

Since 1999, the Central Bank has allowed the *real*/U.S. dollar exchange rate to float freely, and, since that time, the *real*/U.S. dollar exchange rate has fluctuated considerably. In 2010, the *real* appreciated by 4.3 % against the U.S. dollar. In 2011 and 2012, the *real* depreciated by 4.8 % and 8.9 %, respectively, against the U.S. dollar. In 2013 and 2014, the *real* depreciated a further 14.6 % and 13.4 %, respectively against the U.S. dollar. On December 31, 2014, the year-end *real*/U.S. dollar exchange rate was R\$2.6562 per U.S. \$1.00.

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

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

Year ended December 31,	Exchange Rates of R\$ per US\$1.00			
	Period-End	Average(1)	High	Low
2010	1.6662	1.7589	1.8811	1.6554
2011	1.8758	1.6709	1.9016	1.5345
2012	2.0435	1.9588	2.1121	1.7024
2013	2.3426	2.1741	2.4457	1.9528
2014	2.6562	2.3599	2.7403	2.1974
<b>Month</b>				
August 2014	2.2396	2.2680	2.2986	2.2396
September 2014	2.4510	2.3329	2.4522	2.2319
October 2014	2.4442	2.4483	2.5341	2.3914
November 2014	2.5601	2.5484	2.6136	2.4839
December 2014	2.6562	2.6386	2.7403	2.5607
January 2015	2.6623	2.6329	2.7107	2.5690
February 2015 (through February 26)	2.8728	2.8128	2.8811	2.6894

Source: Brazilian Central Bank.

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

On February 26, 2015, the exchange rate was R\$2.8728 to US\$1.00. The *real*/dollar exchange rate fluctuates and, therefore, this exchange rate may not be indicative of future exchange rates.

#### B. Capitalization and Indebtedness

Not applicable.

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

Not applicable.

#### D. Risk Factors

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

## Risks Relating to Brazil

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

In the past, the Brazilian government has intervened in the Brazilian economy and made changes in policy and regulations. The Brazilian government's actions to control inflation and affect other policies have often involved wage and price controls, currency devaluations, capital controls, and limits on imports, among other things. Our business, financial condition, results of operations and the market price of our preferred shares and ADSs may be adversely affected by changes in government policies, especially those related to our sector, such as changes in telephone fees and competitive conditions, as well as general economic factors, including:

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

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

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

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

Various governments may continue to intervene in their financial systems and perform fiscal and monetary adjustments. There is no assurance, however, that these measures will be successful in stabilizing conditions in international financial markets.

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

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

Political conditions in Brazil may affect the confidence of investors and the public in general, as well as the development of the economy. Brazilian president Dilma Rousseff has been reelected for a second four year term, which began in January 2015. Uncertainty regarding future policies and appointments to influential governmental positions following the reelection as well as ongoing investigations into allegations of corruption in state-controlled enterprises may also affect the confidence of investors and the general public. It may also have an adverse impact on the Brazilian economy, our business, financial condition, results of operations and the market price of our preferred shares and ADSs.

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

Brazil has historically experienced high rates of inflation. Inflation and certain governmental measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. In 2014, inflation measured by the Brazilian consumer price index (*Índice de Preços ao Consumidor*), or IPCA, reached 6.41%, below the upper limit established by the CMN, of 6.5% but above the inflation target of 4.5%. In 2015, the Brazilian monetary policy will continue to use the IPCA as a reference for the inflation target. The inflation target for 2015 is set at 4.5%, allowing for a range of 2% above or below this target, which is similar to the target for 2014. If the Central Bank's assessment is that inflation will be above this target in the near future, it may raise interest rates, directly affecting the cost of our debt and indirectly reducing the demand for products and services related to telecommunications. In 2015, factors that may adversely affect consumer inflation are, among others, the depreciation of the *real* against global benchmark currencies, a possible decision by the Brazilian federal government to raise utility prices (such as electricity tariffs), and potential tax increases.

Currently, fixed broadband and mobile service providers use the internal general price index (*Índice Geral de Preços - Disponibilidade Interna*), or IGP-DI, to adjust their prices and TV and cable service providers use the market general price index (*Índice Geral de Preços ao Mercado*), or IGP-M. The IGP-DI and IGP-M are inflation indexes developed by the Fundação Getúlio Vargas, a private organization. Since 2006, telephone fees for fixed line services have been indexed to the telecommunication services index, or IST, adjusted by a factor of productivity, which is defined by ANATEL Resolution 507/2008. The IST is an index composed of other domestic price indexes that is intended to reflect the telecommunications industry's operating costs. As a result, this index serves to reduce potential discrepancies between our industry's revenue and costs, and thus reduce the apparent adverse effects of inflation upon our operations.

The authorization by ANATEL to adjust the rate of fees, which is pegged to the IST, is reduced by a factor of productivity, which is calculated based on a compensation index established by ANATEL to share earnings from fixed charge services with their users. The IST is calculated based on a 12-month period average. This may cause increases in our revenues above or below our costs (including salaries), with potentially adverse impacts on our profitability.

Increases in interest rates may have a material adverse effect on our business. The Monetary Policy Committee of the Central Bank (*Comitê de Política Monetária do Banco Central do Brasil*) sets the basic interest rate for the Brazilian financial system based on the future inflation rate and the central inflation target. On December 31, 2014, the basic interest rate was 11.75% per year, compared to 10.0% per year on December 31, 2013. The basic interest rate was further adjusted on January 21, 2015 and is currently 12.25% per year. Further increases in the basic interest rate may occur throughout 2015 and may have adverse effects on our business and results of operations. According to current market consensus, inflation measured by the IPCA will be higher than the established inflation target of 4.5% for 2015. As a result, the Central Bank may increase the overnight rate (*Sistema Especial de Liquidação e de Custódia*), or SELIC rate, in 2015 to attempt to align actual inflation with the inflation target. Such rate increases may adversely affect our business and results of operations.

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

The exchange rate between the U.S. dollar and the Brazilian *real* has experienced significant fluctuations in recent years. The *real* depreciated 68% against the U.S. dollar between 2000 and 2003, appreciated by 40% from 2004 to 2010 and depreciated by 34% from 2011 to 2014 (calculated according to the annual average exchange rates).

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

Approximately 36.6% and 9.1% of the costs relating to our network infrastructure and services provided by outside vendors is payable or linked to payment by us in U.S. dollars or Euros, respectively. By contrast, 99.8% of our revenue is generated in *reais*, except income derived from hedging transactions, international long-distance interconnection fees and services to customers outside of Brazil.

To the extent that the value of the *real* decreases relative to the U.S. dollar or the Euro, our commitments payable or linked to payment by us in foreign currencies become more expensive. Although our accounts receivable denominated in foreign currencies would also appreciate, the net effect could adversely affect our revenue and expenses.

Nearly all of our transactions denominated in foreign currencies are covered by hedge transactions. Since May 2010, we have been using a “net balance coverage” strategy, pursuant to which we seek to hedge our net foreign exchange exposure arising from invoices issued or received in foreign currencies. Our corporate market risk department periodically reviews our foreign currency invoices and manages our commitments linked to foreign currencies to limit our overall foreign currency exposure. We believe this strategy has substantially reduced our exposure to fluctuations in exchange rates.

Additionally, the IST does not adequately reflect the true effect of exchange rate fluctuations. Thus, our revenue, when translated to U.S. dollars, does not adequately reflect the true effect of exchange rate fluctuations, which may affect our results of operations.

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

The market for securities issued by Brazilian companies may be influenced, to varying degrees, by economic conditions in both developing and developed economies. The reaction of investors to developments in other countries may have an adverse impact on the market value of securities of Brazilian companies. Crises in other emerging countries or the economic policies of other countries may reduce investor demand for securities of Brazilian companies, including our preferred shares. Any of the foregoing developments may adversely affect the market value of our preferred shares and hinder our ability to access the capital markets and finance our operations in the future on acceptable terms and costs, or at all.

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

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

## Risks Relating to the Brazilian Telecommunications Industry and Us

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

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

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

Brazil's telecommunications regulatory framework is continuously evolving. The interpretation and enforcement of regulations, the assessment of compliance with regulations and the flexibility of regulatory authorities are all marked by uncertainty. We operate under authorizations and a concession from the Brazilian government, and our ability to maintain these authorizations and concession is a precondition to our success. However, because of the regulatory framework, we cannot provide assurances that ANATEL will not adversely modify the terms of our authorizations. Furthermore, according to the terms of our operating authorizations and concession, we must meet certain requirements and maintain minimum quality, coverage and service standards. Failure by us to comply with these requirements may result in the imposition of fines or other regulatory responses, including the termination of our operating authorizations and concession. Any partial or total revocation of any of our operating authorizations or our concession would have a material adverse effect on our business, financial condition, revenues, results of operations and prospects. In recent years, ANATEL has also been reviewing and introducing changes in the applicable regulation, especially regarding the interconnection fees among telecommunications service providers in Brazil. Interconnection fees, which are fees charged by telecommunications service providers to each other to interconnect to each other's networks, are an important part of our revenue and cost bases. To the extent that changes to the rules governing interconnection fees reduce the amount of interconnection fees we are able to collect, our businesses, financial conditions, revenues, results of operations and prospects could be materially adversely affected.

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

- the introduction of new or stricter operational and/or service requirements;
- the granting of operating licenses in our areas;
- limitations on interconnection fees we may charge to other telecommunications service providers;
- delays in the granting of, or the failure to grant, approvals for rate increases; and
- antitrust limitations imposed by ANATEL and CADE.

***The GVT acquisition may not be consummated.***

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

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

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

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

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

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

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

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

We operate our fixed line business in the state of São Paulo under a concession granted by the Brazilian government. According to the terms of the concession, we are obligated to meet certain universal service requirements and to maintain minimum quality and service standards. For example, ANATEL requires that we satisfy certain conditions with respect to, among other things, expansion of our network to provide public pay-phone service for all locations with a population over 100 inhabitants, expansion of our network to provide private individual telephone service for all locations with a population over 300 inhabitants, and, with respect to quality of service, targets for the number of call completions. Our ability to satisfy these and other terms and conditions may

be affected by factors beyond our control. Our failure to comply with the requirements of our concession may result in the imposition of fines up to R\$50.0 million or other government actions, including the termination of our concession. Any partial or total revocation of our concession would have a material adverse effect on our financial condition and results of operations.

Moreover, the concession agreements establish that all assets owned by the company and which are indispensable to the provision of the services described in such agreements are considered “reversible assets” (*bens reversíveis*) and are deemed to be part of the concession assets. Reversible assets will be automatically returned to ANATEL upon expiration of the concession agreements, according to the regulation in force at that time and would not be available to creditors in the event of insolvency, bankruptcy or similar events. The most recent net book value of our reversible assets reported to ANATEL is dated December 31, 2014 and estimated at R\$7.6 billion, which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

The expiration date of our fixed line concession agreements is December 31, 2025. The concession agreements contain a provision allowing ANATEL to review the concession terms in 2015 and 2020. This provision permits ANATEL to update the renewed concession agreements with respect to network expansion, modernization and quality of service targets in response to changes in technology, competition in the marketplace and domestic and international economic conditions.

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

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

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

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

We believe that our success will depend on the continued services of our senior management team and other key personnel. Our management team is comprised of highly qualified professionals, each with an average of over 30 years of experience in the telecommunications industry. The loss of the services of any of our senior management team or other key employees could adversely affect our business, financial condition and results of operations. We also depend on the ability of our senior management and key personnel to work effectively as a team.

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

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

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

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

We are exposed to eventual liabilities resulting from our contracting structure for third party service providers. Such potential liabilities may involve claims by third party providers that are treated as direct employees as well as claims for secondary liability resulting from work place injury, wage parity and overtime pay complaints. If a significant portion of these liabilities are decided against us and for which we have not made provisions, our financial condition and results of operation may be adversely affected.

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

Competition remains fierce, despite a weakening macroeconomic environment, and telecommunications companies are seeking to strengthen their competitive position through internal corporate restructurings as well as mergers and acquisitions. We expect that competition for customers will continue to drive us and our competitors to provide innovative and improved products and services. For example, the high level of participation by major Brazilian mobile operators in the Brazilian auction for the 700 MHz frequency, which was conducted in September 2014, confirms the relevance of 4G as a cornerstone of our competitors' long-term growth strategy. Future spectrum auctions by ANATEL may allow new competitors to enter the market and may strengthen the competitive position of some of our current competitors. Bundled offers are also heightening their importance as a commercial driver, fostering companies to offer complete and superior solutions to consumers. To the extent we are unable to keep pace with our competitors, our market position and results of operations may be adversely affected. Moreover, the significant competition in the Brazilian market may adversely affect our margins if we are required to reduce prices or provide special offers to customers in order to maintain or increase market share.

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

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

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

We cannot assure you that new mobile service plans will not be suspended by ANATEL, that the mobile interconnection fees we negotiated will not be changed or that future negotiations regarding mobile termination rates will be as favorable as those that were previously set by ANATEL. If the readjustments to mobile interconnection fees that we negotiated are cancelled or if negotiated mobile interconnection fees in the future are less favorable to us, our business, financial condition, revenues, results of operations and prospects may be adversely affected.

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

ANATEL issues new regulations every year affecting many of our areas of operations. Such new regulations could have an adverse effect on our operating results because: (1) ANATEL could significantly reduce the interconnection fees we are able to charge, thereby reducing our revenues (see “–Our results of operations may be negatively affected by the application of the Personal Mobile Service (Serviço Móvel Pessoal), or SMP, rules relating to mobile services”); (2) ANATEL may allow more favorable conditions for economic groups without significant market power; (3) the granting of new licenses may increase competition in our area from other operators, which could adversely affect our prices or market share, thereby reducing our revenues; (4) ANATEL may require that revenue received for the usage of the SMP network must be included in the calculation of operating revenue, which will increase the cost of renewing licenses; and (5) ANATEL's general plan of updating the telecommunications regulations targets several areas of vital importance for the mobile telecommunications business, such as regulations (A) to improve the quality of services, which may cause an increase in operating costs, (B) of virtual mobile operations, or MVNO, which may cause an increase in competitive pressure, (C) against SMP providers exercising market power to negotiate lower mobile termination rate fees, which could cause a decrease in our revenues from the mobile termination rate fees we are able to charge to SMP providers, and (D) relating to multimedia communication. For a detailed description of the regulations issued by ANATEL and their impact on our business, see “Item 4. Information on the Company–Business Overview–Regulation of the Brazilian Telecommunications Industry.”

***The industry in which we conduct our business is continually changing and evolving technologically.***

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

The advent of new products and technologies could have a variety of consequences. These new products and technologies may reduce the price of our services by providing lower-cost alternatives, for instance over-the-top, or OTT, players (who provide voice and messages over IP), and creation of new digital services. New product and technologies may also be superior to, and render obsolete, the products and services we offer and the technologies we use, thus requiring investment in new technology.

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

In 2010, ANATEL required multichannel multipoint distribution service, or MMDS, companies, including us, to return a significant portion of the 2.5GHz spectrum we owned at that time. In addition, on June 12 and 13, 2012, ANATEL held a public auction for 273 lots of 4G, on the 2.5GHz to 2.69GHz frequencies. We acquired the “X” band, with a nationwide coverage, for R\$1.05 billion. According to spectrum cap rules for bidding processes, we had to return the remaining portion of the 2.5GHz spectrum we previously owned to operate our MMDS services.

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

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

In 2012, ANATEL auctioned a 450 MHz frequency lot that is tied to the 2.5 GHz band, to meet voice and data demand in remote rural areas. Under band "X," which we acquired in the bidding process, we will be required to provide infrastructure in rural areas in the states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, Sergipe, and countryside of São Paulo, for a total of 2,556 municipalities. The schedule for providing infrastructure in the rural areas requires that 100% of municipalities have infrastructure in place by December 2015, with a transmission rate of 256Kbps and by December 31, 2017, all of these municipalities will be expected to have 1Mbps.

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

Regarding the 700 MHz spectrum, ANATEL has allocated the band for the provision of fixed, mobile and broadband services. On September 30, 2014, ANATEL held the public bidding for 18 blocks of 4G, on the 708 to 803 MHz frequencies. We acquired 20 MHz (10+10 MHz) with nationwide coverage, for R\$1.92 billion, at the minimum price, plus R\$904 million for the band cleaning (migration of broadcasters that currently occupy the band and interference management). According to the auction rules, the winning bidders will be responsible for financing and managing the band cleaning process and ANATEL has deducted the cleaning cost associated with two blocks for which no bids were made. The beginning of the spectrum usage could be delayed, because it requires the completion of the band cleaning process. This may have an adverse effect on the 4G data package offerings and consequently on our revenues from mobile data services.

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

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

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

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

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

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

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

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

Currently, there are approximately 250 municipal laws in Brazil that limit the installation of new antennas for mobile service, which has been a barrier to the expansion of mobile networks. Those laws are meant to regulate issues related to zoning and the alleged effects of the radiation and radiofrequencies of the antennas. Initiatives for the approval of a federal law that would establish new guidelines to create a consolidated plan for the installation of antennas have been taken and the plan is currently being reviewed by the Brazilian federal senate, after which it will be subject to presidential approval. However, despite the federal initiatives, as long as the municipal laws remain unchanged, the risk of noncompliance with regulations and of having services of limited quality in certain areas continues to exist.

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

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

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

***We face risks associated with litigation.***

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

## Risks Relating to the Preferred Shares and the ADSs

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

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

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

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

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

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

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

CMN Resolution No. 1,927 currently regulates foreign investments in depositary receipts based on shares issued by Brazilian companies. Pursuant to this regulation, the ADSs benefit from the certificate of foreign capital registration, which permits Citibank N.A., as depositary, to convert dividends and other distributions with respect to preferred shares into foreign currency, and to remit the proceeds abroad. Holders of ADSs who exchange their ADSs for preferred shares will then be entitled to rely on the depositary’s certificate of foreign capital registration for five business days from the date of exchange. Thereafter, they will not be able to remit non-Brazilian currency abroad unless they obtain their own certificate of foreign capital registration, or unless they qualify under CMN Resolution No. 2,689, dated January 26, 2000, which entitles certain investors to buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration. CMN Resolution No. 4,373, of September 29, 2014, will replace both CMN Resolution No. 1,927 and CMN Resolution No. 2,689 as of March 30, 2015. Further rules will be issued by CVM and the Central Bank regulating foreign investments in ADSs, including with regard to the exchange of ADSs for preferred shares and the remittance of funds arising from the sale of these preferred shares.

If holders of ADSs do not qualify under Resolution No. 2,689, they will generally be subject to less favorable tax treatment with respect to our preferred shares. There can be no assurance that the depositary’s certificate of registration or any certificate of foreign capital registration obtained by holders of ADSs will not be affected by future legislative or regulatory changes, or that additional Brazilian law restrictions applicable to their investment in the ADSs may not be imposed in the future.