment benefits plans sponsored by the Company (VisãoPrev and Sistel) seek to meet the flows of assets and liabilities through the acquisition of fixed income securities and other long-term assets.

With the exception of the CTB deficit plans and the healthcare plan under Law No. 9656/98, generally all benefit plans that have fund constituted, present a surplus position. The economic benefit recorded in the Company's assets or that of its subsidiaries does not reflect the total surplus determined in these plans.

The economic benefit stated under assets considers only the portion of the surplus which presents a real possibility of recovery. The means of plan surplus recovery is solely through reductions in future contributions and given that not all plans currently receive enough contributions for full recovery of surpluses, the economic benefit recorded under assets is limited to the total possible recovery amount in accordance with projected future contributions.

The position of plan assets is at December 31, 2017 and 2016, respectively, and plan assets were apportioned based on the company's actuarial liabilities in relation to the total actuarial liabilities of the plan.

The actuarial gains and losses generated in each year are immediately recognized in equity (in other comprehensive income).

The following is a summary of the pension plans and other post-employment benefits:

**a) Post-retirement Health Plans**

a.1) Healthcare Plan to Retirees and Special Coverage Program (PAMA and PAMA-PCE)

The Company, together with other companies of the former Telebrás System, at shared cost, sponsor health care plans (PAMA and PAMA-PCE) for retirees. These plans are managed by Fundação Sistel and are closed plans, not admitting new members.

Contributions to the plans are determined based on actuarial valuations prepared by independent actuaries, in accordance with the rules in force in Brazil. The funding procedure is the capitalization method and the sponsor's contribution is at the fixed percentage of payroll of employees covered by the Telefônica BD plan.

a.2) Health care plan – Law No. 9656/98

The Company manages sponsor a health care plan to retired employees and former employees with fixed contributions to the plan, in accordance with Law No. 9656/98.

As provided for in articles 30 and 31 of said law, participants shall have the right to the health care plan in which they participated while they were active employees. Benefitted participants are classified as retirees and their dependents and dismissed employees and their dependents.

Retirees and dismissed employees, in order to keep their right to the benefits, must make contributions to the plan in accordance with the contribution tables by age bracket established by carriers and/or insurance companies.

**b) Post-Employment Pension Plans**

They include the PBS Assisted Plans ("PBS-A"), CTB, Telefônica DB, Tcoprev and Visão.

On December 9, 2016, Visão Prev obtained approvals from the National Supplementary Pension Authority ("PREVIC") for the incorporation of Vivo Prev and Visão TGestiona plans to the Visão Telefônica plan. In this way, as of January 1, 2017, all participants in Vivo Prev and Visão TGestiona plans became participants in the Visão Telefônica plan. This unification preserves all vested rights, and gives participants of the incorporated plans access to the benefits of the Visão Telefônica plan.

The main purpose of the mergers is to create greater synergy of the benefits offered to the participants, as well as to reduce administrative and operational costs of the plans, as well as to improve administrative efficiency.

The following describes the key information about post-retirement pension plans.

b.1) PBS Assisted Plan (PBS-A)

The PBS-A plan is a defined benefit private pension plan managed by Sistel and sponsored by the Company jointly with the other telecommunications companies originating in the privatization of the Telebrás system. The plan is subject to funding by sponsors in case of any asset insufficiency to ensure pension supplementation of participants in the future.

The PBS-A plan comprises assisted participants of the Sistel Benefit Plan who were already retirees on January 31, 2000, from all the participating sponsors, with joint liability of all sponsors to the plan and Sistel.

Although the PBS-A plan has assets in excess of actuarial liabilities at December 31, 2017 and 2016, such surplus was not recognized due to lack of legal provision in relation to refund thereof, in addition, since it is not a contributive plan, it is not possible to make any deduction from future contributions.

b.2) CTB Plan

Contributions to the CTB plan are determined based on actuarial valuations prepared by independent actuaries, in accordance with the rules in force in Brazil. The funding procedure is the capitalization method and the sponsor’s contribution is a fixed percentage of payroll of employees covered by the plan.

The Company also individually manages and sponsors the CTB Plan, originally provided to former employees of Companhia Telefônica Brasileira (“CTB”) who were in the Company in 1977, with whom an individual retirement concession agreement was executed to encourage their resignation. This is an informal pension supplementation benefit paid to former employees directly by the Company. These plans are closed, and no other members are admitted.

b.3) Telefônica DB Plan

The Company individually sponsor defined benefit retirement plan, the Telefônica DB Plan.

In order to improve allocation of Telefôncia DB plan assets and analyze the coverage ratio of plan obligations in future years, a stochastic ALM study was prepared by Visão Prev and Willis Towers Watson. This ALM study aimed at projecting the ratio between coverage of liabilities (solvency ratio) and the risk of mismatching measured by the standard deviation of the solvency ratio. The study concluded that the plan present sustainable projection of their coverage ratio with the current investments portfolio.

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At the time of the concession, a benefit is calculated, which will be paid in a lifelong form and updated by inflation. This plan is not open to new accessions.

The contributions are defined according to the costing plan, which is calculated considering financial, demographic and economic hypotheses in order to accumulate enough resources to pay the benefit to the participants who are already receiving and to the new pensions.

b.4) Tcoprev Plan

The Company sponsors, individually, the Tcoprev Plan, a hybrid plan for defined benefits and defined contribution of pension benefits, managed by Visão Prev.

The contributions to the Tcoprev plan are: (i) basic contribution, with contributions made by the participant and sponsor; and (ii) voluntary and sporadic contributions, with contribution made only by the participant. In addition to these contributions, the sponsor can make the variable contribution, of an eventual character, being apportioned proportionally to the basic contribution of the participant.

In order to improve allocation of Tcoprev plan assets and analyze the coverage ratio of plan obligations in future years, a stochastic ALM study was prepared by Visão Prev and Willis Towers Watson. This ALM study aimed at projecting the ratio between coverage of liabilities (solvency ratio) and the risk of mismatching measured by the standard deviation of the solvency ratio. The study concluded that the Tcoprev plan present sustainable projection of its coverage ratio with the current investments portfolio.

b.5) VISÃO Plans

The Visão Telefônica and Visão Multi plans will hereinafter be shown jointly under the name VISÃO, due to their similarity.

The Company sponsor defined contribution pension plans with defined benefit components (hybrid plans), i.e. the VISÃO Plans, managed by Visão Prev. The contribution is attributed to each subsidiary in the economic and demographic proportion of its respective obligation to the plan.

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The contributions made by the Company related to defined contribution plans totaled R$43,702 at December 31, 2017 (R$37,879 at December 31, 2016).

The contributions to the Visão Telefônica and Visão Multi plans are: (i) basic and additional contribution, with contributions made by the participant and sponsor; and (ii) additional, sporadic and specific contribution, with contribution made only by the participant.

In addition, the participant has the possibility to choose one of the five investment profiles to apply their balance, they are: Super Conservative, Conservative, Moderate, Aggressive and Aggressive Fixed Income Long Term.

**c) Consolidated Information on Pension Plans and Other Post-Employment Benefits**

c.1) Reconciliation of assets and liabilities:

| | Net liabilities (assets) at 12.31.17 | | | Net liabilities (assets) at 12.31.16 | | |
|---|---|---|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | **Total** | Post-retirement pension plans | Post-retirement health plans | **Total** |
| Present value of DB plan obligations | 1,861,651 | 1,050,576 | **2,912,227** | 1,763,866 | 767,642 | **2,531,508** |
| Fair value of plan assets | 2,585,679 | 726,060 | **3,311,739** | 2,703,593 | 667,993 | **3,371,586** |
| **Net liabilities (assets)** | **(724,028)** | **324,516** | **(399,512)** | **(939,727)** | **99,649** | **(840,078)** |
| Asset limitation | 791,177 | 130,440 | **921,617** | 993,754 | 164,953 | **1,158,707** |
| **Noncurrent assets** | **(9,833)** | **-** | **(9,833)** | **(9,041)** | **-** | **(9,041)** |
| **Current liabilities** | **7,914** | **9,021** | **16,935** | **6,826** | **4,162** | **10,988** |
| **Noncurrent liabilities** | **69,068** | **445,935** | **515,003** | **56,242** | **260,440** | **316,682** |

c.2) Total expenses recognized in the income statement:

| | 2017 | | | 2016 | |
|---|---|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | **Total** | Post-retirement pension plans | Post-retireme health pla |
| Current service cost | 3,044 | 7,606 | **10,650** | 2,811 | 2,70 |
| Net interest on net actuarial assets/liabilities | 5,258 | 29,325 | **34,583** | 5,278 | 2,98 |
| **Total** | **8,302** | **36,931** | **45,233** | **8,089** | **5,74** |

c.3) Amounts recognized in other comprehensive income (loss)

| | 2017 | | | 2016 | | | |
|---|---|---|---|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | **Total** | Post-retirement pension plans | Post-retirement health plans | **Total** | Post-reti pensio |
| Actuarial (gains) losses | 325,292 | 208,195 | **533,487** | (174,496) | 240,072 | **65,576** | (8 |
| Asset limitation effect | (309,780) | (52,411) | **(362,191)** | 182,088 | (10,897) | **171,191** | (54 |
| **Total** | **15,512** | **155,784** | **171,296** | **7,592** | **229,175** | **236,767** | **(62** |

c.4) Changes in amount net of liability (asset) of defined benefit, net

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| | 12.31.17 | | | 12.31.16 | |
|---|---|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | **Total** | Post-retirement pension plans | Post-retiremer health plar |
| **Net interest on net defined benefit liability (asset) at the beginning of the year** | **54,026** | **264,603** | **318,629** | **46,907** | **29,71** |
| Business combinations | (12) | 680 | **668** | - | |
| Expenses | 8,302 | 36,931 | **45,233** | 8,089 | 5,74 |
| Sponsor contributions | (10,680) | (3,041) | **(13,721)** | (8,562) | (31 |
| Amounts recognized in OCI | 15,512 | 155,784 | **171,296** | 7,592 | 229,17 |
| **Net interest on net defined benefit liability (asset) at the end of the year** | **67,148** | **454,957** | **522,105** | **54,026** | **264,60** |
| Actuarial assets per balance sheet | (9,833) | - | **(9,833)** | (9,041) | |
| Actuarial liabilities per balance sheet | 76,982 | 454,956 | **531,938** | 63,068 | 264,60 |

c.5) <u>Changes in defined benefit liability</u>

| | 12.31.17 | | | |
|---|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | **Total** | Pos pe |
| **Defined benefit liability at the beginning of the year** | **1,763,866** | **767,642** | **2,531,508** | |
| Liability assumed after acquisition of company | 249 | 680 | **929** | |
| Current service costs | 3,044 | 7,606 | **10,650** | |
| Interest on actuarial liabilities | 181,208 | 82,488 | **263,696** | |
| Benefits paid | | | **(199,633)** | |

| | | | |
|---|---|---|---|
| | (168,856) | (30,777) | |
| Member contributions paid | 220 | - | **220** |
| Actuarial losses (gains) adjusted by experience | (23,613) | 128,469 | **104,856** |
| Actuarial losses (gains) adjusted by demographic assumptions | (3,320) | (1,543) | **(4,863)** |
| Actuarial losses (gains) adjusted by financial assumptions | 108,853 | 96,011 | **204,864** |
| **Defined benefit liability at the end of the year** | **1,861,651** | **1,050,576** | **2,912,227** |

c.6) <u>Changes in the fair value of plan assets</u>

| | 12.31.17 | | | |
|---|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | **Total** | Post-retirer pension p |
| **Fair value of plan assets at the beginning of the year** | **2,703,593** | **667,993** | **3,371,586** | **2,178** |
| Asset acquired on acquisition of company | 323 | - | **323** | |
| Benefits paid | (160,370) | (27,767) | **(188,137)** | (149, |
| Participants contributions paid | 220 | - | **220** | |
| Sponsor contributions paid | 2,195 | 31 | **2,226** | 2 |
| Interest income on plan assets | 283,090 | 71,061 | **354,151** | 264 |
| Return on plan assets excluding interest income | (243,372) | 14,742 | **(228,630)** | 407 |
| **Fair value of plan assets at the end of the year** | **2,585,679** | **726,060** | **3,311,739** | **2,703** |

c.7) <u>Changes in assets limitation</u>

| | 12.31.17 | | | | |
|---|---|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | **Total** | Post-retirement pension plans | P |
| **Asset Limitation at the beginning of the year** | **993,754** | **164,953** | **1,158,707** | **721,123** | |
| Interest on the asset limitation | | | **125,038** | | |

| | | | | |
|---|---|---|---|---|
| | 107,140 | 17,898 | | 90,543 |
| Changes in the assets limitation, except interest | (309,779) | (52,411) | **(362,190)** | 182,088 |
| Effect generated by company acquisition | 62 | - | **62** | - |
| **Asset Limitation at the end of the year** | **791,177** | **130,440** | **921,617** | **993,754** |

c.8) Results projected for 2018

| | Post-retirement pension plans | Post-retirement health plans | **Total** |
|---|---|---|---|
| Current service cost | 2,931 | 13,722 | **16,653** |
| Net interest on net defined benefit liability/asset | 6,074 | 45,892 | **51,966** |
| **Total** | **9,005** | **59,614** | **68,619** |

c.9) Sponsoring company contributions projected for 2018

| | Post-retirement pension plans | Post-retirement health plans | **Total** |
|---|---|---|---|
| Sponsor contributions | 2,499 | 33 | **2,532** |
| Benefits paid directly by the sponsor | 7,914 | 9,026 | **16,940** |
| **Total** | **10,413** | **9,059** | **19,472** |

c.10) Average weighted duration of defined benefit liability

| | Post-retirement pension plans | Post-retirement health plans |
|---|---|---|
| In 2017 | 8.5 years | 18.7 years |
| In 2016 | 8.9 years | 12.7 years |

c.11) Actuarial assumptions

| | 12.31.17 | |
|---|---|---|
| | **Post-retirement pension plans** | **Post-retirement he** |
| Discount rate to present value of defined benefit liability | Visão: 9.5%<br>PBS-A and CTB: 9.8%<br>Telefônica BD and Tcoprev: 9.9% | |
| Future salary growth rate | PBS-A: N/A<br>Visão, CTB, Telefônica BD and Tcoprev: 5.9% | |
| Medical expense growth rate | N/A | |

Explanation of Responses:

| | | | | |
|---|---|---|---|---|
| Nominal annual adjustment rate of pension benefits | | 4.3% | | |
| Medical service eligibility age | | N/A | | Eligibility on ret |
| Estimated retirement age | years | PBS-A, CTB and Telefônica BD: 57 Visão and Tcoprev: 60 years | | |
| Mortality table for nondisabled individuals | 10% | PBS-A, CTB and Telefônica BD: AT-2000 Basic segregated by gender, down-rated by Visão: AT-2000 Basic segregated by gender, down-rated by 50% | | AT-2000 Basic segregated by ge |
| Mortality table for disabled individuals | 40% | PBS-A, CTB and Telefônica BD: RP-2000 Disabled Female, down-rated by Visão: N/A | 40% | RP-2000 Disable |
| Disability table | Light-Forte | PBS-A, CTB, Telefônica BD and Tcoprev: Visão: Light-Fraca, down rated by 30% | | |
| Turnover | N/A | PBS-A, CTB, Telefônica BD and Tcoprev: Visão: Turnover experience in VISÃO plans (2015 to 2017) | N/A | Law No. 9656/98: Turnover e |

Further to the assumptions stated above, other assumptions common to all plans were adopted in 2017 as follows: (i) Long-term inflation rate  4.3%; and (ii) Annual increase in the use of medical services according to age: 4.0%.

| | 12.31.16 | |
|---|---|---|
| | **Post-retirement pension plans** | **Post-retirement he** |
| Discount rate to present value of defined benefit liability | Vivoprev and Visão: 10.9%<br>PBS-A, CTB, Telefônica BD and Tcoprev: 10.8% | |
| Future salary growth rate | PBS-A: N/A<br>CTB, Telefônica BD, Prev and Visão: 6.2% | |
| Medical expense growth rate | N/A | |
| Nominal annual adjustment rate of pension benefits | 4.5% | |
| Medical service eligibility age | N/A | PAMA and PCE: 5% when reachi<br>of contribution; 3% each subseq<br>retirement |
| Estimated retirement age | PBS-A and CTB: N/A<br>Telefônica BD: 57 years<br>Prev and Visão: 60 years | Law No. 9<br>years |
| Mortality table for nondisabled individuals | PBS-A, CTB, Telefônica BD and Tcoprev: AT-2000 Basic segregated by gender, down-rated by 10%<br>Vivoprev and Visão: AT-2000 Basic segregated by gender, down-rated by 50% | AT-2000 Basic segregated by ge |
| Mortality table for disabled individuals | PBS-A, CTB, Telefônica BD and PBS: RP-2000 Disabled Female, down-rated by 40%<br>Vivoprev and Visão: N/A | PAMA and PCE: RP-2000 Dis<br>Law No<br>segregated by ge |
| Disability table | PBS-A, CTB and Telefônica BD: Mercer Disability<br>Prev and Visão: Light-Fraca, down rated by 30% | |
| Turnover | PBS-A, CTB and Telefônica BD: N/A<br>Prev and Visão: Turnover experience in VISÃO plans (2008 to 2011) | N/A<br>Law No. 9656/98: Turnover e |

Further to the assumptions stated above, other assumptions common to all plans were adopted in 2016 as follows: (i) Long-term inflation rate 4.5%; and (ii) Annual increase in the use of medical services according to age: 4.0%.

c.12) Changes in actuarial assumptions in relation to the prior year

In order to adjust some actuarial assumptions to the economic and demographic reality, a study was conducted for the plans administered by Visão Prev and Sistel, which adopted the definition of the assumptions in their Deliberative Councils.

The main economic and financial assumptions that have changed in relation to the previous fiscal year and that interfere with the defined benefit liability are: (i) rates for discount to present value of the defined benefit liability; (ii) long-term inflation rate; (iii) rate of future wage growth; (iv) rate of growth of medical costs; and (v) annual nominal index of adjustment of social security benefits.

The impacts on the plans' defined benefit liabilities due to the new definition of the actuarial assumptions are as follows:

| | Post-retirement pension plans | Post-retirement health plans | **Total** |
|---|---|---|---|
| Defined benefit liability, based on current actuarial assumptions | 1,861,651 | 1,050,576 | **2,912,227** |
| Defined benefit liability, based on prior-year actuarial assumptions | 1,756,118 | 956,108 | **2,712,226** |
| **Difference from change in actuarial assumptions** | **105,533** | **94,468** | **200,001** |

c.13) Sensitivity analysis for actuarial assumptions

The Company believes that the significant actuarial assumptions with reasonable likelihood of variation due to financial and economic scenarios, which could significantly change the amount of the defined benefit obligation, are the discount rate used to adjust the defined benefit liability to present value and the rate of growth of medical costs.

Sensitivity analysis of the defined benefit liability for scenarios involving a 0.5% increase and a 0.5% decrease in the discount rate used to discount the defined benefit liability to present value is as follows:

| | Post-retirement pension plans | Post-retirement health plans | **Total** |
|---|---|---|---|
| Defined benefit liability, discounted to present value at current rate | 1,861,651 | 1,050,576 | **2,912,227** |
| Defined benefit liability, discounted to present value considering a rate increased by 0.5% | 1,784,735 | 977,286 | **2,762,021** |
| Defined benefit liability, discounted to present value considering a rate decreased by 0.5% | 1,944,833 | 1,132,896 | **3,077,729** |

The following is a sensitivity analysis on the defined benefit obligation for scenarios of 1% increase and 1% reduction in the rate of growth of medical costs:

| | Post-retirement pension plans | Post-retirement health plans | **Total** |
|---|---|---|---|
| Defined benefit liability, Projected by the current medical cost growth rate | 1,861,651 | 1,050,576 | **2,912,227** |
| Defined benefit liability, discounted to present value considering a rate increased by 1% | 1,861,651 | 1,223,724 | **3,085,375** |
| Defined benefit liability, discounted to present value considering a rate decreased by 1% | 1,861,651 | 911,270 | **2,772,921** |

c.14) Allocation of plan assets

| | 12.31.17 | | 12.31 |
|---|---|---|---|
| | Post-retirement pension plans | Post-retirement health plans | Post-retirement pension plans |
| **Investments with market value quoted in active market:** | | | |
| **Fixed income investments** | | | |
| National Treasury Note (NTN) | 1,998,931 | 670,516 | 1,769,606 |
| Treasury Financial Letter | 199,135 | 55,544 | 30,588 |
| Repurchase operations | 142,228 | - | 134,863 |
| Debentures | 13,209 | - | 12,843 |
| Treasury Financial Letter (LFT) | 4,567 | - | 229,793 |
| FIDC shares / Others | 3,694 | - | 6,449 |
| National Treasury Notes (LTN) | 2,165 | - | 1,895 |
| Bank Deposit Certificates (CDB) | 1,317 | - | 36,744 |
| **Variable income investments** | | | |
| Investments in energy sector | 57,781 | - | 246,400 |
| Investments in food and beverage industry | 32,337 | - | 45,054 |
| Investments in aerospace sector | - | - | 28,947 |
| Investments in mining sector | 1,197 | - | 2,581 |
| Investments in other sectors (1) | 7,124 | - | 9,207 |
| **Real estate investments** | 96,525 | - | 121,176 |
| **Loans to participants** | 18,346 | - | 23,562 |
| **Structured investments** | 3,753 | - | 224 |
| **Investments with market value not quoted in active market:** | | | |
| **Loans to participants** | 1,590 | - | 1,850 |
| **Structured investments** | 1,780 | - | 1,811 |
| **Total** | **2,585,679** | **726,060** | **2,703,593** |

(1) Investments in variable income in the following industries: oil, gas and biofuel; telephony; steel and metals; construction and engineering; sales and distribution; transportation; wood and paper; education; financial services and banks; real estate, among; others.

c.15) Maturity of future benefit payments

| | Post-retirement pension plans | Post-retirement health plans | **Total** |
|---|---|---|---|
| 2018 | 162,546 | 38,839 | **201,385** |

| | | | |
|---|---|---|---|
| 2019 | 166,989 | 42,679 | **209,668** |
| 2020 | 171,275 | 47,023 | **218,298** |
| 2021 | 176,423 | 51,987 | **228,410** |
| 2022 | 180,505 | 57,309 | **237,814** |
| 2023 onwards | 5,326,440 | 22,761,339 | **28,087,779** |
| **Total** | **6,184,178** | **22,999,176** | **29,183,354** |

## 31) FINANCIAL INSTRUMENTS AND RISK AND CAPITAL MANAGEMENT

### a) <u>Derivative transactions</u>

The derivative financial instruments contracted by the Company are mainly intended to hedge against foreign exchange risk arising from assets and liabilities in foreign currency, risk of inflation on its debentures and leases indexed to the IPCA and against the risk of changes in TJLP of a portion of debt with BNDES. There are no, derivative financial instruments for speculative purposes and possible currency risks are hedged.

Management understands that the Company's internal controls for its derivatives are adequate to control risks associated with each strategy for the market. Gains/losses obtained or sustained by the Company in relation to its derivatives show that its risk management has been appropriate.

The Company calculates the effectiveness of the derivative contracts to hedge its financial liabilities and cash flows in foreign currency at the beginning of the operation and on an ongoing basis. At December 31, 2017 and 2016, the derivative instruments were effective for the hedged items.

As long as these derivatives contracts qualify for hedge accounting, the hedged item may also be adjusted to fair value, offsetting the result of the derivatives, according to the rules of hedge accounting. This hedge accounting applies both to financial liabilities and probable cash flows in foreign currency.

At December 31, 2017 and 2016, the Company held no embedded derivatives contracts.

Derivatives contracts include specific penalties for breach of contract. Breach of contract provided for in agreements made with financial institutions leads to the early maturity thereof.

a.1) Fair value of derivative financial instruments

The valuation method used to calculate the fair value of financial liabilities (if applicable) and derivative financial instruments was the discounted cash flow method, based on expected settlements or realization of liabilities and assets at market rates prevailing at the balance sheet date.

The fair values of positions in Reais are calculated by projecting future inflows from transactions using B3 yield curves discounting these flows to present value using market DI rates for swaps announced by B3.

The market values of foreign-exchange derivatives were obtained using the market exchange rates in effect at the balance sheet date and projected market rates obtained from the currency's coupon-rate yield curves. The linear convention of 360 calendar days was used to determine coupon rates of positions indexed in foreign currencies, while the exponential convention of 252 business days was used to determine coupon rates for positions indexed to CDI rates.

Consolidated derivatives financial instruments shown below are registered with B3 and classified as swaps, usually, that do not require margin deposits.

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| | Notional Value | | Accumulated effects from fair value Amount receivable (payable) | |
|---|---|---|---|---|
| Description | 12.31.17 | 12.31.16 | 12.31.17 | 12.31.16 |
| **Long position** | **1,166,777** | **2,739,524** | **164,405** | **212,993** |
| Foreign Currency | 326,149 | 1,522,598 | 102,876 | 158,762 |
| US$ (1) (2) | 201,445 | 742,137 | 49,110 | 73,833 |
| EUR (2) | 11,000 | 70,064 | 449 | - |
| LIBOR US$ (1) | 113,704 | 710,397 | 53,317 | 84,929 |
| Floating rate | 643,589 | 898,324 | 28,263 | 31,987 |
| CDI (1) (2) | 249,239 | 254,883 | 82 | 3,979 |
| TJLP (4) | 394,350 | 643,441 | 28,181 | 28,008 |
| Inflation rates | 197,039 | 318,602 | 33,266 | 22,244 |
| IPCA (3) (5) | 166,775 | 192,318 | 33,266 | 17,998 |
| IGPM (6) | 30,264 | 126,284 | - | 4,246 |
| **Short position** | **(1,363,491)** | **(2,573,351)** | **(20,652)** | **(184,616)** |
| Floating rate | (952,283) | (2,391,882) | (16,417) | (184,545) |
| CDI (1) (2) (3) (4) (5) (6) | (952,283) | (2,391,882) | (16,417) | (184,545) |
| Foreign Currency | (411,208) | (181,469) | (4,235) | (71) |
| US$ (2) | (354,356) | (88,710) | (4,235) | (71) |
| LIBOR US$ (1) | (56,852) | (92,759) | - | - |
| | **Long position** | | **164,405** | **212,993** |
| | Current | | 87,643 | 68,943 |
| | Non Current | | 76,762 | 144,050 |
| | **Short position** | | | |

| | | |
|---|---|---|
| | **(20,651)** | **(184,616)** |
| Current | (5,239) | (183,212) |
| Non Current | (15,412) | (1,404) |
| **Amounts receivable, net** | **143,754** | **28,377** |

(1) Foreign currency swaps (US$ and LIBOR) x CDI (R$237,384) - swap transactions for varying debt repayment dates held to hedge currency risk affecting the Company's loans in US$ (carrying amount R$225,254).

(2) Foreign currency swaps (Euro and CDI x Euro) (R$70,946) and (US$ and CDI x US$) (R$56,071) - maturing through February 9, 2018 to hedge currency risk affecting net amounts payable (carrying amount R$70,683 in euros) and receivables (carrying amount R$56,081 in US$).

(3) IPCA x CDI rate swaps (R$39,497) - maturing through 2019 to hedge the same flow as the debentures (4th issue - 3rd series) indexed to the IPCA (carrying amount R$40,322).

(4) TJLP x CDI swaps (R$390,314) - maturing through 2019 to hedge the risk of TJLP variation on loan with BNDES (carrying amount R$441,167).

(5) IPCA x CDI swaps (R$224,820) - maturing in 2033 to hedge risk of change in finance lease rate pegged to IPCA (carrying amount R$217,178).

(6) IGPM x CDI swaps (R$42,842) - maturing 2016 through 2018 to hedge IGP-DI variation risk affecting regulatory commitments related to 4G license.

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The table below shows the breakdown of swaps maturing after December 31, 2017:

| | Maturing in | | | | |
|---|---|---|---|---|---|
| Swap contract | 2018 | 2019 | 2020 | 2021 onwards | Amount receivable (payable) at 12.31.17 |
| Foreign currency x CDI | 65,670 | 36,937 | - | - | 102,607 |
| CDI x Foreign Currency | (4,524) | (93) | - | - | (4,617) |
| TJLP x CDI | 20,838 | 7,343 | - | - | 28,181 |
| IPCA x CDI | 722 | 9,633 | 1,129 | 6,402 | 17,886 |
| IGPM x CDI | (303) | - | - | - | (303) |
| **Total** | **82,403** | **53,820** | **1,129** | **6,402** | **143,754** |

For the purposes of preparing its financial statements, the Company adopted the fair value hedge accounting methodology for its foreign currency swaps x CDI, IPCA x CDI, IGPM x CDI and TJLP x CDI for hedging or financial debt. Under this arrangement, both derivatives and hedged risk are recognized at fair value.

The ineffective portion at December 31, 2017 was R$1,289 (R$2,091 at December 31, 2016).

At December 31, 2017 and 2016, the transactions with derivatives generated consolidated negative (net) result of R$41,985 and R$347,870, respectively (Note 26).

a.2) <u>Sensitivity analysis to the Company’s risk variables</u>

The IFRS 7  requires by disclosing sensitivity analyses for each type of market risk that management understands to be significant when originated by financial instruments to which the entity is exposed at the end of each period, including all derivatives financial instrument transactions.

In making the above analysis, each of the transactions with derivative financial instruments was assessed and assumptions included a probable scenario and two others that could adversely impact the Company.

In the probable scenario the assumption is to use, on the maturity dates of each of the transactions, what the market had been showing through B3 yield curves (currencies and interest rates), as well as data available at IBGE, Central Bank, FGV, among others. In the probable scenario, there is no impact on the fair value of the above-mentioned derivatives. However, for scenarios II and III, risk variables were considered to deteriorate by 25% and 50% respectively.

Since the Company only holds derivatives to hedge its foreign-currency assets and liabilities, changing scenarios are tracked by the corresponding hedged items, thus showing that effects are almost non-existent. For these transactions, the Company reported the consolidated net exposure in each of the above-mentioned three scenarios at December 31, 2017.

Sensitivity analysis - net exposure

| Transaction | Risk | Probable | 25% |
|---|---|---|---|
| Hedge (long position) | Derivatives (depreciation risk EUR) | (70,683) | |
| Payables in EUR | Debt (appreciation risk EUR) | (42,808) | |
| Receivables in EUR | Debt (depreciation risk EUR) | 113,754 | |
| | Net Exposure | 263 | |
| Hedge (short position) | Derivatives (depreciation risk US$) | (56,071) | |
| Payables in US$ | Debt (appreciation risk US$) | 164,648 | |
| Receivables in US$ | Debt (depreciation risk US$) | (108,567) | |
| | Net Exposure | 10 | |
| Hedge (long position) | Derivatives (risk of decrease in IPCA) | 279,566 | |
| Debt in IPCA | Debt (risk of increase in IPCA) | (381,564) | |
| | Net Exposure | (101,998) | |
| Hedge (long position) | Derivatives (risk of decrease in IGP-DI) | 42,538 | |
| Debt in IGP-DI | Debt (risk of increase in IGP-DI) | (140,859) | |
| | Net Exposure | (98,321) | |
| Hedge (long position) | Derivatives (risk of decrease in UMBND) | 221,553 | |
| Debt in UMBND | Debt (risk of increase in UMBND) | (225,708) | |
| | Net Exposure | (4,155) | |
| Hedge (long position) | Derivatives (risk of decrease in TJLP) | 418,496 | |
| Debt in TJLP | Debt (risk of increase in TJLP) | (1,586,846) | |
| | Net Exposure | (1,168,350) | |
| Hedge (CDI position) | | | |
| Hedge US$ and EUR (short and long position) | Derivatives (risk of decrease in CDI) | (130,892) | |
| Hedge IPCA (short position) | Derivatives (risk of increase in CDI) | (279,566) | |
| Hedge IGPM (short position) | Derivatives (risk of increase in CDI) | (42,538) | |
| Hedge UMBND (short position) | Derivatives (risk of increase in CDI) | (221,553) | |
| Hedge TJLP (short position) | Derivatives (risk of increase in CDI) | (418,496) | |
| | **Net Exposure** | **(1,093,045)** | |
| **Total net exposure in each scenario** | | **(2,465,596)** | |
| **Net effect on changes in current fair value** | | **-** | |

The assumptions used by the Company for the sensitivity analysis at December 31, 2017 were as follows:

Sensitivity analysis assumptions

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| Risk Variable | Probable | 25% depreciation | 50% depreciation |
|---|---|---|---|
| US$ | 3.3080 | 4.1350 | 4.9620 |
| EUR | 3.9676 | 4.9595 | 5.9514 |
| JPY | 0.0293 | 0.0367 | 0.0440 |
| IPCA | 2.79% | 3.49% | 4.19% |
| IGPM | -0.52% | -0.65% | -0.78% |
| IGP-DI | -0.27% | -0.34% | -0.41% |
| UMBND | 0.0646 | 0.0807 | 0.0969 |
| URTJLP | 2.0314 | 2.5392 | 3.0470 |
| CDI | 6.89% | 8.61% | 10.34% |

For calculation of the net exposure for the sensitivity analysis, all derivatives were considered at market value and hedged items designated for hedge for accounting purposes were also considered at fair value.

The fair values shown in the table above are based on the portfolio position at December 31, 2017, but do not reflect an estimate for realization due to the dynamism of the market, which is constantly monitored by the Company. The use of different assumptions could significantly affect the estimates.

**b) Fair value**

The Company assessed their financial assets and liabilities in relation to market values using available information and appropriate valuation methodologies. However, both the interpretation of market data and the selection of valuation methods require considerable judgment and reasonable estimates to produce the most adequate realization value. As a result, the estimates shown do not necessarily indicate amounts that could be realized in the current market. The use of different assumptions for the market and/or methodologies may have a material effect on estimated realization values. At December 31, 2017 and 2016, neither the Company not its subsidiaries detected any significant and enduring impairment of their financial instruments.

The fair value of all assets and liabilities are classified within the fair value hierarchy described below, based on the lowest level of information that is significant to the fair value measurement as a whole:

Level 1: quoted market prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: valuation techniques for which significant lower level of information to measure the fair value directly or indirectly observable; and

Level 3: valuation techniques for which the lowest and significant level of information to measure the fair value is not available.

During years ended December 31, 2017 and 2016, there were no transfers between fair value measurements of level 3 and level 1 and 2.

The following table show the composition of financial assets and liabilities at December 31, 2017 and 2016.

| | Classification by category | Fair value hierarchy | Book value 12.31.17 | Book value 12.31.16 | Fair value 12.31.17 | Fair value 12.31.16 |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| **Current** | | | | | | |
| Cash and cash equivalents (Note 4) | Amortized cost | | 4,050,338 | 5,105,110 | 4,050,338 | 5,105,110 |
| Trade accounts receivable, net (Note 5) | Loans and receivables | | 8,588,466 | 8,701,688 | 8,588,466 | 8,701,688 |
| Derivative transactions (Note 31) | Measured at fair value through profit or loss | Level 2 | 2,480 | 3,979 | 2,480 | 3,979 |
| Derivative transactions (Note 31) | Hedges (economic) | Level 2 | 85,163 | 64,964 | 85,163 | 64,964 |
| **Noncurrent** | | | | | | |
| Short-term investments pledged as collateral | Amortized cost | | 81,486 | 78,166 | 81,486 | 78,166 |
| Trade accounts receivable, net (Note 5) | Loans and receivables | | 273,888 | 305,411 | 273,888 | 305,411 |
| Derivative transactions (Note 31) | Hedges (economic) | Level 2 | 76,762 | 144,050 | 76,762 | 144,050 |
| **Total financial assets** | | | **13,158,583** | **14,403,368** | **13,158,583** | **14,403,368** |
| **Financial Liabilities** | | | | | | |
| **Current** | | | | | | |
| Trade accounts payable (Note 15) | Amortized cost | | 7,447,100 | 7,611,246 | 7,447,100 | 7,611,246 |
| Loans, financing and finance lease (Note 20) | Amortized cost | | 1,316,034 | 1,256,147 | 1,463,609 | 1,363,539 |
| Loans, financing and finance lease (Note 20) | Measured at fair value through profit or loss | Level 2 | 304,921 | 1,286,828 | 317,231 | 1,307,310 |
| | Amortized cost | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Debentures (Note 20) | | | 1,412,174 | 2,120,197 | 1,532,427 | 2,242,291 |
| Debentures (Note 20) | Measured at fair value through profit or loss | Level 2 | 312 | 307 | 1,490 | 1,412 |
| Derivative transactions (Note 31) | Measured at fair value through profit or loss | Level 2 | 4,504 | 4,111 | 4,504 | 4,111 |
| Derivative transactions (Note 31) | Hedges (economic) | Level 2 | 735 | 179,101 | 735 | 179,101 |
| **Noncurrent** | | | | | | |
| Trade accounts payable (Note 15) | Amortized cost | | - | 71,907 | - | 71,907 |
| Loans, financing and finance lease (Note 20) | Amortized cost | | 1,353,582 | 1,837,077 | 1,291,974 | 1,668,524 |
| Loans, financing and finance lease (Note 20) | Measured at fair value through profit or loss | Level 2 | 520,421 | 874,982 | 505,422 | 822,818 |
| Debentures (Note 20) | Amortized cost | | 3,068,243 | 1,396,813 | 2,866,372 | 1,260,814 |
| Debentures (Note 20) | Measured at fair value through profit or loss | Level 2 | 40,010 | 36,990 | 37,717 | 34,124 |
| Contingent consideration (Note 20) | Measured at fair value through profit or loss | Level 2 | 446,144 | 414,733 | 446,144 | 414,733 |
| Derivative transactions (Note 31) | Hedges (economic) | Level 2 | 15,412 | 1,404 | 15,412 | 1,404 |
| | | | **15,929,592** | **17,091,843** | **15,930,137** | **16,983,334** |

**c) <u>Capital management</u>**

The purpose of the Company's capital management is to ensure maintenance of a high credit rating before institutions and an optimal capital ratio in order to support the Company's business and maximize shareholder value.

The Company manages its capital structure by making adjustments and adapting to current economic conditions. For this purpose, the Company may pay dividends, raise new loans, issue debentures and contract derivatives. For the year ended December 31, 2017, there were no changes in capital structure objectives, policies or processes.

In its net debt structure, the Company includes balances referring to loans, financing, debentures, finance leasing, contingent consideration and transactions with derivatives, less cash and cash equivalents, short-term investments to secure BNB financing and guarantor of the contingent consideration liability.

The Company’s ratio of consolidated debt to shareholders’ equity consists of the following:

| | 12.31.17 | 12.31.16 |
|---|---|---|
| Cash and cash equivalents | 4,050,338 | 5,105,110 |
| Loans, financing, debentures, financial lease and contingent consideration | (8,461,841) | (9,224,074) |
| Derivative transactions, net | 143,754 | 28,377 |
| Short-term investment pledged as collateral | 11,722 | 10,773 |
| Asset guarantor of contingent consideration | 446,144 | 414,733 |
| **Net debt** | **3,809,883** | **3,665,081** |
| Net equity | 69,461,358 | 69,244,419 |
| **Net debt-to-equity ratio** | **5.48%** | **5.29%** |

**d) Risk management policy**

The Company is exposed to several market risks as a result of its commercial operations, debts contracted to finance its activities and debt-related financial instruments.

d.1) Currency Risk

There is risk arising from the possibility that the Company may incur losses due to fluctuating exchange rates, which add to costs arising from loans denominated in foreign currencies.

At December 31, 2017, 2.7% of financial debt was foreign-currency denominated (14.0% at December 31, 2016). The Company enters into derivative transactions (currency hedge) with financial institutions to hedge against exchange rate variation affecting its total indebtedness in foreign currency (R$225,254 and R$1,287,864 at 31 December 2017 and 2016, respectively). Its total debt on these dates was covered by asset positions in currency-exchange hedge transactions with CDI-rate swaps.

There is also foreign exchange risk for non-financial assets and liabilities denominated in foreign currencies, which may generate a smaller amount receivable or larger amount payable depending on the exchange rate in the period.

Hedging transactions were engaged to minimize the risks associated with exchange-rate variation of non-financial assets and liabilities in foreign currencies. This balance is subject to daily changes due to the dynamics of the business. However, the Company intends to cover the net balance of these rights and obligations (US$16,953 thousand receivable and €17,535 thousand payable by December 31, 2017 and US$17,293 thousand receivable and €5,695 thousand payable by December 31, 2016) to mitigate its foreign exchange risks.

d.2) Interest and Inflation Risk

This risk arises because the Company may incur losses in the event of an unfavorable change in the domestic interest rate, which may adversely affect financial expenses resulting from the portion of debentures referenced to the CDI and liability positions in derivatives (currency hedge, IPCA and TJLP) pegged to floating interest rates (CDI).

The debt with BNDES is indexed to the Long-Term Interest Rate (TJLP) which is set on a quarterly basis by the National Monetary Council. During the year 2016 and for the quarter ended March 30, 2017, the TJLP was 7.5%. In the third quarter of 2017, the TJLP remained at 7.0%, until the end of the year.

Inflation risk arises from the Minas Comunica debentures of the 1st issue, which are tied to the IPCA and thus may adversely affect financial expenses in the event of an unfavorable change in this index.



To reduce exposure to the variable interest rate (CDI), the Company invested their cash equivalents of R$3,932,539 at December 31, 2017 (R$4,906,741 at December 31, 2016), mostly in short-term CDI-based financial investments (Bank Deposit Certificates). The carrying amounts of these instruments approach their fair values, since they may be redeemed in short term.

d.3) Liquidity Risk

Liquidity risk is the possibility of the Company not holding sufficient funds to meet their commitments due to different currencies and dates of realization of rights and settlement of obligations.

The Company structure the maturity dates of non-derivative financial contracts, as shown in Note 20, and their respective derivatives, as shown in the schedule of payments disclosed in this note, to avoid affecting their liquidity.

The Company cash flow and liquidity and those of its subsidiaries are managed on a daily basis by the departments in charge to ensure that operating cash flows and prior funding, when necessary, will be sufficient to meet their schedule of commitments in order to avoid liquidity risk.

Below, we summarize the maturity profile of our consolidated financial liabilities as set forth in loan agreements:

| At 12.31.17 | Less than one year | From 1 to 2 years | From 2 to 5 years | Over 5 years |
|---|---|---|---|---|
| Trade accounts payable (Note 15) | 7,447,100 | - | - | - |
| Loans, financing and finance lease (Note 20) | 1,620,955 | 780,904 | 885,411 | 207,688 |
| Contingent consideration (Note 20) | - | - | - | 446,144 |
| Debentures (Note 20) | 1,412,486 | 66,252 | 3,042,001 | - |
| Derivative transactions (Note 31) | 5,239 | 93 | - | 15,319 |
| **Total** | **10,485,780** | **847,249** | **3,927,412** | **669,151** |

| At 12.31.16 | Less than one year | From 1 to 2 years | From 2 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|
| Trade accounts payable (Note 15) | 7,611,246 | - | - | 71,907 | 7,683,153 |
| Loans, financing and finance lease (Note 20) | 2,542,975 | 1,129,939 | 1,326,269 | 255,851 | 5,255,034 |
| Contingent consideration (Note 20) | - | - | - | 414,733 | 414,733 |
| Debentures (Note 20) | 2,120,504 | 1,355,683 | 78,120 | - | 3,554,307 |
| Derivative transactions (Note 31) | 183,212 | 1,185 | 97 | 122 | 184,616 |
| **Total** | **12,457,937** | **2,486,807** | **1,404,486** | **742,613** | **17,091,843** |

d.4) Credit Risk

The risk arises from the possibility of the Company incurring losses due to difficulty in receiving amounts billed to their customers and sales of prepaid handsets and cards that have been pre-activated for the distribution network.

The credit risk on accounts receivable is diversified and mitigated by strict control of the customer base. The Company constantly monitors the level of accounts receivable from postpaid services, and limits bad-debt risk by cutting off access to telephone lines if bills are past due. The mobile customer base predominantly uses the prepaid system, which requires purchase of credits beforehand and therefore does not pose credit risk. Exceptions are made for emergency services that must be maintained for security or national defense reasons.

Credit risk on sales of pre-activated prepaid handsets and cards is managed by a conservative policy for granting credit, using modern credit scoring methods, analyzing financial statements and consultations to commercial databases, in addition to requesting guarantees.

The Company is also subject to credit risk arising from their investments, letters of guarantee received as collateral for certain transactions and receivables from derivative transactions. The Company control the credit limits granted to each counterpart and diversify this exposure across first tier financial institutions as per current credit policies of financial counterparties.

d.5) Social and Environmental Risks

Our operations and properties are subject to various environmental laws and regulations that, among others, govern environmental licenses and records, protection of fauna and flora, air emissions, waste management and remediation of contaminated sites. If we fail to meet present and future requirements, or to identify and manage new or existing contamination, we will incur in significant costs, which include cleaning costs, damages, compensation, fines, activities suspension and other penalties, investments to improve our facilities or change our processes, or interruption of operations. The identification of environmental conditions not currently identified, more stringent inspections by regulatory agencies, the entry into force of more stringent laws and regulations or other unanticipated events may occur and, ultimately, result in significant environmental liabilities and their costs. The occurrence of any of the above factors could have a material adverse effect on our business, results of operations and financial position. According to Article 75 of Law No. 9605 of 1998, the maximum fine per breach of environmental law is R$50,000.

From the social point of view, we are exposed to contingent liabilities due to the fact that our structure foresees the hiring of outsourced service providers. These potential liabilities may involve labor claims by service providers who could eventually be treated as direct employees, which would generate requests for links and joint liability in overtime claims and occupational accidents, among others. If we obtain an unfavorable decision in relation to a significant portion of these contingencies that have not yet been provisioned, our financial and equity situation and the results of our operations may be affected.

d.6) Insurance Coverage

The policy of the Company, as well as the Telefónica Group, includes contracting insurance coverage for all assets and liabilities involving significant and high-risk amounts, based on management's judgment and following Telefónica corporate program guidelines.

At December 31, 2017, maximum limits of claims (established pursuant to the agreements of each entity consolidated by the Company) for significant assets, liabilities or interests covered by insurance and their respective amounts were R$1,501,052 for operational risks (with loss of profit) and R$75,000 for general civil liability.

d.7) Other Risks

The Company is required to comply with Brazilian anti-corruption laws and regulations, as well as laws and regulations on the same subject in jurisdictions where it has its securities traded. In particular, the Company is subject, in Brazil, to the Law nº 12.846/2013 and, in the United States, to the U.S. Foreign Corrupt Practices Act of 1977.

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

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

**32) COMMITMENTS AND GUARANTEES (RENTALS)**

The Company lease equipment, facilities, and several stores, administrative buildings, and sites (containing radio-base stations and towers), through several non-cancellable operating agreements maturing on different dates, with monthly payments.

At December 31, 2017, the total amounts corresponding to the full period of the contracts were as follows:

| | |
|---|---|
| Up to 1 year | 2,285,148 |
| From 1 to 5 years | 7,442,212 |
| Over five years | 5,017,985 |
| **Total** | **14,745,345** |

**33) ADDITIONAL INFORMATION ON CASH FLOWS**

a) <u>Reconciliation of cash flow financing activities</u>

The following is a reconciliation of cash flow financing activities for the year ended December 31, 2017.

| | | **Cash flows from financing activities** | | **Cash flows from operating activities** | **Financing activities not involving cash equivalents** | | | |
|---|---|---|---|---|---|---|---|---|
| **Consolidated** | **At 12/31/16** | **Addtions** | **Write-offs (payments)** | **Write-offs (payments)** | **Financial charges and foreign exchange variation** | **Additions of financial lease and supplier financing** | **Business combinations** | **a** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Interim dividends and interest on equity | 2,195,031 | - | (3,668,551) | - | - | - | - |
| Loans and financing | 4,880,606 | 55,876 | (2,449,773) | (333,676) | 385,021 | 571,444 | - |
| Finance lease | 374,428 | - | (35,722) | (11,973) | 45,265 | 13,462 | - |
| Debentures | 3,554,307 | 3,000,000 | (2,000,000) | (513,937) | 480,369 | - | - |
| Derivative financial instruments | (28,377) | - | (159,408) | 2,086 | 42,334 | - | (389) |
| Contingent Consideration | 414,733 | - | - | - | 31,411 | - | - |
| **Total** | **11,390,728** | **3,055,876** | **(8,313,454)** | **(857,500)** | **984,400** | **584,906** | **(389)** |

b) Financing transactions that do not involve cash

The main financing transactions that do not involve cash of the Company refer to the acquisition of assets through finance leases. At December 31, 2017 and 2016, these transactions totaled R$13,462 and R$61,866, respectively.

Explanation of Responses:

Explanation of Responses: