INGRAM MICRO INC
Form 10-K
February 27, 2013
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 29, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 1-12203

Ingram Micro Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	**62-1644402**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

1600 E. ST. ANDREW PLACE, SANTA ANA, CALIFORNIA 92705

(Address, including Zip Code, of Principal Executive Offices)

(714) 566-1000

(Registrant s telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of Each Class:	**Name of Each Exchange on Which Registered:**
Class A Common Stock,	New York Stock Exchange
Par Value $.01 Per Share	

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ

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

Indicate by check mark whether registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.101 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large Accelerated Filer þ	Accelerated Filer ¨	Non-Accelerated Filer ¨	Smaller Reporting Company ¨
		(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant s most recently completed second fiscal quarter, at June 30, 2012, was $2,530,502,788 based on the closing sale price on such last business day of $17.47 per share.

The registrant had 150,489,157 shares of Class A Common Stock, par value $0.01 per share, outstanding at January 26, 2013.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Proxy Statement for the registrant s Annual Meeting of Shareholders to be held June 5, 2013 are incorporated by reference into Part III of this Annual Report on Form 10-K.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

ITEM 1. BUSINESS

The following discussion includes forward-looking statements, including but not limited to, management s expectations of competition; market share; revenues, margin, expenses and other operating results or ratios; economic conditions; vendor terms and conditions; deployment of enterprise systems; process and efficiency enhancements; cost savings; cash flows; working capital levels and days; capital expenditures; liquidity; capital requirements; acquisitions and integration costs; operating models; exchange rate fluctuations and related currency gains and losses; resolution of contingencies; seasonality; interest rates and exposures; and rates of return. In evaluating our business, readers should carefully consider those factors discussed under Risk Factors. We disclaim any duty to update any forward-looking statements. Unless otherwise stated, all currency amounts, other than per share information, contained in this Part I are stated in thousands.

Overview

Ingram Micro Inc., a Fortune 100 company, is the largest global wholesale technology distributor, by net sales, and a global leader in information technology (IT) supply-chain management, mobile device lifecycle services and logistics solutions. We distribute and market a large variety of technology and mobility products from leading companies, such as Acer, Apple, Cisco, Hewlett-Packard (HP), IBM, Lenovo, Microsoft, Samsung and many others. As a vital link in the technology value chain, we create sales and profitability opportunities for vendors, resellers and other customers through unique marketing programs; outsourced logistics and mobile device lifecycle solutions; technical support; financial services; product aggregation and distribution; solutions creation and cloud service models.

We have operations in 37 countries: North America (United States and Canada), Europe (Austria, Belgium, France, Finland, Germany, Hungary, Italy, the Netherlands, Norway, Poland, Portugal, Slovakia, Spain, Sweden, Switzerland and the United Kingdom), Asia-Pacific (Australia, the People s Republic of China (including Hong Kong), Egypt, India, Indonesia, Lebanon, Malaysia, New Zealand, Senegal, Singapore, South Africa, Thailand, Turkey and United Arab Emirates) and Latin America (Brazil, Chile, Colombia, Mexico and Peru). Additionally, we serve many other markets where we do not have an in-country presence through our various export sales offices, including our general telesales operations in numerous geographies. We sell our products and services to a global customer base of more than 200,000 customers in approximately 160 countries. We believe we are the only global broad-based distributor with distribution operations in every region. Based on currently available data, we believe that we are the market share leader in IT distribution, by net sales, in North America and Latin America, number two in Europe and number three in Asia-Pacific.

We began business in 1979, operating as Micro D Inc., a California corporation. Through a series of acquisitions, mergers and organic growth, Ingram Micro s global footprint, product breadth and service capabilities have expanded and strengthened in North America, Europe, Latin America and Asia-Pacific, which now includes Middle East and Africa. Over the past 10 years we have completed 22 acquisitions. In recent years, our acquisitions have been primarily focused on global expansion of our specialty product and service offerings. In 2012, we made major strides in expanding our presence in areas of strategic focus through the following acquisitions: Brightpoint, Inc. (BrightPoint), the global leader in mobile device lifecycle services; certain IT distribution businesses of Aptec Holding Ltd. (Aptec), a Dubai-based value-added distributor in the Middle East and Africa; and Promark Technology (Promark), a U.S.-based, value-added distributor focused on sales to government customers.

We have historically reported on our four geographic segments: North America, Europe, Latin America and Asia-Pacific and have also added a fifth reportable segment for global mobility, consisting of the mobile device lifecycle services business of BrightPoint that we acquired on October 15, 2012. For a discussion of our geographic reporting segments, see Note 8 to our consolidated financial statements on Item 8. Financial Statements and Supplementary Data.

Areas of Focus

Distribution We buy, hold title to, and sell technology products and/or services to resellers who, in turn, typically sell directly to end-users or other resellers. Resellers build efficiencies and reduce costs by relying on Ingram Micro for product availability, marketing, credit, training and enablement, technical support and inventory management. Our predictive analytics tools convert our data into insights which we use to deliver more value to our customers and vendors, offering them a targeted approach to market penetration and more profitable growth opportunities. We offer programs and services designed to support value-added resellers (VARs) in serving as technology sources for the small-to-medium sized business (SMB) market. The SMB end-user segment is generally one of the largest segments of the IT market in terms of number of customers and total revenue, and typically provides higher gross margins for distributors as it is more challenging for suppliers to penetrate directly. We support Internet-based resellers through expanded line card offerings and customized, personalized delivery directly to their end-user customers.

We purchase a wide variety of mobile voice and data products from the leading mobile device manufacturers, as well as accessories used with mobile devices, and market and sell these products to independent agents, dealers and retailers. We also distribute accessories to mobile network operators and mobile virtual network operators (MVNOs), which are wireless communications service providers that do not own the radio spectrum or wireless network infrastructure over which they provide services and obtain bulk access to network services from network operators. We purchase and resell original equipment manufacturer and aftermarket accessories, either prepackaged or in bulk. Our accessory packaging services provide mobile operators and retail chains with custom packaged and/or branded accessories based on the specific requirements of those customers. Two-tier distribution continues to be an integral element of the go-to-market strategy for IT and mobile device suppliers.

Value-Add We are advancing our presence in the higher-value segment of the IT market. We have added products, services and capabilities and associates with the requisite technical skills to broaden our portfolio of higher-value technology solutions. Our expanded capabilities and portfolio enable our resellers to capture opportunities in areas such as the data center market, enterprise computing, storage solutions, virtualization, enterprise software, unified communications, networking and security. By strengthening our position in specialty product categories, our resellers are able to provide end-users with more complete solutions, augmenting IT products with other categories such as automatic identification and data capture (AIDC), point-of-sale (POS), mobility, physical security, consumer electronics (CE), professional audio visual and digital signage products.

Cloud We have aggregated more than 150 cloud solutions from vendors across every solution category. Our resellers in certain geographic markets can access our catalog of cloud solutions and tailor cloud offerings to fit the business needs of their end-user customers. New cloud solutions are thoroughly assessed to ensure quality and reliability before becoming part of our cloud services portfolio. We provide tools and support to assist resellers in providing cloud services to their customers. Originally a North American initiative, we have launched cloud services to varying degrees in a number of geographies and we intend to roll out our program globally. We expect to broaden our cloud services portfolio in line with market demand. By leveraging our cloud services offerings, resellers avoid the investments necessary for independent service deployment while enjoying a recurring revenue stream.

Logistics Our expertise in logistics enables us to extend our business beyond traditional distribution and technology products. We offer fee-based supply chain services, encompassing the end-to-end functions of the supply chain to vendors choosing to sell direct. Likewise, we offer fee-based services to retailers and Internet resellers seeking fulfillment services, inventory management, reverse logistics, and other supply chain services for both IT and non-IT products. Our customized logistics services for the mobility industry include procurement; inventory management; software loading, kitting and customized packaging; fulfillment; credit services; receivables management; call center services; activation services; website hosting; e-fulfillment solutions; repair, refurbish and recycle services; reverse logistics; transportation management; sale of prepaid airtime and other services. We provide these services to mobile network

Table of Contents

operators, MVNOs and mobile device manufacturers. Our supply chain services are designed to enable our logistics customers to better compete by reducing their costs and improving their asset efficiency. Our effective and efficient platform allows customers to benefit from quickly deployed and flexible solutions.

Company Strengths

We believe that the current technology industry generally favors large, financially-sound distributors that have broad product portfolios, economies of scale, strong business partner relationships and wide geographic reach. Our value is in enabling our business partners both reseller customers and vendors to become more efficient, knowledgeable and profitable. Our strengths position us well to meet the needs of our reseller and vendor partners worldwide in both difficult economic times and growth cycles, and to lead the IT and mobility distribution, mobile device lifecycle services, and logistics markets as they evolve.

Strong Working Capital Management and a Solid Financial Position. We are committed to strong working capital management. Maintaining a close relationship with resellers enables us to monitor demand to optimize our investment in inventory, while preserving customer fill rates and service levels. We continue to carefully manage our inventory days on hand through targeted initiatives aimed at minimizing excess and obsolete goods while improving our purchasing processes and product flow. Furthermore, we continue to effectively manage our accounts receivable through timely collections, disciplined credit limits, customer terms and process efficiencies to minimize our working capital requirements. Our conservative approach to capital management, as well as our diversified portfolio of capital resources, serves us well in the current credit markets. Our financial strength enables us to provide valuable credit to our customers, employing a disciplined approach to account management and creditworthiness. We also believe that we continue to be well-positioned to support growth initiatives and invest in incremental profitable growth opportunities. Finally, we believe our financial position provides us with a competitive advantage as a reliable, long-term business partner for our supplier and reseller partners.

Commitment to Diversification. We believe that our ability to execute on new initiatives, adapt to new business models and enter new geographic markets provides a competitive advantage by enabling us to capture opportunities and overcome the risks, volatility and demand fluctuations in a single market, vendor or product segment.

Product Markets In recent years, we have made a number of investments focused on augmenting our IT product distribution business through the global expansion of our specialty product offerings and solutions, such as AIDC/POS, CE, data center and enterprise computing. Our acquisition of BrightPoint in 2012 was a significant step toward further diversifying our business and expanding our presence in the rapidly growing mobility market, as well as expanding our geographic reach. Our enterprise computing business was expanded in the U.S. through the 2012 acquisition of Promark, a storage-focused value-added distributor. Our acquisition of Promark strengthens our position in high-value products and solutions, as well as extending our leadership and reach within the public sector by providing our resellers with federal, state and other U.S. government revenue opportunities through Promark s General Services Administration Schedule. We believe that our diversified and evolving product portfolio will provide a solid platform for continued growth.

Geographic Coverage Our acquisition of Aptec in 2012 extended our geographic reach into the Middle East and North Africa. Our presence in more markets than any other broad-based technology products distributor provides us with a more balanced global portfolio which allows us to better manage and mitigate risk. Our broad global footprint enables us to better serve our resellers and suppliers by leveraging our extensive sales and distribution network.

Differentiated Service Offerings We believe that our service offerings provide a means to diversify our revenue stream while distinguishing us from our competitors. Our logistics services enable us to earn fees from technology and mobility suppliers that choose to bypass distribution and sell directly to resellers and/or end-users. We have further diversified our logistics business, offering supply chain services to retailers and Internet resellers for non-technology products. We continue to expand the markets and products that we serve with our logistics model and we continue to provide innovative solutions for our reseller customers and vendor partners such as with our cloud services offerings.

Customers

We conduct business with most of the leading resellers of IT products and services around the world and with many of the world s leading mobility companies. Our broad customer base is divided into segments which include VARs, corporate resellers, retailers, custom installers, systems integrators, mobile network operators, MVNOs, direct marketers, Internet-based resellers, independent dealers, reseller purchasing associations, managed service providers, cloud providers, PC assemblers, independent agents and dealers, and other distributors. Many of our customers are heavily dependent on distribution partners with the necessary systems, capital, inventory availability, and distribution facilities in place to provide fulfillment and other services. We also provide supply chain management services to a variety of customers, including retailers, Internet-based resellers, IT vendors, mobile network operators, MVNOs, and mobile device manufacturers. We try to reduce our exposure to the impact of business fluctuations by maintaining a balance in the customer segments we serve.

In most cases we conduct business with our customers under our general terms and conditions, without minimum purchase requirements. We also have resale contracts with our reseller customers that are terminable at will after a reasonable notice period and have no minimum purchase requirements. We generally sell our products pursuant to customer purchase orders and subject to our terms and conditions. We generally ship products on the same day orders are accepted from the customer. Unless otherwise requested, substantially all of our products are delivered by common freight carriers. Backlog is generally not material to our business because orders are generally filled shortly after acceptance. We have specific agreements in place with certain manufacturers and resellers in which we provide supply chain management services such as order management, technical support, call center services, logistics management, configuration management, and procurement management services. These agreements generally may be terminated by either party without cause following reasonable notice. The service offerings we provide to our customers are discussed further below under Services. Our mobility logistics services are typically provided pursuant to agreements with terms between one and three years and generally may be terminated by either party subject to a short notice period.

Our business is not substantially dependent on any of these distribution or supply chain services contracts. No single customer accounted for more than 10% of our total revenue in fiscal 2012.

Sales and Marketing

We employ sales representatives worldwide, both in the field and on our campuses, who assist resellers with product specifications and solution design, system configuration, new product/service introductions, pricing, and availability. In addition, our sales representatives regularly introduce our reseller partners to new technologies and markets in order to assist them in expanding their business.

Our product management and marketing groups help create demand for our suppliers products and services, enable the launch of new products, and facilitate customer contact. Our marketing programs are tailored to meet specific supplier and reseller customer needs. These needs are met through a wide offering of services by our in-house marketing organizations, including advertising, direct mail campaigns, market research, online marketing, retail programs, sales promotions, training, solutions marketing, and assistance with trade shows and other events. We also create and utilize specialized channel marketing communities to deliver focused resources and business building support to solution providers.

Table of Contents

Products

We distribute and market hundreds of thousands of technology products worldwide from the industry s premier computer hardware suppliers, mobility hardware suppliers, networking equipment suppliers, software publishers, and other suppliers of computer peripherals, CE, AIDC/POS and physical security products. Based on publicly available information, we believe we offer the largest breadth of products in our industry. Product assortments vary by market, and the suppliers relative contribution to our sales also varies from country to country. Although our revenue mix by product category on a worldwide basis has remained relatively stable over the past several years, we have seen a slight shift in favor of systems over peripherals more recently, as an improved economic environment in some areas has driven a system refresh cycle and personal mobile devices, including tablets, have experienced strong growth rates.

The table below represents our revenue mix by product category on a consolidated basis over the past several years (excluding the newly acquired BrightPoint mobility business which includes mobile handsets, tablets, navigation devices, aircards, SIM cards, flash memory, and other mobility accessories). Our product mix has generally been within the following ranges:

IT Peripherals:	*35-40%*
Systems:	*30-35%*
Software:	*12-17%*
Networking:	*12-17%*

IT Peripherals. We offer a variety of products within the peripherals category that fall within several sub-categories:

traditional IT peripherals such as printers, scanners, displays, projectors, monitors, panels, mass storage, and tape;

digital signage products such as large format LCD and plasma displays, enclosures, mounts, media players, content software, content creation, content hosting, and installation services;

CE products such as mobile phones, digital cameras, digital video disc players, game consoles, televisions, audio, media management and home control;

AIDC/POS products such as barcode/card printers, AIDC scanners, AIDC software, and wireless infrastructure products;

physical security products such as Internet protocol video surveillance, security alarm systems, fire alarm systems, access control smart cards and printers;

services provided by third parties and resold by Ingram Micro such as engineering contract-labor services and extended coverage warranties;

component products such as processors, motherboards, hard drives, and memory; and

supplies and accessories such as ink and toner supplies, paper, carrying cases, and anti-glare screens.

Systems. We define our systems category as self-standing computer systems capable of functioning independently. We offer a variety of systems, such as rack, tower and blade servers; desktops; and portable personal computers and tablets.

Software. We define our software category as a broad variety of applications containing computer instructions or data that can be stored electronically. We offer a variety of software products, such as business application software, operating system software, entertainment software, middleware, developer software tools, security software (firewalls, intrusion detection, and encryption), storage software and virtualization software.

Table of Contents

Networking. Our networking category includes networking hardware, communication products and network security hardware. Networking hardware includes switches, hubs, routers, wireless local area networks, wireless wide area networks, network interface cards, cellular data cards, network-attached storage and storage area networks. Communication products incorporate Voice over Internet Protocol (or VoIP), communications, modems, phone systems and video/audio conferencing. Network security hardware includes firewalls, Virtual Private Networks (or VPNs), intrusion detection, and authentication devices and appliances.

Services

We offer a variety of services to our customers and suppliers, and, in some instances, to end-users on behalf of our customers. Our services may be purchased individually or in combination with other services, or they may be provided along with our product sales. Our services include:

supply chain services (product procurement, inventory management, order management and fulfillment, reverse logistics, transportation management, customer care, credit and collection management services);

integration services (compatibility assurance, order configuration, drop ship to end-users);

technical support (real-time, multi-vendor support; certified technical expertise; technology help desks; pre-sales consultative support);

training services (manufacturer-certified, self-study and instructor-led training courses for resellers and end-users);

financial and credit services (credit lines extended to resellers and to end-users on behalf of resellers, end-user leasing programs);

marketing services (targeted marketing activities including direct mail, external media advertising, telemarketing campaigns, national and regional trade shows, web-based marketing);

predictive analytics services (a U.S.-based service using our proprietary algorithms to generate insights from our internal and external data and disseminate them to internal constituents (e.g., sales and marketing departments) and external users (e.g., customers and vendors) to inform more profitable decisions);

e-commerce services (EDI-, XML- and web-based electronic links to reseller customers to enable electronic transactions);

reseller community hosting services (Ingram Micro-enabled communities of resellers bound by a common specialized focus (e.g., government and SMB) that are provided with connections and resources to grow their specific businesses);

managed services (help desk services, security solutions, remote monitoring and management, hosting services, security services and business continuity);

cloud services (communication and collaboration services, security services, infrastructure services, recovery business applications and platform services, cloud management services, etc.);

managed print services (automatic supplies replenishment, remote printer maintenance monitoring, help desk, equipment lease options);

professional services (IT staffing solutions, warranty services, IT asset disposition); and

mobility logistics services *(*procurement, inventory management, software loading, kitting and customized packaging, fulfillment, credit services, receivables management, call center services, activation services, website hosting, e-fulfillment solutions, repair, refurbish and recycle services, reverse logistics, transportation management, sale of prepaid airtime).

Although services continue to represent one of the key components of our long-term strategy, they represented less than 10% of our annual revenues in 2012 and are not expected to exceed that level in the near term.

Table of Contents

Suppliers

We sell the products of more than 1,700 suppliers, which represent the world s leading computer hardware, networking equipment, mobility, AIDC/POS, and CE manufacturers and software publishers. Products purchased from HP generated approximately 18%, 21%, and 23% of our consolidated net sales in fiscal years 2012, 2011 and 2010, respectively and products purchased from Apple Inc. generated approximately 10% of our consolidated net sales in 2012.

Our suppliers generally provide warranties on the products we distribute and allow returns of defective products, including those returned to us by our customers. We generally do not independently provide warranties on the products we distribute; however, local laws may impose warranty obligations upon distributors (such as in the case of supplier liquidation). In certain markets we administer extended warranty programs, supported by a third party, on supplier products. We provide warranty services for products that we build to order from components purchased from other sources. Provision for estimated warranty costs is recorded at the time of sale and periodically adjusted to reflect actual experience. Historically, warranty expense has not been material.

We have written distribution agreements with many of our suppliers and these agreements usually provide for nonexclusive distribution rights and often include territorial restrictions that limit the countries in which we may distribute the products. Some of our agreements with our suppliers may contain limitations of liability to our suppliers obligations and warranties. The agreements also are generally short-term, subject to periodic renewal, and often contain provisions permitting termination by either party without cause upon relatively short notice. Certain distribution agreements either require (at our option) or allow for the repurchase of inventory upon termination of the agreement. In cases where suppliers are not obligated to accept inventory returns upon termination, some suppliers will nevertheless elect to repurchase the inventory while other suppliers will assist with either liquidation or resale of the inventory.

Competition

Each geographic region in which we operate (North America, Europe, Asia-Pacific and Latin America) is highly competitive. In the current economic environment, competitive pressure in the form of aggressive pricing is acute. Competitive factors vary in importance with the type of product, service or solution offered. In addition to pricing, other competitive factors include:

- ability to tailor specific solutions to customer needs;
- availability of technical and product information;
- effectiveness of information systems;
- credit terms and availability;
- effectiveness of sales and marketing programs;
- products and services availability;
- quality and breadth of product lines and services;
- speed and accuracy of delivery; and

availability of web- or call center-based sales.

We compete against broad-based IT distributors such as Tech Data and Synnex Corporation. There are a number of specialized competitors that focus on one market or product or a particular sector with which we compete. Examples include Avnet and Arrow in components and enterprise products; Westcon in networking and security; D&H Distributing, ADI, and Petra in consumer electronics; and ScanSource and BlueStar in AIDC/POS products. While we face some competitors in more than one region, others are specialized in local markets, such as Synnex Technology International (Asia-Pacific), Digital China (China), Redington (Asia-Pacific), Express

Table of Contents

Data (Australia and New Zealand), Intcomex (Latin America), Esprinet (Italy and Spain), ALSO-Actebis Holding AG (Europe) and Metra Group (Asia-Pacific). Our mobile device distribution competitors include Brightstar (all regions), Aerovoice (North America), Cellnet Group Ltd. (Asia-Pacific) and Axcom (Europe). Examples of competitors in specific mobility service areas include Foxconn (North America and Latin America) in repair, refurbish and recycle services; Avenir S.A. (Europe) in activation services and Incomm (North America and Latin America) in prepaid airtime. We believe that suppliers, resellers and other customers pursuing global strategies continue to seek distributors with global sales and support capabilities.

The evolving direct-sales relationships between manufacturers, resellers, and end-users continue to introduce change into our competitive landscape. We compete, in some cases, with hardware suppliers and software publishers that sell directly to reseller customers and end-users. However, we may become a business partner with these companies by providing supply chain services optimized for the IT market. Additionally, as consolidation occurs among certain reseller segments and customers gain market share and build capabilities similar to ours, certain resellers, such as direct marketers, may become our competitors. As some manufacturer and reseller customers move their back-room operations to distribution partners, such outsourcing and value-added services may become areas of opportunity. There has been an accelerated movement among transportation and logistics companies to provide many of these fulfillment and e-commerce supply chain services. Within this arena, we face competition from major transportation and logistics suppliers such as DHL, Menlo Worldwide Logistics and UPS Supply Chain Solutions. Our competitors in mobile logistics services include Brightstar (all regions), GENCO-ATC (North America and Latin America) and Arvato Logistics Services (Europe).

In our mobility distribution and services business we operate in a highly competitive industry and market and believe that such competition may intensify in the future. The distribution of mobile devices and the provision of logistics services within the global mobility industry have, in the past, been characterized by relatively low barriers to entry. The markets for mobile devices and integrated services are characterized by rapidly changing technology and evolving industry standards, often resulting in product obsolescence, short product life cycles and changing competition. Accordingly, our success is dependent upon our ability to anticipate and identify technological changes in the industry and successfully adapt our offering of products and services to satisfy evolving industry and customer requirements.

The advent of cloud computing, or software-, platform- and infrastructure-as-a-service, provides another means for suppliers to deliver technology solutions directly to end-users and bypass the IT distribution channel. IT distributors are developing initiatives to remain relevant as this, and other alternative delivery models, evolve. We have developed service offerings designed to enable resellers to offer cloud computing solutions to end-users and will continue to refine service offerings around new delivery models.

We are constantly seeking to expand our business into areas closely related to our IT products and services distribution business. As we enter new business areas, including value-added services, we may encounter increased competition from current competitors and/or from new competitors, some of which may be our current customers.

Seasonality

We experience some seasonal fluctuation in demand in our business. For instance, we typically see lower demand, particularly in Europe, in the summer months. We also normally see an increase in demand in the September-to-December period, driven primarily by pre-holiday impacts on stocking levels in the retail channel and on volume of business for our North American fee-based logistics services.

Inventory Management

We strive to maintain sufficient quantities of product inventories to achieve optimum order fill rates. Our business, like that of other distributors, is subject to the risk that the value of our inventory will be impacted adversely by suppliers price reductions or by technological changes affecting the usefulness or desirability of the products comprising the inventory. It is the policy of many suppliers of technology and mobility products to offer distributors limited protection from the loss in value of inventory due to technological change or a supplier s price reductions. When protection is offered, the distributor may be restricted to a designated period of time in which products may be returned for credit or exchanged for other products or during which price protection credits may be claimed. We continually take various actions, including monitoring our inventory levels and controlling the timing of purchases, to maximize our protection under supplier programs and reduce our inventory risk. However, no assurance can be given that current protective terms and conditions will continue or that they will adequately protect us against declines in inventory value, or that they will not be revised in such a manner as to adversely impact our ability to obtain price protection. In addition, suppliers may become insolvent and unable to fulfill their protection obligations to us. We are subject to the risk that our inventory values may decline and protective terms under supplier agreements may not adequately cover the decline in values. In addition, we distribute a small amount of private label products for which price protection is not customarily contractually available, for which we do not normally enjoy return rights, and for which we bear certain increased risks. We manage these risks through pricing and continual monitoring of existing inventory levels relative to customer demand, reflecting our forecasts of future demand and market conditions. On an ongoing basis, we reduce inventory values for excess and obsolescence to assist in the liquidation of impacted inventories.

Inventory levels may vary from period to period, due, in part, to differences in actual demand from that forecasted when placing orders, the addition of new suppliers or new lines with current suppliers, expansion into new product areas, such as AIDC/POS and CE, and strategic purchases of inventory. In addition, payment terms with inventory suppliers may vary from time to time, and could result in fewer inventories being financed by suppliers and a greater amount of inventory being financed by our capital. Our payment patterns can be influenced by incentives, such as early pay discounts offered by suppliers.

Trademarks and Service Marks

We own or license various trademarks and service marks, including, among others, Ingram Micro, the Ingram Micro logo, V7 (Video Seven), VentureTech Network, AVAD, Vantex, BrightPoint and Aptec. Certain of these marks are registered, or are in the process of being registere the United States and various other countries. Even though our marks may not be registered in every country where we conduct business, in many cases we have acquired rights in those marks because of our continued use of them.

Employees

As of December 29, 2012, we employed more than 20,800 associates worldwide (as measured on a full-time equivalent basis). Certain of our employees in Europe, Asia-Pacific and Latin America are subject to union representation, collective bargaining or similar arrangements. Our success depends on the talent and dedication of our associates, and we strive to attract, hire, develop, and retain outstanding associates. We believe we realize significant benefits from having a strong and seasoned management team with many years of experience in the IT and related industries.

Corporate Social Responsibility

We introduced our Corporate Social Responsibility initiative three years ago, solidifying our commitment to being an outstanding corporate citizen in all aspects of our business, including prudent stewardship of our resources, limiting our impact on the environment and maintaining a safe and respectful workplace. Our efforts were recognized with the rank of 43 on *Newsweek* s 2012 Green Rankings of the 500 largest companies in the U.S., the highest rank among technology distributors. Our associates worldwide continue to show their commitment to saving energy, reducing paper consumption and contributing their time, skills and financial resources to our communities. Our sustainability commitment is formally captured on our corporate website and in our publicly available baseline annual report (*www.ingrammicro.com/smartcitizen*).

Regulatory Matters

The following disclosure is being made in accordance with Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012:

During the quarter ended December 29, 2012, Aptec, our wholly-owned non-U.S. subsidiary, made six sales to a reseller which identified its intended customer as Iranian Hospital, which is located in Dubai, United Arab Emirates. These sales by our subsidiary to the reseller consisted of technology products resulting in revenue to us of approximately $81, with net profits of substantially less than that.

Iranian Hospital is operated by the Iranian Red Crescent Society, a humanitarian aid organization that is a member organization of the International Red Cross and Red Crescent Federation (IFRC). According to its Fundamental Principles, the IFRC requires that all of its member organizations remain autonomous from government actors. The IFRC has informed us that it does not consider the Iranian Red Crescent Society to be an Iranian government entity, and that to its knowledge, the Iranian Red Crescent Society is a non-governmental organization with its own general assembly and governing board that is elected and independent of the government. Neither Iranian Hospital nor the Iranian Red Crescent Society appears on the list of specially designated nationals and blocked persons maintained by the Office of Foreign Assets Control (OFAC). However, OFAC has recently given us oral guidance that it believes the Iranian Red Crescent Society to be wholly owned by the Government of Iran and accordingly part of the Government of Iran. We have blocked further sales to resellers where Iranian Hospital or Iranian Red Crescent Society is identified as their customer.

As of the date of this report, we are not aware of any other activity, transaction or dealing by us or any of our affiliates during the fiscal year ended December 29, 2012 that requires disclosure in this report under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012.

Available Information

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended. We therefore file periodic reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). Such reports may be obtained by visiting the Public Reference Room of the SEC at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at (800) SEC-0330. In addition, the SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements and other information.

Financial and other information can also be accessed through our website at *www.ingrammicro.com*. There, we make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the SEC. The information posted on, or accessible through, our website is not incorporated into this Annual Report on Form 10-K.

EXECUTIVE OFFICERS OF THE COMPANY

The following list of executive officers of Ingram Micro is as of February 27, 2013:

Alain Monié. Mr. Monié, age 62, has been our president and chief executive officer since January 20, 2012. He rejoined the company as our president and chief operating officer on November 1, 2011, after a year as chief executive officer of APRIL Management Pte., a multinational industrial company based in Singapore. Prior to his role at APRIL Management Pte., Mr. Monié served as president and chief operating officer of Ingram Micro from 2007 to 2010. He joined Ingram Micro in February 2003 as executive vice president, and served in that role and as president of Ingram Micro Asia-Pacific from January 2004 to August 2007. He spent more than two years as president of the Latin American Division of Honeywell International. He joined Honeywell through the corporation s merger with Allied Signal Inc., where he built a 17-year career on three continents, progressing from a regional sales manager to head of Asia-Pacific operations from October 1997 to December 1999. Mr. Monié has been a member of the Board of Directors of Amazon.com, Inc. since November 2008, and was elected to the Board of Ingram Micro in November 2011. Mr. Monié was a member of the Board of Directors of Jones Lang LaSalle from October 2005 to May 2009.

William D. Humes. Mr. Humes, age 48, is our chief operating and financial officer and has served in this role since April 2012. Mr. Humes served in his role as senior executive vice president and chief financial officer from April 2005 to March 2012. Previously, he was senior vice president and chief financial officer designee from October 2004 to March 2005, corporate vice president and controller from February 2004 to October 2004, vice president, corporate controller from February 2002 to February 2004 and senior director, worldwide financial planning, reporting and accounting from September 1998 to February 2002. Prior to joining Ingram Micro, Mr. Humes was a senior audit manager at PricewaterhouseCoopers LLP.

Paul D. Bay. Mr. Bay, age 42, is our senior executive vice president and president of Ingram Micro North America and has served in this role since January 2013. He previously served as acting president, Ingram Micro North America from November 2012 to December 2012 and executive vice president, Ingram Micro North America from June 2010 to October 2012. Mr. Bay originally joined Ingram Micro in 1995 and held numerous roles through 2006 when he left his position as senior vice president of vendor management to become chief executive officer of Punch Software, a seller of home design, landscape and architectural software, until he returned to Ingram Micro in June 2010. Before joining Ingram Micro in 1995, Mr. Bay held sales positions with firms in Southern California, including Triad Computer Systems Corp.

Shailendra Gupta. Mr. Gupta, age 50, is our senior executive vice president and president of Ingram Micro Asia-Pacific and has served in this role since January 2008. In addition to Mr. Gupta s responsibilities for the Asia-Pacific region, since October 2012, Mr. Gupta is also responsible for Ingram Micro s global mobility business. Mr. Gupta served as our senior vice president, Ingram Micro Asia-Pacific from August 2007 to January 2008. Prior to joining Ingram Micro, Mr. Gupta spent nine years with Tech Pacific Group, starting in 1995 as managing director of India, then in 2001 was promoted to chief executive officer. Mr. Gupta joined Ingram Micro in 2004 as chief operating officer of Ingram Micro Asia-Pacific when Ingram Micro acquired Tech Pacific. Prior to Tech Pacific, Mr. Gupta spent ten years with Godrej & Boyce Manufacturing Co. Ltd., India, a large diversified Indian conglomerate, where he held various managerial positions including manufacturing plant responsibility.

Alain Maquet. Mr. Maquet, age 61, has been our senior executive vice president and president of EMEA since July 2009. Mr. Maquet previously served as executive vice president and president of Ingram Micro Latin America and had served in such role since March 2005. Mr. Maquet also served as our senior vice president, southern and western Europe from January 2001 to February 2004. Mr. Maquet joined Ingram Micro in 1993 as the managing director of France and had added additional countries to his responsibilities over the years. His career spans over three decades, the majority of which are in the technology industry. In addition, Mr. Maquet had co-founded an IT distribution company before joining Ingram Micro.

Larry C. Boyd. Mr. Boyd, age 60, is our executive vice president, secretary and general counsel and has served in this role since March 2004. He previously served as senior vice president, U.S. legal services, for Ingram Micro North America from January 2000 to January 2004. Prior to joining Ingram Micro, he was a partner with the law firm of Gibson, Dunn & Crutcher from January 1985 to December 1999.

Nimesh Dave. Mr. Dave, age 42, has been our executive vice president, global business process since September 2012. Mr. Dave has also assumed oversight for the company s worldwide information and business systems while Ingram Micro conducts a search for a successor chief information officer. Prior to joining Ingram Micro, Mr. Dave served as senior vice president, commercial operations, strategy and supply-chain solutions for

Table of Contents

Tech Data Espana and also served as part of Tech Data s European Executive Leadership Team from December 2009 to August 2012. Prior to that, he held several senior executive roles in information technology in the Americas and Europe for Tech Data including vice president worldwide IT Integration, director of support services and director of international systems from November 1997 to November 2009.

Robert K. Gifford. Mr. Gifford, age 55, has been our executive vice president, global logistics since June 2010. Before joining Ingram Micro, Mr. Gifford served as senior vice president, global supply chain for Ecolab Inc., a Fortune 500 manufacturer and distributor serving the hospitality, institutional and industrial markets from October 2005 to June 2010. He led all aspects of the company s supply chain globally. Prior to Ecolab, Mr. Gifford was the vice president of worldwide logistics for HP. He joined HP following the 2002 acquisition of Compaq, where he spent seven years in manufacturing and supply-chain management.

Lynn Jolliffe. Ms. Jolliffe, age 60, is our executive vice president, human resources and has served in this role since July 2007. She joined Ingram Micro in 1999 as the vice president of human resources for the European region. Ms. Jolliffe served as vice president of human resources for the North American region from October 2006 until June 2007. Prior to Ingram Micro, she served in various executive roles in Canada with Holt Renfrew Ltd. and White Rose Limited.

Mario F. Leone. Mr. Leone, age 57, has been our executive vice president and chief information officer since January 2009. He will be leaving the company on March 1, 2013. Prior to joining Ingram Micro, Mr. Leone served as senior vice president and chief information officer at Federal-Mogul Corporation, a global supplier of powertrain and safety technologies serving the automotive, industrial and worldwide after-markets from May 2005 to January 2009. Mr. Leone was previously senior vice president and chief information officer at FIAT, and its business unit IVECO, a leading European industrial vehicle company from January 2002 to May 2005.

John Soumbasakis. Mr. Soumbasakis, age 43, has been our executive vice president and president, Latin America since January 2012 and served as senior vice president and president, Latin America since April 2011. Mr. Soumbasakis was previously our senior vice president, specialty solutions division, North America from December 2010 to April 2011, senior vice president strategic divisions from July 2008 to December 2010, vice president & general manager data capture/point of sale, North America from May 2005 to July 2008, and vice president, corporate business development from February 2003 to May 2005. Prior to joining Ingram Micro, Mr. Soumbasakis was a principal for The Boston Consulting Group, a global management consulting firm.

G. Sam Kamel. Mr. Kamel, age 49, has been our senior vice president, corporate strategy since October 2010. Mr. Kamel previously served as senior vice president, strategic business development at Fox Networks Group where he was responsible for new business opportunities, joint ventures and acquisitions from July 2008 to March 2009 and served as an independent consultant from March 2009 to September 2010. Previously, Mr. Kamel served as general manager of business operations at Microsoft International from March 2004 to July 2008. Mr. Kamel has also held general management and corporate development positions at various technology-related companies, including E-LOAN, Autodesk and Netscape, and was an associate at McKinsey & Company, a global management consulting firm.

ITEM 1A. RISK FACTORS

CAUTIONARY STATEMENTS FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Private Securities Litigation Reform Act of 1995 (the Act) provides a safe harbor for forward-looking statements to encourage companies to provide prospective information, so long as such information is identified as forward-looking and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the forward-looking statement(s). Ingram Micro desires to take advantage of the safe harbor provisions of the Act.

Our periodic and current reports filed with the Securities and Exchange Commission, periodic press releases, and other public documents and statements, may contain forward-looking statements. In addition, our representatives may participate in speeches and calls with market analysts; conferences, meetings and calls with investors and potential investors in our securities; and other meetings and conferences. Some of the information presented in these calls, meetings and conferences may also be forward-looking. We disclaim any duty to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Described below and throughout this report are certain risks that could affect our business, financial results and results of operations. These risk factors should be considered in connection with evaluating your investment in our company because these factors could cause our actual results and conditions to differ materially from our historical performance or those projected in our forward-looking statements. Before you invest in our company, you should know that making such an investment involves risks, including the risks described below. The risks that have been highlighted here are not the only ones that we face. There may be additional risks that are not presently material or known. If any of the risks actually occur, our business, financial condition or results of operations could be negatively affected. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

RISK FACTORS

Our acquisition and investment strategies may not produce the expected benefits, which may adversely affect our results of operations. We have made, and may continue to make, acquisitions or investments in companies around the world to further our strategic objectives and support key business initiatives. Acquisitions and investments involve risks and uncertainties, some of which may differ from those associated with our historical operations. For example, in 2012 we acquired BrightPoint, a global leader in mobile device lifecycle services; Aptec, a Dubai-based value-added distributor in the Middle East and Africa, with products and solutions covering data center, storage, security, networking and software categories, including technical services; and Promark, a value-added distributor in the U.S. with a core technology focus on data storage, data management and electronic document imaging products and services. We also initiated new business operations in Colombia and exited our Argentina business.

Significant risks and uncertainties related to our acquisition and investment strategies which could materially and adversely affect our financial performance include the following:

- distraction of management s attention away from normal business operations while coordinating and integrating a geographically dispersed organization;
- insufficient profit generation to offset liabilities assumed and expenses associated with the strategy;
- inability to successfully integrate the acquired businesses, which may be more difficult, costly or time-consuming than anticipated, including inability to retain key employees, difficulties with integrating different business systems and technology platforms and consolidating corporate, administrative, technological and operational infrastructures;
- inability to preserve our and the acquired company s customer, supplier and other important relationships;
- inability to adapt to challenges of new markets, including geographies, products and services, or to identify new profitable business opportunities from expansion of existing products or services;
- inability to adequately bridge possible differences in cultures and management philosophies;

exposure to new regulations, such as those relating to U.S. federal government procurement regulations, those in new geographies or those applicable to new products or services;

Table of Contents

substantial increases in our debt; and

issues not discovered in our due diligence process.

In addition, we may divest business units that do not meet our strategic, financial and/or risk tolerance objectives. No assurance can be given that we will be able to dispose of business units on favorable terms or without significant costs.

We are dependent on a variety of information systems, which, if not properly functioning and available, or if we experience system security breaches, data protection breaches, or other cyber-attacks, could adversely disrupt our business and harm our reputation and net sales. We depend on a variety of information systems for our operations, many of which are proprietary, which have historically supported many of our business operations such as inventory and order management, shipping, receiving, and accounting. Because most of our information systems consist of a number of internally developed applications, it can be more difficult to upgrade or adapt them compared to commercially available software solutions.

We are currently in the process of migrating our operations from our legacy proprietary system that was developed in the late-1980s to SAP in a phased, country-by-country approach over the next several years. We have deployed SAP in several operations in Asia-Pacific, Europe and Latin America, as well as SAP financial modules in North America since our first deployment in 2009. Due to challenges in our earlier round of implementations, we have chosen to slow down our deployment schedule in order to ensure the effectiveness and stability of upgrades already completed and apply what we have learned to subsequent implementations. We are continuing to evaluate our schedule for deploying the enterprise system in additional locations. While we will adjust the deployment schedule as required to best serve our customers, we can make no assurances that we will not have disruptions, delays and/or negative business impacts from forthcoming deployments.

Any disruptions, delays or deficiencies in the design and implementation of the new ERP system, or in the performance of our legacy systems could adversely affect our ability to effectively run and manage our business and potentially our customers ability to access our price and product availability information or place orders. Portions of our IT infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and be more expensive, time consuming, disruptive and resource-intensive. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes. We may also be limited in our ability to integrate any new business that we may acquire. If our information systems do not allow us to transmit accurate information, even for a short period of time, to key decision makers, the ability to manage our business could be disrupted and the results of operations and financial condition could be adversely affected. Failure to properly or adequately address these issues could impact our ability to perform necessary business operations, which could adversely affect our reputation, competitive position, business, results of operations and financial condition.

We also rely on the Internet for a significant percentage of our orders and information exchanges with our customers. The Internet, in general, and individual websites have experienced a number of disruptions, slowdowns and security breaches, some of which were caused by organized attacks. To date, we do not believe that our website and systems have experienced any material breakdowns, disruptions or breaches in security; however, we cannot assure that this will not occur in the future. If we were to experience a security breakdown, disruption or breach that compromised sensitive information, this could harm our relationships with our customers, suppliers or associates; impair our order processing; or more generally prevent our customers and suppliers from accessing information, which could cause us to lose business. Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate or compromise our confidential information or that of third parties, create system disruptions or cause shutdowns. In addition, sophisticated hardware and operating system software and applications that we procure from third parties may contain defects in design or manufacture, including bugs and other problems that could unexpectedly interfere with the operation of the system. The costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions, delays, cessation of service and loss of existing or potential customers that may impede our sales, distribution or other critical functions.

We manage and store various proprietary information and sensitive or confidential data relating to our business. In addition, we routinely process, store and transmit large amounts of data for our partners, including sensitive and personally identifiable information. Breaches of our security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us or our customers, including the potential loss or disclosure of such information or data as a result of fraud, trickery or other forms of deception, could expose us, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our brand and reputation or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant. Such breaches, costs and consequences could adversely affect our business, results of operations or cash flows.

Changes in macroeconomic conditions can affect our business and results of operations. Our revenues, profitability, financial position and cash flows, are highly dependent on the broader movements of the macroeconomic environment. For example, our results of operations have been and continue to be adversely affected by the difficult conditions experienced in the global economy in recent periods. Economic weakness and uncertainty, including the ongoing macroeconomic challenges in many countries globally and the debt crisis in certain countries in the European Union, have resulted, and may result in the future, in decreased revenue, margins and earnings; difficulty managing inventory levels and collecting customer receivables; decreased availability of trade credit from suppliers or decreased capital availability through debt and similar financing from external parties. In addition, sustained uncertainty about current global economic conditions, continued negative economic trends or instability, or another recession, may negatively impact our business, leading to:

- reduced demand for products in general;
- more intense competition, which may lead to loss of sales and/or market share;
- reduced prices, and lower gross margin;
- loss of vendor rebates;
- extended payment terms with customers;
- increased bad debt risks;
- shorter payment terms with vendors;
- reduced access to liquidity and higher financing and interest costs;
- increased currency volatility making hedging more expensive and more difficult to obtain; and
- increased inventory losses related to obsolescence and/or excess quantities.

Each of these factors, individually or in the aggregate, could adversely affect our results of operations, financial condition and cash flows. The economic downturn may also lead us to take additional restructuring actions and reduce associated expenses in response to the lower sales volume. We may not be able to adequately adjust our cost structure in a timely fashion to remain competitive, which may cause our profitability to suffer.

Our European operations contributed 28% to our net revenue in 2012. The European Union is currently in a prolonged period of economic uncertainty. Policy disagreement between countries regarding challenges such as fiscal and financial risk sharing have become more pronounced. If a member nation of the European Union were to default on its national debt, the resulting financial turmoil could disrupt liquidity markets and materially hamper our or our business partners ability to access capital and materially adversely affect our business and financial results. Other income and expense could vary materially from expectations depending on changes in interest rates, borrowing costs, currency exchange rates, hedging expenses and the fair value of derivative instruments.

Failure to retain and recruit key personnel would harm our ability to meet key objectives. Because of the nature of our business, which includes a high volume of transactions, business complexity, wide geographical coverage, and broad scope of products, suppliers, and customers, we are highly dependent on our ability to retain the services of our key management, sales, IT, operational, and finance personnel. Our continued success is also dependent upon our ability to retain and recruit other qualified employees, including highly skilled technical, managerial, and marketing personnel, to meet our needs. Competition for qualified personnel is intense. We may not be successful in attracting and retaining the personnel we require, which could have a material adverse effect on our business. In addition, we have, from time to time, reduced our personnel levels in various geographies and functions, in response to economic, business and other factors, through our restructuring and outsourcing activities. These reductions could negatively impact our relationships with our workforce, or make hiring other employees more difficult. In addition, failure to meet performance targets for the company may result in reduced levels of incentive compensation, which may affect our ability to retain key personnel. Additionally, changes in our workforce, including those resulting from government regulations, collective bargaining agreements or the availability of qualified personnel, could disrupt operations or increase our operating cost structure.

Our failure to adequately adapt to industry changes could negatively impact our future operating results. The technology and mobility products industry is subject to rapid technological change, new and enhanced product specification requirements, evolving industry standards and changes in the way technology products are distributed and/or managed. We have been and will continue to be dependent on innovations in hardware, software and services offerings, as well as the acceptance of those innovations by customers. A decrease in the rate of innovation, or the lack of acceptance of innovations by customers, could have an adverse effect on our business, results of operations or cash flows. Suppliers may also give us limited or no access to new products being introduced.

Changes may cause inventory in stock to decline substantially in value or to become obsolete, regardless of the general economic environment. Although it is the policy of many suppliers of products to offer distributors like us, who purchase directly from them, limited protection from the loss in value of inventory due to technological change or such suppliers price reductions (price protection), if major suppliers decrease the availability of price protection to us, such a change in policy could lower our gross margins on products we sell or cause us to record inventory write-downs. In addition, suppliers could become insolvent and unable to fulfill their protection obligations to us. We offer no assurance that price protection will continue, that unforeseen new product developments will not adversely affect us, or that we will successfully manage our existing and future inventories.

Significant changes in supplier terms, such as higher thresholds on sales volume before distributors may qualify for discounts and/or rebates, the overall reduction in the amount of incentives available, reduction or termination of price protection, return levels, or other inventory management programs, or reductions in payment terms or trade credit, or vendor-supported credit programs, may adversely impact our results of operations or financial condition.

Finally, if we were not able to adequately adapt to the emergence of alternative means of distribution for software and hardware, such as site licenses, electronic distribution and cloud computing, our future operating results could be adversely affected.

We continually experience intense competition across all markets for our products and services. Our competitors include local, regional, national, and international distributors, as well as suppliers that employ a direct-sales model. As a result of intense price competition in the IT and mobility products and services distribution industry, our gross margins have historically been narrow and we expect them to continue to be

Table of Contents

narrow in the future. In addition, when there is overcapacity in our industry, our competitors may reduce their prices in response to this overcapacity.

The competitive landscape has also experienced a consolidation among suppliers and customers and this trend is expected to continue, which could result in a reduction or elimination of promotional activities by the remaining suppliers or customers as they seek to reduce their expenditures, which could, in turn, result in decreased demand from end-users and our reseller customers for our products or services. Additionally, the past several years have witnessed a consolidation within the mobile operator community, and this trend is expected to continue. This trend could result in a reduction or elimination of promotional activities by the remaining mobile operators as they seek to reduce their expenditures, which could, in turn, result in decreased demand for our products or services. Moreover, consolidation of mobile operators reduces the number of potential contracts available to us and other providers of logistic services. We could also lose business or face price pressures if mobile operators that are our customers are acquired by other mobile operators that are our customers or not our customers.

We offer no assurance that we will not lose market share, or that we will not be forced in the future to reduce our prices in response to the actions of our competitors and thereby experience a reduction in our gross margins. Furthermore, to remain competitive we may be forced to offer more credit or extended payment terms to our customers. This could increase our required capital, financing costs, and the amount of our bad debt expenses.

We have also initiated and expect to continue to initiate other business activities and may face competition from companies with more experience and/or from new entrants in those markets. As we enter new areas of business or geographies, or we expand our offerings of new products or vendors, we may encounter increased competition from current competitors and/or from new competitors, some of which may be our current customers or suppliers, which may negatively impact our sales or profitability.

We operate a global business that exposes us to risks associated with conducting business in multiple jurisdictions. Sales outside the United States made up approximately 62% of our net revenue in 2012. In addition, an increasing portion of our business activity is being conducted in emerging markets, including China and India. As a result, our future operating results and financial condition could be significantly affected by risks associated with conducting business in multiple jurisdictions, including, but not limited to, the following:

- trade protection laws, policies and measures;
- import and export duties, customs levies and value-added taxes;
- compliance with foreign and domestic import and export regulations and anticorruption laws, including the Iran Threat Reduction and Syria Human Rights Act of 2012, U.S. Foreign Corrupt Practices Act, or similar laws of other jurisdictions for our business activities outside the U.S., the violation of which could result in severe penalties including monetary fines, criminal proceedings and suspension of export privileges;
- managing compliance with legal and regulatory requirements and prohibitions, including compliance with local laws and regulations that differ or are conflicting among jurisdictions;
- environmental laws and regulations, such as those relating to product disposal;
- differing employment practices and labor issues;
- political instability, terrorism and potential military conflicts or civilian unrest; economic instability in a specific country or region;

earthquakes, power shortages, telecommunications failures, water shortages, tsunamis, floods, hurricanes, typhoons, fires, extreme weather conditions, medical epidemics or pandemics and other natural or manmade disasters or business interruptions in a region or specific country;

complex and changing tax laws and regulations in various jurisdictions;

potential restrictions on our ability to repatriate funds from our foreign subsidiaries; and

difficulties in staffing and managing international operations.

The potential criminal penalties for violations of export regulations and anti-corruption laws, particularly the U.S. Foreign Corrupt Practices Act, data privacy laws and environmental laws and regulations in many jurisdictions, create heightened risks for our international operations. In the event that a governing regulatory body determined that we have violated applicable export regulations or anti-corruption laws, we could be fined significant sums, incur sizable legal defense costs and/or our export capabilities could be restricted, which could have a material and adverse effect on our business and reputation.

Additionally, we have been and expect to continue to be subject to new and increasingly complex U.S. and other local government regulations that affect our operations in the U.S. and globally. These regulations could result in increased costs to implement processes necessary to comply or such compliance could result in the reduction of the level of business we can effectively process.

While we have and will continue to adopt measures designed to promote compliance with these laws, we cannot assure you that such measures will be adequate or that our business will not be materially and adversely impacted in the event of an alleged violation.

We are also exposed to market risk primarily related to foreign currencies and interest rates. In particular, we are exposed to changes in the value of the U.S. dollar versus the local currency in which the products are sold and goods and services are purchased, including devaluation and revaluation of local currencies. Since more than half of our sales are from countries outside of the United States, other currencies, including, but not limited to, the euro, British pound, Chinese yuan, Indian rupee, Australian dollar, Mexican peso, and Brazilian real, can have an impact on Ingram Micro s results (expressed in U.S. dollars).

In particular, the uncertainty with respect to the ability of certain European countries to continue to service their sovereign debt obligations and the related European financial restructuring efforts may cause the value of the euro and other European currencies to fluctuate. Currency variations also contribute to variations in sales of products and services in impacted jurisdictions. For example, in the event that one or more European countries were to replace the euro with another currency, Ingram Micro s sales into such countries, or into Europe generally, would likely be adversely affected until stable exchange rates are established. Accordingly, fluctuations in foreign currency rates, most notably the strengthening of the dollar against the euro, could adversely affect our revenue growth in future periods. In addition, currency variations can adversely affect margins on sales of our products in countries outside of the United States.

We have managed our exposure to fluctuations in the value of currencies and interest rates using a variety of financial instruments entered into with financial institutions. Although we believe that our exposures are appropriately diversified across counterparties and that, through our ongoing monitoring procedures, these counterparties are creditworthy financial institutions, we are exposed to credit loss in the event of nonperformance by these counterparties. In addition, our hedging activities may not offset fully any adverse financial impact resulting from currency variations, which could affect our financial results.

Terminations of a supply or services agreement or a significant change in supplier terms or conditions of sale could negatively affect our operating margins, revenue or the level of capital required to fund our operations. A significant percentage of our net sales relates to products sold to us by relatively few suppliers. As a result of such concentration risk, terminations of supply or services agreements, or a significant change in the terms or conditions of sale from one or more of our more significant partners, or bankruptcy or closure of business by one or more of our more significant partners could negatively affect our operating margins, revenues or the level of capital required to fund our operations. Our suppliers have the ability to make, and in the past have

Table of Contents

made, rapid and significantly adverse changes in their sales terms and conditions, such as reducing the amount of price protection and return rights as well as reducing the level of purchase discounts and rebates they make available to us. In most cases, we have no guaranteed price or delivery agreements with suppliers. In certain product categories, such as systems, limited price protection or return rights offered by suppliers may have a bearing on the amount of product we may be willing to stock. We expect restrictive supplier terms and conditions to continue in the foreseeable future. Our inability to pass through to our customers the impact of these changes, as well as our failure to develop systems to manage ongoing supplier programs, could cause us to record inventory write-downs or other losses and could have a negative impact on our gross margins.

We receive purchase discounts and rebates from suppliers based on various factors, including sales or purchase volume, breadth of customers and achievement of other goals set by the vendors. These purchase discounts and rebates may affect gross margins. Many purchase discounts from suppliers are based on percentage increases in sales of products. Our operating results could be negatively impacted if these rebates or discounts are reduced or eliminated or if our vendors significantly increase the complexity of process and costs for us to receive such rebates.

Our ability to obtain particular products or product lines in the required quantities and to fulfill customer orders on a timely basis is critical to our success. The IT industry experiences significant product supply shortages and customer order backlogs from time to time due to the inability of certain suppliers to supply certain products on a timely basis. As a result, we have experienced, and may in the future continue to experience, short-term shortages of specific products, which can in turn have significant impacts on pricing of such products. In addition, suppliers who currently distribute their products through us may decide to shift to or substantially increase their existing distribution, through other distributors, their own dealer networks, or directly to resellers or end-users. Suppliers have, from time to time, made efforts to reduce the number of distributors with which they do business. This could result in more intense competition as distributors strive to secure distribution rights with these vendors, which could have an adverse effect on our operating results. If suppliers are not able to provide us with an adequate supply of products to fulfill our customer orders on a timely basis or we cannot otherwise obtain particular products or a product line or suppliers substantially increase their existing distribution through other distributors, their own dealer networks, or directly to resellers, our reputation, sales and profitability may suffer.

Substantial defaults by our customers or the loss of significant customers could have a negative impact on our business, results of operations, financial condition or liquidity. As is customary in many industries, we extend credit to our customers for a significant portion of our net sales. Customers have a period of time, generally 30 to 45 days after date of invoice, to make payment. We are subject to the risk that our customers will not pay for the products they have purchased. The risk that we may be unable to collect on receivables may increase if our customers experience decreases in demand for their products and services or otherwise become less stable, due to adverse economic conditions. If there is a substantial deterioration in the collectability of our receivables or if we cannot obtain credit insurance at reasonable rates, are unable to collect under existing credit insurance policies, or fail to take other actions to adequately mitigate such credit risk, our earnings, cash flows and our ability to utilize receivable-based financing could deteriorate. In addition, our customers do not have an obligation to make purchases from us. In the event a significant customer decides to make its purchases from another distributor, experiences a significant change in demand from its own customer base, becomes financially unstable, or is acquired by another company, our revenues, and our ability to access rebates from vendors may be negatively impacted, resulting in an adverse effect on our business or results of operations.

Changes in, or interpretations of, tax rules and regulations, changes in mix of our business amongst different tax jurisdictions, and deterioration of the performance of our business may adversely affect our effective income tax rates or operating margins and we may be required to pay additional taxes and/or tax assessments, as well as record valuation allowances relating to our deferred tax assets. We are subject to both income and transaction-based taxes in substantially all countries and jurisdictions in which we operate, which are complex. Changes to tax regulations or to their interpretation or application by governments could adversely affect our future earnings and cash flows. Our effective income tax rate in the future could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes to our operating structure, changes in tax laws and the discovery of new information in the course of our tax return preparation process.

Likewise, unanticipated changes to our transaction tax liabilities could adversely affect our future results of operations, cash flows and our competitive position. We engage in a high volume of transactions where multiple types of consumption, commercial and service taxes are potentially applicable. An inability to appropriately identify, charge, remit and document such taxes, along with an inconsistency in the application of these taxes by the applicable taxing authorities, may negatively impact our gross and operating margins, financial position or cash flows.

We are subject to the continuous examination of both our income and transaction tax returns by the Internal Revenue Service and other domestic and foreign tax authorities. While we regularly evaluate our tax contingencies and uncertain tax positions to determine the adequacy of our provision for income and other taxes based on the technical merits and the likelihood of success resulting from tax examinations, any adverse outcome from these continuous examinations may have an adverse effect on our operating results and financial position.

Our goodwill and identifiable intangible assets could become impaired, which could reduce the value of our assets and reduce our net income in the year in which the write-off occurs. Goodwill represents the excess of the cost of an acquisition over the fair value of the assets acquired. We also ascribe value to certain identifiable intangible assets, which consist primarily of customer relationships and trade names, among others, as a result of acquisitions. We may incur impairment charges on goodwill or identifiable intangible assets if we determine that the fair values of the goodwill or identifiable intangible assets are less than their current carrying values. We evaluate, on a regular basis, whether events or circumstances have occurred that indicate all, or a portion, of the carrying amount of goodwill may no longer be recoverable, in which case an impairment charge to earnings would become necessary.

A decline in general economic conditions or global equity valuations could impact our judgments and assumptions about the fair value of our businesses and we could be required to record impairment charges on our goodwill or other identifiable intangible assets in the future.

We have incurred and will incur additional depreciation and amortization expense over the useful lives of certain assets acquired in connection with business combinations, and to the extent that the value of goodwill or intangible assets with indefinite lives acquired in connection with a business combination and investment transaction become impaired, we may be required to incur material charges relating to the impairment of those assets. For example, we had $428,401 of goodwill and $372,482 of identifiable net intangible assets recorded in connection with various acquisitions as of December 29, 2012. If our future results of operations for these acquired businesses do not perform as expected or are negatively impacted by any of the risk factors noted herein or other unforeseen events, we may have to recognize impairment charges which would adversely affect our results of operations.

Changes in our credit rating or other market factors, such as adverse capital and credit market conditions or reductions in cash flow from operations, may affect our ability to meet liquidity needs, reduce access to capital, and/or increase our costs of borrowing. Our business requires significant levels of capital to finance accounts receivable and product inventory that is not financed by trade creditors. This is especially true when our business is expanding, including through acquisitions, but we still have substantial demand for capital even during periods of stagnant or declining net sales. In order to continue operating our business, we will continue to need access to capital, including debt financing and inbound and outbound flooring and draft discounting facilities. In addition, changes in payment terms with either suppliers or customers could increase our capital requirements. Our ability to repay current or future indebtedness when due, or have adequate

Table of Contents

sources of liquidity to meet our business needs may be affected by changes to the cash flows of our subsidiaries. A reduction of cash flow generated by our subsidiaries may have an adverse effect on our liquidity. Under certain circumstances, legal, tax or contractual restrictions may limit our ability or make it more costly to redistribute cash between subsidiaries to meet our overall operational or strategic investment needs, or for repayment of indebtedness requirements.

We believe that our existing sources of liquidity, including cash resources and cash provided by operating activities, supplemented as necessary with funds available under our credit arrangements, will provide sufficient resources to meet our working capital and cash requirements for at least the next twelve months. However, volatility and disruption in the capital and credit markets, including increasingly complex regulatory constraints on these markets, may increase our costs for accessing the capital and credit markets. In addition, adverse capital and credit market conditions may also limit our ability to replace, in a timely manner, maturing credit arrangements or our ability to access committed capacities or the capital we require may not be available on terms acceptable to us, or at all, due to inability of our finance partners to meet their commitments to us. Furthermore, if we do not meet various covenant requirements of our corporate finance programs, including

cross-default threshold provisions, we may not be able to access the majority of our credit programs with our finance partners. The lack of availability of such funding could harm our ability to operate or expand our business.

In addition, our cash and cash equivalents (including trade receivables collected and/or monies set aside for payment to creditors) are deposited and/or invested with various financial institutions located in the various countries in which we operate. We endeavor to monitor these financial institutions regularly for credit quality; however, we are exposed to risk of loss on such funds or we may experience significant disruptions in our liquidity needs if one or more of these financial institutions were to suffer bankruptcy or similar restructuring.

We cannot predict what losses we might incur in litigation matters and contingencies that we may be involved with from time to time. There are various claims, lawsuits and pending actions against us. It is our opinion that the ultimate resolution of these matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows. However, we can make no assurances that we will ultimately be successful in our defense of any of these matters. See Part I. Item 3. Legal Proceedings, in this Form 10-K for a discussion of our material legal matters.

We may become involved in intellectual property disputes that could cause us to incur substantial costs, divert the efforts of management or require us to pay substantial damages or licensing fees. From time to time, we receive notifications alleging infringements of intellectual property rights allegedly held by others relating to the products or services we sell. Litigation with respect to patents or other intellectual property matters could result in substantial costs and diversion of management and other resources and could have an adverse effect on our operations. Further, we may be obligated to indemnify and defend our customers if the products or services we sell are alleged to infringe any third party s intellectual property rights. While we may be able to seek indemnification from our suppliers to protect our customers and us against such claims, there is no assurance that we will be successful in obtaining such indemnification or that we will be fully protected against such claims. We may also be prohibited from marketing products, could be forced to market products without desirable features, or could incur substantial costs to defend legal actions, including where third parties claim that we or vendors who may or may not have indemnified us are infringing upon their intellectual property rights. In recent years, individuals and groups have begun purchasing intellectual property assets for the sole purpose of making claims of infringement and attempting to extract settlements from target companies. Even if we believe that such infringement claims are without merit, the claims can be time-consuming and costly to defend and divert management s attention and resources away from our business. Claims of intellectual property infringement may require us to enter into costly settlements or pay costly damage awards, or face a temporary or permanent injunction prohibiting us from marketing or selling certain products or services, which could affect our ability to compete effectively. If an infringement claim is successful, we may be required to pay damages or

Table of Contents

seek royalty or license arrangements, which may not be available on commercially reasonable terms. Even if we have an agreement that indemnifies us against such costs, the indemnifying party may be unable or unwilling to uphold its contractual obligations to us.

Our failure to comply with the requirements of environmental regulations could adversely affect our business. We are subject to various federal, state, local and foreign laws and regulations addressing environmental and other impacts from product disposal, use of hazardous materials in products, recycling of products at the end of their useful life and other related matters. Compliance with these environmental laws may have a material adverse effect on our business. These laws include the European Union Waste Electrical and Electronic Equipment Directive as enacted by individual European Union countries and other similar legislation adopted in North America, which make producers of electrical goods, including computers and printers, responsible for collection, recycling, treatment and disposal of recovered products. While we strive to ensure we are in compliance with all applicable regulations, certain of these regulations impose strict liability. Additionally, we may be held responsible for the prior activities of entities that we have acquired. Failure to comply with these regulations could result in substantial costs, fines and civil or criminal sanctions, as well as third-party claims for property damage or personal injury. Further, environmental laws may become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with violation.

We face a variety of risks in our reliance on third-party service companies, including shipping companies for the delivery of our products and outsourcing arrangements. We rely almost entirely on arrangements with third-party shipping and freight forwarding companies for the delivery of our products. The termination of our arrangements with one or more of these third-party shipping companies, or the failure or inability of one or more of these third-party shipping companies to deliver products from suppliers to us or products from us to our customers, could disrupt our business and harm our reputation and operating results.

In addition, we have outsourced various transaction-oriented service and support functions to business process outsource providers. We have also outsourced a significant portion of our IT infrastructure function and certain IT application development functions to third-party providers. We may outsource additional functions to third-party providers. Our reliance on third-party providers to provide service to us, our customers and suppliers and for our IT requirements to support our business could result in significant disruptions and costs to our operations, including damaging our relationships with our suppliers and customers, if these third-party providers do not meet their obligations to adequately maintain an appropriate level of service for the outsourced functions or fail to adequately support our IT requirements. As a result of our outsourcing activities, it may also be more difficult to recruit and retain qualified employees for our business needs.

Changes in accounting rules could adversely affect our future operating results. Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles. These principles are subject to interpretation by various governing bodies, including the Financial Accounting Standards Board and the SEC, who create and interpret appropriate accounting standards. Future periodic assessments required by current or new accounting standards may result in additional noncash charges and/or changes in presentation or disclosure. A change from current accounting standards could have a significant adverse effect on our reported financial position or results of operations.

Our quarterly results have fluctuated significantly. Our quarterly operating results have fluctuated significantly in the past and will likely continue to do so in the future as a result of:

- general changes in economic or geopolitical conditions, including changes in legislation or regulatory environments in which we operate;

- competitive conditions in our industry, which may impact the prices charged and terms and conditions imposed by our suppliers and/or competitors and the prices we charge our customers, which in turn may negatively impact our revenues and/or gross margins;

- seasonal variations in the demand for our products and services, which historically have included lower demand in Europe during the summer months, worldwide pre-holiday stocking in the retail channel during the September-to-December period and the seasonal increase in demand for our North American fee-based logistics services in the fourth quarter, which affects our operating expenses and gross margins;

- changes in product mix, including entry or expansion into new markets, as well as the exit or retraction of certain business;

- the impact of and possible disruption caused by integration and reorganization of our businesses and efforts to improve our IT capabilities, as well as the related expenses and/or charges;

- currency fluctuations in countries in which we operate;

- variations in our levels of excess inventory and doubtful accounts, and changes in the terms of vendor-sponsored programs such as price protection and return rights;

- changes in the level of our operating expenses;

- the impact of acquisitions and divestitures;

- variations in the mix of profits between multiple tax jurisdictions, including losses in certain tax jurisdictions in which we are not able to record a tax benefit, as well as changes in assessments of uncertain tax positions or changes in the valuation allowances on our deferred tax assets, which could affect our provision for taxes and effective tax rate;

- the occurrence of unexpected events or the resolution of existing uncertainties, including, but not limited to, litigation or regulatory matters;

- the loss or consolidation of one or more of our major suppliers or customers;

- product supply constraints; and

- interest rate fluctuations and/or credit market volatility, which may increase our borrowing costs and may influence the willingness or ability of customers and end-users to purchase products and services.

These historical variations in our business may not be indicative of future trends in the near term. Our narrow operating margins may magnify the impact of the foregoing factors on our operating results. We believe that you should not rely on period-to-period comparisons of our operating results as an indication of future performance. In addition, the results of any quarterly period are not indicative of results to be expected for a full fiscal year.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate headquarters is located in Santa Ana, California. We support our global operations through an extensive sales and administrative office and distribution network throughout North America, Europe, Asia-Pacific and Latin America. We operate 119 distribution centers worldwide (greater than 5,000 square feet in size).

We lease substantially all our facilities on varying terms. We do not anticipate any material difficulties with the renewal of any of our leases when they expire or in securing replacement facilities on commercially reasonable terms. We also own several facilities, the most significant of which are two of our distribution centers in Plainfield, Indiana and part of our office/distribution facilities in Straubing, Germany.

Table of Contents

ITEM 3. LEGAL PROCEEDINGS

Our Brazilian subsidiary has received a number of tax assessments including: (1) a 2005 Federal import tax assessment claiming certain commercial taxes totaling Brazilian Reais 12,714 ($6,232 at December 29, 2012 exchange rates) were due on the import of software acquired from international vendors for the period January through September of 2002; (2) a 2007 Sao Paulo Municipal tax assessment claiming Brazilian Reais 29,111 ($14,270 at December 29, 2012 exchange rates) of service taxes were due on the resale of acquired software covering years 2002 through 2006, plus Brazilian Reais 25,972 ($12,731 at December 29, 2012 exchange rates) of associated penalties; and (3) a 2011 Federal income tax assessment, a portion of which claims statutory penalties totaling Brazilian Reais 15,900 ($7,794 at December 29, 2012 exchange rates) for delays in providing certain electronic files during the audit of tax years 2008 and 2009, which was conducted through the course of 2011. After working with our advisor, we believe the matters raised in the various assessments, other than the three assessments noted above, represent a remote risk of loss.

In addition to the amounts assessed, it is possible that we could also be assessed up to Brazilian Reais 27,253 ($13,359 at December 29, 2012 exchange rates) for penalties and interest on the 2005 assessment and up to Brazilian Reais 120,394 ($59,017 at December 29, 2012 exchange rates) for interest and inflationary adjustments on the 2007 assessment. After working with our advisors on these matters, we believe we have good defenses against each matter and do not believe it is probable that we will suffer a material loss for amounts in the 2007 and the 2011 assessments or any other unassessed amounts noted above. While we will continue to vigorously pursue administrative and, if applicable, judicial action in defending against the 2005 Federal import tax assessment, we continue to maintain a reserve for the full amount assessed at December 29, 2012.

In March 2008, we and one of our subsidiaries were named as defendants in a lawsuit arising out of the 2005 bankruptcy of Refco, Inc., and its subsidiaries and affiliates (collectively, Refco). The liquidators of numerous Cayman Island-based hedge funds filed suit (the Krys action) against Grant Thornton LLP, Mayer Brown Rowe & Maw, LLP, Phillipp Bennet, and numerous other individuals and entities. The Krys action alleges that we and our subsidiary aided and abetted the fraud and breach of fiduciary duty of Refco insiders and others by participating in loan transactions between the subsidiary and Refco in early 2000 and early 2001, causing damage to the hedge funds in an unspecified amount. The action is pending in the U.S. District Court for the Southern District of New York. On July 31, 2012, the trial court entered judgment in our favor, dismissing plaintiffs claims against us and our subsidiary with prejudice. Plaintiffs have appealed that judgment, but we do not expect the final disposition of the Krys matter to have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock. Our Common Stock is traded on the New York Stock Exchange under the symbol IM. The following table sets forth the high and low price per share, based on closing price, of our Common Stock for the periods indicated.

		HIGH	LOW
Fiscal Year 2012	First Quarter	$ 19.72	$ 18.09
	Second Quarter	19.53	16.86
	Third Quarter	17.55	14.46
	Fourth Quarter	17.37	14.83
Fiscal Year 2011	First Quarter	$ 21.03	$ 18.92
	Second Quarter	21.50	17.00
	Third Quarter	18.55	15.78
	Fourth Quarter	19.10	15.75

As of December 29, 2012 there were 493 holders of record of our Common Stock. Because many of such shares are held by brokers and other institutions, on behalf of shareowners, we are unable to estimate the total number of shareowners represented by these record holders.

Dividend Policy. We have neither declared nor paid any dividends on our Common Stock in the preceding two fiscal years. We currently intend to retain future earnings to fund ongoing operations and finance the growth and development of our business. Any future decision to declare or pay dividends will be at the discretion of the Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, and such other factors as the Board of Directors deems relevant. In addition, certain of our debt facilities contain restrictions on the declaration and payment of dividends.

Equity Compensation Plan Information. The following table provides information, as of December 29, 2012, with respect to equity compensation plans under which equity securities of our company are authorized for issuance, aggregated as follows: (i) all compensation plans previously approved by our shareholders and (ii) all compensation plans not previously approved by our shareholders.

Plan Category	(a) Number of securities (in thousands) to be issued upon exercise of outstanding options, warrants and rights(1)	(b) Weighted-average exercise price of outstanding options, warrants and rights(1)	(c) Number of securities (in thousands) remaining available for equity compensation plans (excluding securities reflected in column (a))(2)
Equity compensation plans approved by shareholders	5,645	$ 17.36	9,335
Equity compensation plans not approved by shareholders	None	None	None
TOTAL	5,645	$ 17.36	9,335

(1) Does not reflect any unvested award of time and performance restricted stock units/award of 5,364 at 100% target and an additional 1,621 shares at maximum achievement.

(2) Balance reflects shares available to issue, taking into account granted options, time vested restricted stock units/awards and performance vested restricted stock units assuming maximum achievement.

25

Table of Contents

Share Repurchase Program. In October 2010, our Board of Directors authorized a new three-year, $400,000 share repurchase program, of which $124,095 is remaining for repurchase at December 29, 2012. Under the program, we may repurchase shares in the open market and through privately negotiated transactions. Our repurchases are funded with available borrowing capacity and cash. The timing and amount of specific repurchase transactions will depend upon market conditions, corporate considerations and applicable legal and regulatory requirements. There was no share repurchase activity during the fourth quarter of 2012.

ITEM 6. SELECTED FINANCIAL DATA

SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents our selected consolidated financial data. The results of operations of our acquisitions have been consolidated with our results of operations beginning on their acquisition dates. The information set forth below should be read in conjunction with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and the historical consolidated financial statements and notes thereto, included elsewhere in this Annual Report on Form 10-K. Over the last five years, we have made a number of acquisitions, including Brightpoint, Inc., or BrightPoint, in October 2012. The results of the acquired entities have been included in our consolidated financial statements since their respective dates of acquisition.

Our fiscal year is a 52-week or 53-week period ending on the Saturday nearest to December 31. References below to 2012, 2011, 2010, 2009, and 2008 represent the fiscal years ended December 29, 2012 (52-weeks), December 31, 2011 (52-weeks), January 1, 2011 (52-weeks), January 2, 2010 (52-weeks) and January 3, 2009 (53-weeks), respectively.

	2012	2011	2010	2009	2008
			($ in 000s, except per share data)		
Selected Operating Information					
Net sales	$ 37,827,299	$ 36,328,701	$ 34,588,984	$ 29,515,446	$ 34,362,152
Gross profit(1)	2,035,389	1,908,282	1,892,291	1,670,209	1,940,091
Income (loss) from operations(2)	462,352	458,646	484,433	295,940	(332,169)
Income (loss) before income taxes	396,184	387,871	438,061	269,248	(382,138)
Net income (loss)(3)	305,909	244,240	318,060	202,138	(394,921)
Basic earnings (loss) per share	2.03	1.57	1.98	1.24	(2.37)
Diluted earnings (loss) per share	1.99	1.53	1.94	1.22	(2.37)
Selected Balance Sheet Information					
Cash and cash equivalents	$ 595,147	$ 891,403	$ 1,155,551	$ 910,936	$ 763,495
Total assets	11,480,448	9,146,516	9,084,032	8,179,350	7,083,473
Total debt	1,054,543	392,428	636,401	379,495	478,388
Stockholders equity	3,611,253	3,272,777	3,241,182	3,011,813	2,655,845

(1) Includes reduction in cost of sales of $9,112, $9,758 and $8,224 in 2010, 2009 and 2008, respectively, for the release of portions of the commercial taxes reserve recorded in 2007 in Brazil as the statute of limitations for such assessment had expired.

(2) Includes items from footnote (1) above as well as: (i) net reorganization costs of $9,676, $5,131, $1,137, $34,083 and $17,029 in 2012, 2011, 2010, 2009 and 2008, respectively; (ii) expense-reduction program costs of $16,365 in 2012, primarily related to professional, consulting and integration costs associated with our acquisition of BrightPoint and asset impairments associated with the closure of our in-country Argentina operations, charged to selling, general and administrative, or SG&A, expenses; and (iii) charges for the impairment of goodwill of $2,490 and $742,653 in 2009 and 2008, respectively.

(3) Includes the after-tax impact of items noted in footnotes (1) and (2) above and a net discrete tax benefit of $34,890 in 2012 primarily related to the release of a valuation allowance on foreign tax credits, write-off of

Table of Contents

historical tax basis of the investment we have maintained in our Latin American subsidiary holding companies, which was realized in the current year; partially offset by a non-cash income tax charge for a valuation allowance recorded against our deferred tax assets in Australia; and a non-cash income tax charge of $24,810 in 2011 for a valuation allowance recorded against our deferred tax assets in Brazil.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless otherwise stated, all currency amounts, other than per share information, contained in this Management s Discussion and Analysis of Financial Condition and Results of Operations, are stated in thousands.

Overview of Our Business

Sales

We are the largest wholesale technology distributor and a global leader in IT supply-chain, mobile device lifecycle services and logistics solutions worldwide based on revenues. We offer a broad range of IT products and supply chain solutions and help generate demand and create efficiencies for our customers and suppliers around the world. Our acquisition of BrightPoint in October 2012 expanded our product and service offerings to mobile device lifecycle services and logistics solutions worldwide. Our results of operations have been, and are expected to continue to be, directly affected by the conditions in the economy in general. In this regard, our consolidated net sales declined 14.1% in 2009, primarily as a result of the downturn in the macroeconomic environment that started in 2008. As the recession became more pronounced globally in 2009, we began to strategically leverage our gross margins and strong balance sheet to drive incremental sales in the second half of 2009, while the overall IT demand environment started showing modest signs of improvement near the end of that year. In 2010, the overall global economy continued to improve and businesses began to re-invest in technology despite pockets of financial weakness continuing in certain economies. These economic drivers, coupled with our continued efforts to enhance our customer and vendor positions in the IT market, drove an increase in our consolidated net sales of 17.2% in 2010. In 2011, we experienced a more moderate increase of 5.0% which reflected a more stable demand level for technology products and services across a number of the markets in which we operate, with greater strength coming from North and Latin America, offset in part by softer demand, particularly in consumer markets in Europe and parts of Asia-Pacific, and business disruptions in Australia due to our ERP system deployment in the first quarter of 2011 and the loss of market share that followed in that business. The demand level for technology products remained generally stable but not robust in 2012 with continued strength coming from North and Latin America, while the Asia-Pacific region experienced strong growth in two of our largest operations, China and India, offset in part by the continued challenges in Australia. Our sales and results of operations have also been impacted by our acquisitions of BrightPoint, Aptec Holdings Ltd., or Aptec, and Promark Technology Inc., or Promark, which together provided approximately three percentage points of our consolidated sales growth in 2012. These factors, offset in part by the continued soft economic conditions in most parts of Europe, increased our consolidated net sales by 4.1% in 2012.

We are in the process of migrating our operations from our legacy proprietary system that was developed in the late-1980s to SAP in a phased, country-by-country approach over the next several years. We have deployed SAP in several operations globally beginning in 2009. In February 2011, we also deployed the new system in Australia, one of our largest operations. This deployment was somewhat unique in that Australia had operated on a different legacy enterprise system than most of our other operations and had recently implemented Ingram Micro s warehouse management system, designed for our largest, most sophisticated distribution centers. This deployment revealed connectivity issues with our warehouse management system and certain web-based tools, resulting in order delays that diminished sales and margins. Although these system connectivity issues have been resolved, the customer experience with our new system was also not as robust as that which we had provided with our legacy systems thereby also impacting sales. In 2012, we have addressed the customer-service and order management functionality of the new system to better meet our customers needs, which we expect to yield improvement in customer service levels in 2013. The pace of recovery in Australia during 2012 yielded subdued revenues and profitability, as we addressed these additional functionality points and as we adopted more aggressive marketing and pricing strategies to regain lost market share.

Gross Margin

The IT and mobility distribution industry in which we operate is characterized by narrow gross profit as a percentage of net sales, or gross margin, and narrow income from operations as a percentage of net sales, or operating margin. Historically, our margins have been impacted by pressures from price competition and declining average selling prices, as well as changes in vendor terms and conditions, including, but not limited to, variations in vendor rebates and incentives, our ability to return inventory to vendors, and time periods qualifying for price protection. We expect competitive pricing pressures and restrictive vendor terms and conditions to continue in the foreseeable future. In addition, our margins have been and may continue to be impacted by our inventory levels which are based on projections of future demand, product availability, product acceptance and marketability, and market conditions. Having available inventory during periods of product shortages enables us to better meet customer demands and may provide potential for favorable pricing conditions; however, a sudden decline in demand and/or rapid technological changes in products could cause us to have a charge for excess and/or obsolete inventory. We continue to refine our pricing strategies, inventory management processes and vendor program processes to respond to market conditions. In addition, we continuously monitor and work to change, as appropriate, certain terms, conditions and credit offered to our customers to reflect those being imposed by our vendors, recover costs and/or facilitate sales opportunities. We have also strived to improve our profitability through diversification of product offerings, including our presence in specialty product and service categories, such as AIDC/POS, enterprise computing, cloud computing, and consumer electronics. Our acquisition of BrightPoint significantly enhanced our fee-for-service logistics offerings with mobile device lifecycle services and solutions which we expect will improve margins in future periods.

Selling, General and Administrative Expenses or SG&A Expenses

Another key area for our overall profitability management is the monitoring and control of our level of SG&A expenses. As the various factors discussed above have impacted our levels of sales and gross margins over the past several years, we have instituted a number of cost reduction and profit enhancement programs and as well as other reorganization actions across each of our regions to respond to the downturn in the economy and to further enhance productivity and profitability. As the economic downturn began in 2008, and impacted our levels of sales as discussed previously herein, our SG&A expenses increased to 4.36% and 4.47% of consolidated net sales in 2008 and 2009, respectively, from 4.18% or less in the years prior. To counter this, we implemented in 2008 and 2009, a number of additional expense-reduction programs with the most significant impacts in North America and Europe. These actions included the rationalization and re-engineering of certain roles and processes, resulting in the reduction of headcount and consolidation of certain facilities. These efforts to reduce costs, as well as continued cost control measures since the completion of these actions, allowed us to leverage our higher volume of net sales in 2010 and 2011, resulting in the decline of SG&A expenses as a percentage of consolidated net sales to 4.02% and 3.95%, respectively, our lowest levels for this metric in a decade. In 2012, our SG&A expenses as a percentage of sales increased to 4.08% and have primarily been impacted by our acquisitions of BrightPoint and Aptec, as well as our smaller strategic acquisitions to increase our presence in specialty product offerings, such as AIDC/POS and enterprise computing. While these acquisitions increased our revenues and market shares, they also represent opportunities to streamline and realize operational synergies. However, as we grow our higher-margin product offerings and fee-for-service mobility device lifecycle solutions and traditional logistics offerings, we expect our SG&A expenses will increase as a percent of consolidated net sales.

Table of Contents

Amortization of Intangible Assets

Our overall profitability is also impacted by amortization, as well as impairment losses, on our intangible assets. Our amortization of intangible assets was $15,877, $17,270 and $16,743 in 2008, 2009 and 2010, respectively, or relatively flat at 0.05% of consolidated net sales from 2008 through 2010. Certain intangible assets related to our large acquisition in 2004 were fully amortized by 2010 reducing our expense to $12,550 or 0.03% of consolidated net sales in 2011. In 2012, amortization increased to $20,711 or 0.05% of consolidated net sales primarily due to our acquisition of BrightPoint. We expect our amortization expense in 2013 to be approximately $47,000 related to our existing intangible assets (see Note 2 to our consolidated financial statements).

Acquisitions

We have complemented our internal growth initiatives with strategic business acquisitions over the past five years and will continue to evaluate potential acquisitions consistent with our growth strategy. In October 2012, we have expanded our product and service offerings to mobile device lifecycle services and logistics solutions globally through the acquisition of BrightPoint. We have expanded our value-added distribution of AIDC/POS solutions through acquisitions of the distribution businesses of Eurequat SAS, Intertrade A.F. AG, and Paradigm Distribution Ltd. in Europe, and Vantex Technology Distribution Limited, or Vantex, and the Cantechs Group in Asia-Pacific. We have expanded our presence in the mid-range enterprise market through the acquisitions of Promark in North America, Aretê Sistemas S.A., or Aretê, Computacenter Distribution, or CCD, Albora Soluciones SL, or Albora, and interAct BVBA, or interAct, in Europe and Aptec, Value Added Distributors Limited, or VAD, and Asiasoft Hong Kong Limited, or Asiasoft, in Asia-Pacific.

Working Capital and Debt

The IT products and services distribution business is working capital intensive. Our business requires significant levels of working capital, primarily trade accounts receivable and inventory, which is partially financed by vendor trade accounts payable. As a general rule, our net investment in working capital increases when sales volumes increase. Conversely, this level of investment tends to decline in times of declining sales. For our working capital needs, we rely heavily on trade credit from vendors, and also on trade accounts receivable financing programs and proceeds from our senior unsecured notes and debt facilities. Due to our narrow operating margins, we maintain a strong focus on management of working capital and cash provided by operations, as well as our debt and cash levels. However, our debt and/or cash levels may fluctuate significantly on a day-to-day basis due to timing of customer receipts and periodic payments to vendors. A higher concentration of payments received from customers toward the end of each month, combined with the timing of payments we make to our vendors, typically yields lower debt balances and higher cash balances at our period-ends than is the case throughout the quarter or year. Our future debt requirements may increase and/or our cash levels may decrease to support growth in our overall level of business, changes in our required working capital profile, or to fund acquisitions, share repurchases or other investments in the business.

Our Critical Accounting Policies and Estimates

The discussions and analyses of our consolidated financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of significant contingent assets and liabilities at the financial statement date, and reported amounts of revenue and expenses during the reporting period. On an ongoing basis, we review and evaluate our estimates and assumptions, including, but not limited to, those that relate to trade accounts receivable; vendor programs; inventory; goodwill, intangible and other long-lived assets; income taxes; and contingencies and litigation. Our estimates are based on our historical experience and a variety of other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making our judgments about the carrying values of assets and liabilities that

Table of Contents

are not readily available from other sources. Although we believe our estimates, judgments and assumptions are appropriate and reasonable based upon available information, these assessments are subject to a wide range of sensitivities. Therefore, actual results could differ from these estimates.

We believe the following critical accounting policies are affected by our judgments, estimates and/or assumptions used in the preparation of our consolidated financial statements.

Trade Accounts Receivable We provide allowances for doubtful accounts on our trade accounts receivable for estimated losses resulting from the inability of our customers to make required payments. Changes in the financial condition of our customers or other unanticipated events, which may affect their ability to make payments, could result in charges for additional allowances exceeding our expectations. Our estimates are influenced by the following considerations: the large number of customers and their dispersion across wide geographic areas; a continuing credit evaluation of our customers financial condition; aging of trade accounts receivable, individually and in the aggregate; credit insurance coverage; the value and adequacy of collateral received from our customers in certain circumstances; our historical loss experience; and changes in credit risk and capital availability of our customers resulting from economic conditions. From time to time, we have had one customer account for 10% or more of our consolidated trade accounts receivable, although no single customer has accounted for 10% or more of our consolidated net sales.

Vendor Programs We receive funds from vendors for price protection, product return privileges, product rebates, marketing/promotion, infrastructure reimbursement and meet-competition programs, which are recorded as adjustments to product costs, revenue, or SG&A expenses according to the nature of the program. Some of these programs may extend over more than one quarterly reporting period. We accrue rebates or other vendor incentives as earned based on sales of qualifying products or as services are provided in accordance with the terms of the related program. Actual rebates may vary based on volume or other sales achievement levels, which could result in an increase or reduction in the estimated amounts previously accrued. We also provide reserves for receivables on vendor programs for estimated losses resulting from vendors inability to pay or rejections of claims by vendors.

Inventory Our inventory levels are based on our projections of future demand and market conditions. Any sudden decline in demand and/or rapid product improvements and technological changes could cause us to have excess and/or obsolete inventory. On an ongoing basis, we review for estimated excess or obsolete inventory and write down our inventory to its estimated net realizable value based upon our forecasts of future demand and market conditions. If actual market conditions are less favorable than our forecasts, additional inventory write-downs may be required. Our estimates are influenced by a number of considerations, including: protection from loss in value of inventory under our vendor agreements; our rights to return inventory to vendors in accordance with contractual stipulations; aging of inventory; changes in demand due to the economic environment; rapid product improvements and technological changes and historical loss experience.

Goodwill, Intangible Assets and Other Long-Lived Assets We evaluate goodwill and other intangible assets in accordance with the provisions issued by the Financial Accounting Standards Board, or the FASB. We assess potential impairment of our goodwill, other identifiable intangible assets and other long-lived assets when there is evidence that recent events or changes in circumstances, such as significant changes in the manner of use of the asset, negative industry or economic trends, and significant underperformance relative to historical or projected future operating results, have made recovery of an asset s carrying value unlikely. No impairment of our goodwill or identifiable intangible assets was indicated in 2012, 2011 or 2010.

Income Taxes As part of the process of preparing our consolidated financial statements, we estimate our income taxes in each of the taxing jurisdictions in which we operate. This process involves estimating our actual current tax expense together with assessing the future tax impact of any differences resulting from the different treatment of certain items, such as the timing for recognizing revenues and expenses for tax versus financial reporting purposes. These differences may result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We are required to assess the likelihood that our deferred tax assets, which include net operating loss carryforwards, tax credits and temporary differences that are expected to be deductible in future years, will be recoverable from future taxable income. In making that assessment, we consider the nature of the deferred tax assets and related statutory limits on utilization, recent operating results, future market growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies. If, based upon available evidence, recovery of the full amount of the deferred tax assets is not likely, we provide a valuation allowance on any amount not likely to be realized. In that regard, we recorded a charge of $41,845 in the fourth quarter of 2012 to provide a valuation allowance on our deferred tax assets in Australia, primarily as a result of the continued losses incurred in that country. We also considered new events that occurred during the fourth quarter, in particular the acquisition of BrightPoint and the impact the combination will have on our ability to utilize our foreign tax credits in the U.S., and concluded that it is now more likely than not that an additional $29,978 of foreign tax credits are realizable, resulting in a partial release of the valuation allowance on those deferred tax assets.

Our effective tax rate includes the impact of not providing taxes on undistributed foreign earnings considered indefinitely reinvested. Material changes in our estimates of cash, working capital and long-term investment requirements in the various jurisdictions in which we do business could impact our effective tax rate if we no longer consider our foreign earnings to be indefinitely reinvested.

The provision for tax liabilities and recognition of tax benefits involves evaluations and judgments of uncertainties in the interpretation of complex tax regulations by various taxing authorities. In situations involving uncertain tax positions related to income tax matters, we do not recognize benefits unless their sustainability is deemed more likely than not. As additional information becomes available, or these uncertainties are resolved with the taxing authorities, revisions to these liabilities or benefits may be required, resulting in additional provision for or benefit from income taxes reflected in our consolidated statement of income.

Contingencies and Litigation There are various claims, lawsuits and pending actions against us, including those noted in Part I, Item 3. Legal Proceedings. If a loss arising from these actions is probable and can be reasonably estimated, we record the amount of the estimated loss. If the loss is estimated using a range within which no point is more probable than another, the minimum estimated liability is recorded. If a loss is reasonably possible, but not probable, we disclose the nature of the significant contingency and, if quantifiable, the possible loss or range of loss that could result from the resolution of the matter. As additional information becomes available, we reassess any potential liability related to these actions and may need to revise our estimates. Such revisions or ultimate resolution of these matters could materially impact our consolidated results of operations, cash flows or financial position (see Note 10 to our consolidated financial statements).

Results of Operations

We do not allocate stock-based compensation expense (see Note 12 to our consolidated financial statements) to our operating units; therefore, we are reporting this as a separate amount. The following tables set forth our net sales by geographic region and the percentage of total net sales represented thereby, as well as operating income and operating margin by geographic region for each of the fiscal years indicated. In 2012, we have added a reportable segment for mobility which reflects our acquisition of BrightPoint.

	2012		2011		2010	
Net sales by geographic region:						
North America	$ 15,880,103	42.0%	$ 15,250,560	42.0%	$ 14,549,103	42.1%
Europe	10,614,811	28.1	11,371,043	31.3	10,871,237	31.4
Asia-Pacific	8,347,170	22.1	7,920,649	21.8	7,570,403	21.9
Latin America	1,943,841	5.1	1,786,449	4.9	1,598,241	4.6
BrightPoint	1,041,374	2.7				
Total	$ 37,827,299	100.0%	$ 36,328,701	100.0%	$ 34,588,984	100.0%

	2012		2011		2010	
Operating income and operating margin by geographic region:						
North America	$ 283,689	1.79%	$ 281,155	1.84%	$ 230,458	1.58%
Europe	103,278	0.97	136,306	1.20	135,681	1.25
Asia-Pacific	53,613	0.64	46,508	0.59	113,003	1.49
Latin America	37,700	1.94	25,488	1.43	32,353	2.02
BrightPoint	11,290	1.08				
Stock-based compensation expense	(27,218)		(30,811)		(27,062)	
Total	$ 462,352	1.22%	$ 458,646	1.26%	$ 484,433	1.40%

Our income from operations in 2012 includes reorganization, expense-reduction program costs or acquisition related costs of $26,041, or 0.07% of consolidated net sales ($9,628, or 0.06% of net sales, in North America; $3,055, or 0.03% of net sales, in Europe; $4,451, or 0.05% of net sales, in Asia-Pacific; $2,355, or 0.12% of net sales, in Latin America; and $6,552, or 0.63% of net sales, for BrightPoint), as discussed in Note 3 to our consolidated financial statements.

Our income from operations in 2011 includes reorganization costs of $5,131, or 0.01% of consolidated net sales, ($749, or less than 0.01% of net sales, in North America; $1,453, or 0.01% of net sales, in Europe; $2,730, or 0.03% of net sales, in Asia-Pacific; and $199, or 0.01% of net sales, in Latin America) as discussed in Note 3 to our consolidated financial statements.

Our income from operations in 2010 includes the release of a portion of our commercial tax reserve in Brazil totaling $9,112, or 0.03% of consolidated net sales and 0.57% of Latin America net sales.

We sell products purchased from many vendors, but generated approximately 18%, 21% and 23% of our consolidated net sales in 2012, 2011 and 2010, respectively, from products purchased from Hewlett-Packard Company and approximately 10% of our consolidated net sales in 2012 from products purchased from Apple Inc. There were no other vendors and no customers that represented 10% or more of our consolidated net sales in each of the last three years.

The following table sets forth certain items from our consolidated statement of income as a percentage of net sales, for each of the fiscal years indicated.

	2012	2011	2010
Net sales	100.00%	100.00%	100.00%
Cost of sales	94.62	94.75	94.53
Gross profit	5.38	5.25	5.47
Operating expenses:			
Selling, general and administrative	4.08	3.95	4.02
Amortization of intangible assets	0.05	0.03	0.05
Reorganization costs	0.03	0.01	0.00
Income from operations	1.22	1.26	1.40
Other expense, net	0.17	0.19	0.13
Income before income taxes	1.05	1.07	1.27
Provision for income taxes	0.24	0.40	0.35
Net income	0.81%	0.67%	0.92%

Table of Contents

Results of Operations for the Years Ended December 29, 2012, December 31, 2011 and January 1, 2011

Our consolidated net sales increased by 4.1% and 5.0% in 2012 and 2011, respectively. Regionally, net sales from our North American operations increased in 2012 and 2011 by 4.1% and 4.8%, respectively, net sales from our Asia-Pacific operations increased by 5.4% and 4.6%, respectively, and net sales from our Latin American operations increased by 8.8% and 11.8%, respectively, while net sales from our European operations decreased by 6.7% in 2012 and increased 4.6% in 2011. Net sales from our BrightPoint operations acquired during the fourth quarter of 2012 was $1,041,374. Our acquisitions of BrightPoint, Aptec in Asia-Pacific and Promark in North America during the fourth quarter of 2012 contributed approximately 3.1% of the year-over-year consolidated sales growth, while Aptec and Promark contributed approximately 0.9% and less than 0.1% of the year-over-year Asia-Pacific and North America sales growth, respectively. In 2012, the translation impacts of weaker European, Asia-Pacific and Latin American currencies relative to the U.S. dollar had negative impacts of approximately six, two and six percentage points in the respective regions net sales with a combined negative effect of approximately three percentage points on our consolidated net sales. In 2012, the remaining increase in our consolidated and regional net sales in 2012 compared to 2011 primarily reflected a generally solid demand for technology products and services across a number of the markets in which we operate with greater strength coming from our North and Latin American regions. Our North American net sales was driven by solid growth in all U.S. business divisions, including double-digit increases in higher margin businesses of physical security, accessories and fee-for-service logistics, offset partially by a decline in our Canadian operation primarily due to soft economic conditions and the benefit of a key product launch in the prior year that did not recur this year. The increase in our Latin American net sales in 2012 compared to 2011 primarily reflected continued robust demand in the region, despite the negative impact of foreign exchange translation discussed above. The decrease in our European net sales in 2012 compared to 2011 was primarily attributable to the translation impacts of European currencies, as discussed above. Our European net sales were relatively flat in local currencies reflecting declines in our Southern European and Benelux countries, all of which continue to experience challenging economic conditions, offset by solid growth in Germany, the UK and France. The increase in our Asia-Pacific net sales in 2012 compared to 2011 was primarily attributable to the strong growth in two of our largest operations, China and India. We continue to experience challenges in Australia, which negatively affected the region s revenue growth by five percentage points, but did not have a significant impact on our consolidated revenue growth.

The solid increase in our consolidated and regional net sales in 2011 compared to 2010 primarily reflected translation impact of strengthening European, Asia-Pacific and Latin American currencies relative to the U.S. dollar which contributed approximately five, five and one percentage points of the increase in the respective region s net sales. The combined translation impacts of these foreign currencies contributed approximately three percentage points of the year-over-year increase in our consolidated net sales in 2011. The remaining increase in our consolidated and regional net sales in 2011 compared to 2010 primarily reflected a generally stable level of demand for technology products and services across a number of the markets in which we operate with greater strength coming from our North and Latin American regions. However, this was offset in part by soft demand, particularly in consumer markets in Europe and parts of Asia-Pacific, business disruptions in Australia due to the system deployment beginning in February 2011 and the slower than expected market-share recovery in that country since then, which negatively impacted our year-over-year Asia-Pacific region and consolidated net sales in 2011 by approximately nine and two percentage points, respectively. Our acquisitions in 2011 and 2010 did not have a material impact on our year-over-year regional and consolidated sales growth.

Our gross margin was 5.38% in 2012, 5.25% in 2011 and 5.47% in 2010. The gross margin in 2012 and 2011 included approximately two and eight basis points, respectively, from a favorable inventory position and pricing on hard disk drives due to product shortages caused by the 2011 flooding in Thailand. The gross margin in 2010 included the positive impact of $9,112, or three basis points of consolidated net sales, from partial releases of our commercial tax reserve in Brazil as the statute of limitations for an assessment had expired. The increase in gross margin in 2012 reflects the higher mix of mobility logistics services which was accretive to 2012 gross profit as a percentage of net sales by approximately 14 basis points primarily due to the acquisition of BrightPoint and improved performance in our higher margin specialty businesses and fee-for-service logistics business, largely offset by a greater mix of high volume, lower gross margin sales. Gross margin was also impacted by a highly competitive selling environment in many countries and a greater mix of sales into the e-tail and retail segments in international markets, which is generally lower margin business. The decline in gross margin in 2011 reflected the negative impact of approximately seven basis points primarily resulting from the disruption in our Australian operations, as well as competitive pricing dynamics driven in part by the weakness in several European and Asian markets, a greater mix of lower gross margin products, such as tablets, and higher sales in lower gross margin geographies due to more rapid growth in emerging markets such as China and India. These factors were partially offset by our favorable inventory position and pricing on hard disk drives as discussed above. We continuously evaluate and modify our pricing policies and certain terms, conditions and credit offered to our customers to reflect those being imposed by our vendors and general market conditions. We may experience fluctuations in our sales growth in the near term, or these modifications may negatively impact our gross margin. In addition, increased competition and any further retractions or softness in economies throughout the world may hinder our ability to maintain and/or improve gross margins from the levels realized in recent periods.

Total SG&A expenses were $1,542,650, $1,431,955 and $1,389,978 in 2012, 2011 and 2010, respectively. Total SG&A expenses as a percentage of net sales were 4.08%, 3.95% and 4.02% in 2012, 2011 and 2010, respectively. Total SG&A expenses increased $110,695, or 7.7%, and increased 13 basis points as a percentage of net sales in 2012 compared to 2011. Approximately $86,000 of the increase relates to our acquisitions during the fourth quarter of 2012. The increase also reflects direct variable costs associated with the growth in volume of our business as well as acquisition-related costs of $11,898, asset impairments of $1,923 associated with the closure of our in-country Argentina operations, costs of $2,500 associated with the exit of our former chief executive officer, and investments in strategic initiatives and system and process improvements incurred in the current year. These factors were generally offset by the translation impacts of foreign currencies, which yielded an approximate $34,000 reduction year-over-year, a decrease in stock-based compensation expense of $3,593 associated with our long-term incentive plans and our continued cost control management. Our SG&A expenses, as a percentage of net sales, declined seven basis points in 2011 compared to 2010, primarily due to leverage on the higher volume of net sales and cost control measures throughout our business in 2011. Total SG&A expenses increased $41,977 or 3.0% in 2011 compared to 2010. The single biggest driver of this increase was the translation impact of strengthening foreign currencies relative to the U.S. dollar, which contributed approximately $39,000 of the year-over-year increase. An increase in stock-based compensation expense of $3,749 associated with our long-term incentive plans and continued investments in strategic growth initiatives and system enhancements, as well as merit compensation increases for our associates, were more than offset by successful cost control measures throughout our business and reductions in bad debt expense due to better experience in the collections of aged accounts receivable.

Amortization of intangible assets was $20,711, $12,550 and $16,743 in 2012, 2011 and 2010, respectively. Amortization as a percentage of net sales were 0.05%, 0.03% and 0.05% in 2012, 2011 and 2010, respectively. The increase in 2012 was primarily due to our acquisition of BrightPoint. In 2010, certain intangible assets related to our large acquisition in 2004 were fully amortized reducing our expense in 2011.

In 2012, we recorded a net charge for reorganization costs of $9,676, or approximately 0.03% of consolidated net sales, which consisted of $9,044 primarily related to employee termination benefits for workforce reductions in our Australian and New Zealand operations in Asia-Pacific, Germany and other parts of our European operations, as well as some in our Latin America and BrightPoint operations; and $632 primarily related to a previously restructured facility in North America for which we modified estimates for higher than initially expected costs through the life of the remaining lease; partially offset by the net reversal of certain employee termination obligations from reorganization actions recorded in earlier years that were settled favorably. In 2011, we recorded a net charge for reorganization costs of $5,131, or approximately 0.01% of consolidated net sales, which consisted primarily of $6,215 of employee termination benefits for workforce reductions in our Australian operations in Asia-Pacific as well as in parts of North America, Europe and Latin America, partially offset by $1,084 for the net reversal of certain excess lease obligation liabilities from reorganization actions recorded in earlier years that were settled favorably. See Note 3 to our consolidated

Table of Contents

financial statements for further details. We may pursue other business process and/or organizational changes, which may result in additional charges related to consolidation of facilities, restructuring of business functions and workforce reductions in the future.

Our consolidated operating margins were 1.22%, 1.26% and 1.40% in 2012, 2011 and 2010, respectively. Regionally, operating margins from our North American operations were 1.79%, 1.84% and 1.58% in 2012, 2011 and 2010, respectively. Operating margins from our Europe operations were 0.97%, 1.20% and 1.25% in 2012, 2011 and 2010, respectively. Operating margins from our Asia-Pacific operations were 0.64%, 0.59% and 1.49% in 2012, 2011 and 2010, respectively. Operating margins from our Latin American operations were 1.94%, 1.43% and 2.02% in 2012, 2011 and 2010, respectively. Operating margin from BrightPoint was 1.08% in 2012. Our operating margins included the impacts of reserve reversals for commercial taxes, acquisition and integration charges, and reorganization costs as discussed previously. The overall decrease in our consolidated and Asia-Pacific operating margin, in 2012 and 2011 compared to 2010 largely reflects the impact of disruptions in our Australian business as discussed previously. The decrease in our European operating margin in 2012 compared to 2011 and 2010 was largely due to the continued softness in the economic environment in region, particularly in Southern Europe and the Benelux regions. Our 2011 European operating margin benefited by approximately 20 basis points from a favorable inventory position and pricing on hard disk drives due to product shortages caused by the 2011 flooding in Thailand. In North America, our operating margin in 2012 and 2011 improved compared to 2010 largely due to the economies of scale realized from the higher net sales level and greater mix of business from higher margin specialty business units. The year-over-year increase in our Latin American operating margin in 2012 primarily reflected continued sales growth in the region. In 2011, our Latin American operations experienced losses due to continued operational challenges in our Brazilian operations, which generated the overall decline in our operating margin from 2010.

Net other expense consisted primarily of interest income and expense, foreign currency exchange gains and losses, costs of discounting drafts received from customers, primarily in Europe, and other non-operating gains and losses. We incurred net other expense of $66,168, $70,775 and $46,372 in 2012, 2011 and 2010, respectively. The decrease in 2012 compared to 2011 was primarily attributable to the loss recognized in 2011 of $5,624 from the termination of our cash flow hedge and write-off of the remaining unamortized deferred financing costs related to the settlement of our senior unsecured term loan in September 2011, offset partially by higher interest expense as a result of the $300,000 in public debt issued in August 2012 and other increases in our other debt, which were primarily associated with our acquisition of BrightPoint, as well as higher net foreign-currency losses in 2012. The increase in 2011 compared to 2010 was primarily attributable to higher interest expense as a result of a full year of interest expense associated with our $300,000 in public debt issued in August 2010; a lower net cash position resulting from $225,905 in share repurchases; increased working capital required to support year-over-year sales growth; the loss of $5,624 from the termination of our cash flow hedge and write-off of the remaining unamortized deferred financing costs related to our senior unsecured term loan; and higher net losses on foreign currency exchange, the majority of which relate to the foreign-currency translation impact on Euro-based inventory purchases in our pan-European entity, which designates the U.S. dollar as its functional currency.

Our provision for income taxes in 2012, 2011 and 2010 was $90,275, $143,631 and $120,001, respectively. Our effective tax rate in 2012, 2011 and 2010 was 22.8%, 37.0% and 27.4%, respectively. The year-over-year decrease in the effective tax rate from 2011 to 2012 is largely driven by the net non-cash income tax benefit of $34,890 recorded in 2012, representing a 8.8% decrease in the effective tax rate for the year, which was primarily comprised of: a tax benefit of $35,613 related to the write-off of the historical tax basis of the investment we have maintained in one of our Latin American subsidiary holding companies; a tax benefit of $29,978 related to the partial release of a valuation allowance that had previously been recorded against foreign tax credit carryforwards maintained in the U.S.; a tax benefit of $4,857 related to the release of the valuation allowance previously recorded by our subsidiary in Spain; and a tax benefit of $2,277 driven largely by the realization of previously unrecognized tax benefits due to the expiry of the respective statutes of limitation in the jurisdictions in which the benefits were claimed; partially offset by a tax charge of $41,845 for a valuation allowance recorded against our deferred tax assets in Australia. The year-over-year increase in the effective tax rate from 2010 to 2011 primarily reflected the non-cash income tax charge of $24,810 recorded in 2011, representing a 6.4%

Table of Contents

increase in the effective tax rate for the year, driven by the establishment of a valuation allowance against all of our deferred tax assets in Brazil. Aside from the items discussed above, the changes in our effective tax rates in 2012, 2011 and 2010 were primarily attributable to a change in the mix of profit among different tax jurisdictions and losses in certain tax jurisdictions in which we are not able to record a tax benefit due to uncertainty of realizability.

Quarterly Data; Seasonality

Our quarterly operating results have fluctuated significantly in the past and will likely continue to do so in the future as a result of various factors as more fully described in Part I, Item 1A. Risk Factors.

The following table sets forth certain unaudited quarterly historical financial data for each of the eight quarters in the two years ended December 29, 2012. This unaudited quarterly information has been prepared on the same basis as the annual information presented elsewhere herein and, in our opinion, includes all adjustments necessary for a fair statement of the selected quarterly information. This information should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K. The operating results for any quarter shown are not necessarily indicative of results for any future period.

	Net Sales	Gross Profit	Income From Operations	Income Before Income Taxes	Net Income	Diluted Earnings Per Share
2012						
Quarter Ended:(1)(2)						
March 31, 2012	$ 8,635,381	$ 467,557	$ 104,051	$ 88,590	$ 89,973	$ 0.58
June 30, 2012	8,777,895	452,730	97,785	83,458	61,274	0.40
September 29, 2012	9,034,141	453,892	92,649	75,026	53,311	0.35
December 29, 2012	11,379,882	661,210	167,867	149,110	101,351	0.66
2011						
Quarter Ended:(2)(3)						
April 2, 2011	$ 8,723,712	$ 454,072	$ 100,054	$ 81,405	$ 56,310	$ 0.34
July 2, 2011	8,749,025	459,232	97,148	83,822	59,731	0.37
October 1, 2011	8,903,020	440,720	85,379	67,094	23,326	0.15
December 31, 2011	9,952,944	554,258	176,065	155,550	104,873	0.68

(1) Includes the net pre-tax impact of reorganization costs (credits) as follows: first quarter, $557; second quarter, $839; third quarter, $5,268; and fourth quarter, $3,012. Includes the pre-tax impact of expense-reduction program costs as follows: first quarter, $2,500 for costs associated with the transition of our former chief executive officer; second quarter, $6,011 for acquisition-related charges and costs related to the closure of our in-country Argentina operations; third quarter, $2,270 for acquisition-related charges; and fourth quarter, $5,584 for acquisition-related charges and integration costs. Includes non-cash income tax charges as follows: first quarter, $28,532 of a net tax benefit primarily related to the write-off of the historical tax basis of the investment we have maintained in one of our Latin American subsidiary holding companies, realized during the quarter; second quarter, $4,378 of a net tax benefit as a result of the lapse of the statute of limitations and its impact on a tax-related reserve in Australia and positive adjustments resulting from the resolution of portions of the Internal Revenue Service audit in the U.S.; third quarter, $1,658 of a net tax benefit for various tax-related adjustments; and fourth quarter, $4,734 of a net tax charge related to a valuation allowance recorded against our deferred tax assets in Australia; offset by the release of valuation allowance on foreign tax credits, as well as the release of a valuation allowance in Spain.

(2) Diluted earnings per share is calculated independently each quarter and for the full year based upon their respective weighted average shares outstanding. Therefore, the sum of the quarterly earnings per share may not equal the annual earnings per share reported.

(3) Includes the net pre-tax impact of reorganization costs (credits) as follows: first quarter, ($269); third quarter, $1,156; and fourth quarter, $4,244. The third quarter includes a pre-tax loss of $5,624 from the termination of a cash flow hedge and the write-off of remaining unamortized costs related to our senior unsecured loan and a non-cash charge to record a valuation allowance of $24,810 against all of the deferred tax assets of our operating subsidiary in Brazil.

Liquidity and Capital Resources

Cash Flows

We finance our working capital needs and investments in the business largely through net income before noncash items, available cash, trade and supplier credit, and various financing facilities. As a distributor, our business requires significant investment in working capital, particularly trade accounts receivable and inventory, which is partially financed by vendor trade accounts payable. As a general rule, when sales volumes are increasing, our net investment in working capital dollars typically increases, which generally results in decreased cash flow generated from operating activities. Conversely, when sales volume decreases, our net investment in working capital decreases, which generally results in increases in cash flows generated from operating activities. The following is a detailed discussion of our cash flows for 2012, 2011 and 2010. The lower cash and cash equivalents level at December 29, 2012 compared to December 31, 2011, primarily reflects: our acquisitions of BrightPoint, Aptec and Promark; our investments in property and equipment; our repurchases of Class A Common Stock; and our investment in the business in the form of net working capital to support our year-over-year sales growth. These factors are partially offset by: the ongoing generation of profits from the business excluding noncash items, the proceeds from the issuance of $300,000 senior unsecured notes due 2022, and from debt facilities as well as the proceeds from the exercise of stock options.

As of December 29, 2012 and December 31, 2011, we have book overdrafts of $415,207 and $511,172, respectively, representing checks issued on disbursement bank accounts but not yet paid by such banks. These amounts are classified as accounts payable in our consolidated balance sheet and are typically paid by the banks in a relatively short period of time. We have closely managed our overall working capital investment in 2012 and 2011 and our level of working capital days achieved as of December 29, 2012 and December 31, 2011 were both at the low end of our targeted range. Our investment in working capital may increase in future periods as we pursue profitable sales and market share growth and/or new business opportunities through targeted investment in working capital. This may include strategic pursuit of additional early pay discounts on trade accounts payable or purchase discounts on inventory, or we may allow extended payment terms or larger credit lines to certain customers. While each of these factors may yield net additional investment in working capital, as well as sales growth and/or improved profitability, we will, however, manage the risks associated with these strategies and the optimization of resulting returns on invested capital.

Operating activities provided net cash of $45,721, $295,859 and $179,322 in 2012, 2011 and 2010, respectively. As noted above, our cash flows from operations are significantly affected by net working capital which is in turn impacted by both fluctuations in volume of sales, as well as normal period-to-period variations in days of working capital outstanding due to the timing of collections from customers, movement of inventory and payments to vendors. The net cash provided by operating activities in each of the last three years principally reflects our net income before noncash charges, offset partially by an increase in our net working capital. The principal driver of the increase in working capital is the previously discussed higher sales volumes in 2012 and 2011, as our working capital days outstanding were relatively flat at the end of both 2012 and 2011, and the higher levels of sales to close out the fourth quarter of 2010 compared to the end of 2009 as we continued to experience positive trends in the macroeconomic environment in the fourth quarter of 2010 compared to the fourth quarter of 2009.

Investing activities used net cash of $989,029, $124,620 and $79,351 in 2012, 2011 and 2010, respectively. The net cash used by investing activities in 2012 was primarily due to cash payments related to the acquisitions of BrightPoint, Aptec, and Promark totaling $899,464. The remainder of cash used in investing activities was primarily related to capital expenditures. The capital expenditures for 2011 were higher than 2010 and 2012 which primarily reflected investments to enhance our underlying infrastructure and IT systems and our incremental investment in a new warehouse in Australia in 2011. We presently estimate that our capital expenditures will approximate $100,000 in 2013 for ongoing investments to support existing infrastructure and continued enhancements to our IT systems.

Financing activities provided net cash of $639,761 and $146,357 in 2012 and 2010, respectively, and used net cash of $414,042 in 2011. The net cash provided by financing activities in 2012 primarily reflects $296,256 in net proceeds from the issuance of our $300,000 senior unsecured notes due in 2022, $355,918 in net proceeds from our debt facilities and $31,335 in proceeds from the exercise of stock options, partially offset by the repurchase of Class A Common Stock for $50,000 under our stock repurchase programs. The increased proceeds from our financing activities were largely used to finance our acquisitions in 2012. The net cash used by financing activities in 2011 primarily reflects the repayment of the outstanding principal balance of our senior unsecured term loan and related interest rate swap agreement of $239,752 and the repurchase of $225,905 of Class A Common Stock, partially offset by $39,465 in proceeds from the exercise of stock options and $9,017 in net proceeds from our revolving credit facilities used to fund normal operations. The net cash provided by financing activities in 2010 primarily reflects $297,152 in net proceeds from the issuance of our $300,000 senior unsecured notes due in 2017 and $38,439 in proceeds from the exercise of stock options, partially offset by the repurchase of Class A Common Stock for $152,285 under our stock repurchase programs, and net repayments of $40,672 on our debt facilities and senior unsecured term loan.

Our levels of debt and cash and cash equivalents are highly influenced by our working capital needs. As such, our cash and cash equivalents balances and borrowings fluctuate from period-to-period and may also fluctuate significantly within a quarter. The fluctuation is the result of the concentration of payments received from customers toward the end of each month, as well as the timing of payments made to our vendors. Accordingly, our period-end debt and cash balances may not be reflective of our average levels or maximum debt and/or minimum cash levels during the periods presented or at any point in time.

Acquisitions

In 2012, we acquired all of the outstanding shares of BrightPoint and Promark and the assets and liabilities of Aptec. The acquisition of BrightPoint expanded our product and service offerings to mobile device lifecycle services and logistics solutions worldwide. The acquisition of Aptec extended our reach into the Middle East and Africa, with products and solutions covering data center, storage, security, networking and software categories, including technical services, while the acquisition of Promark further strengthened our position in higher value products and solutions and extended our reach within the public sector in the North America region. These entities were acquired for an aggregate price, including the assumption of debt, of $899,126.

In 2011, we acquired the assets and liabilities of Aretê in Spain, which further strengthened our capabilities in value-added distribution in our Europe region. This entity was acquired for an aggregate cash price of $2,106.

In 2010, we acquired all of the outstanding shares of interAct and Albora in our Europe region and the assets and liabilities of Asiasoft in our Asia-Pacific region. These acquisitions further strengthened our capabilities in virtualization, security and middleware solutions and enterprise computing. These entities were acquired for an aggregate cash price of $8,329.

For a full discussion of the above acquisitions, refer to Note 4 of our consolidated financial statements.

Capital Resources

We have a range of financing facilities which are diversified by type, maturity and geographic region with various financial institutions worldwide with a total capacity of approximately $3,531,275, of which $1,054,543 was outstanding at December 29, 2012. These facilities have staggered maturities through 2022. Our cash and cash equivalents totaled $595,147 and $891,403 at December 29, 2012 and December 31, 2011, respectively, of which $533,585 and $773,816, respectively, resided in operations outside of the U.S. Our ability to repatriate these funds to the U.S. in an economical manner may be limited. Our cash balances are deposited and/or invested with various financial institutions globally that we endeavor to monitor regularly for credit quality. However, we are exposed to risk of loss on funds deposited with the various financial institutions and money market mutual funds and we may experience significant disruptions in our liquidity needs if one or more of these financial institutions were to suffer bankruptcy or similar restructuring. As of December 29, 2012 and December 31, 2011, we had book overdrafts of $415,207 and $511,172, respectively, representing checks issued on disbursement bank accounts but not yet paid by such banks. These amounts are classified as accounts payable in our consolidated balance sheet and are typically paid by the banks in a relatively short period of time. We believe that our existing sources of liquidity provide sufficient resources to meet our capital requirements, including the potential need to post cash collateral for identified contingencies (see Note 10 to our consolidated financial statements and Part I, Item 3. Legal Proceedings), for at least the next twelve months. Nevertheless, depending on capital and credit market conditions, we may from time to time seek to increase or decrease our available capital resources through changes in our debt or other financing facilities. Finally, since the capital and credit markets can be volatile, we may be limited in our ability to replace in a timely manner maturing credit facilities and other indebtedness on terms acceptable to us, or at all, or to access committed capacities due to the inability of our finance partners to meet their commitments to us.

The following is a detailed discussion of our various financing facilities.

In August 2012, we issued through a public offering $300,000 of 5.00% senior unsecured notes due 2022, resulting in cash proceeds of approximately $296,256, net of discount and issuance costs of $1,794 and $1,950, respectively. Interest on the notes is payable semiannually in arrears on February 10 and August 10, commencing February 10, 2013. At December 29, 2012, our senior unsecured notes due 2022 have a carrying value of $298,275, net of unamortized discount of $1,725. We also have $300,000 of 5.25% senior unsecured notes due 2017. Interest on the notes is payable semiannually in arrears on March 1 and September 1 of each year. These notes may be redeemed by us in whole at any time or in part from time to time, at our option, at redemption prices that are designated in the terms and conditions of the respective notes.

We have a revolving trade accounts receivable-backed financing program in North America which provides for up to $675,000 in borrowing capacity. In November 2012, we entered into an agreement to increase the borrowing capacity of this program for up to $675,000 from the previous amount of $500,000, and to extend its maturity to November 2015. This financing program, subject to the financial institutions approval and availability of eligible receivables, may be increased to $900,000 in accordance with the extended terms of the program. The interest rate of this program is dependent on designated commercial paper rates (or, in certain circumstances, an alternate rate) plus a predetermined margin. We had borrowings of $345,000 and $0 at December 29, 2012 and December 31, 2011, respectively, under this North American financing program.

We have a revolving trade accounts receivable-backed financing program in Europe that matures in January 2014 and provides for a borrowing capacity of up to 100,000, or approximately $132,000 at December 29, 2012 exchange rates. The current program requires certain commitment fees, and borrowings under this program incur financing costs based on EURIBOR plus a predetermined margin. We had no borrowings at December 29, 2012 and December 31, 2011 under this European financing program.

We have two other revolving trade accounts receivable-backed financing programs in Europe, which mature in May 2013, and respectively provide for a maximum borrowing capacity of £60,000, or approximately $97,000, and 90,000, or approximately $119,000, at December 29, 2012 exchange rates. These programs require certain commitment fees, and borrowings under the programs incur financing costs, based on LIBOR and EURIBOR, respectively, plus a predetermined margin. We had no borrowings at December 29, 2012 and December 31, 2011 under these European financing programs.

Table of Contents

We have a multi-currency revolving trade accounts receivable-backed financing program in Asia-Pacific that matures in May 2014 and provides for a borrowing capacity of up to 160,000 Australian dollars, or approximately $166,000 at December 29, 2012 exchange rates. The interest rate for this financing program is dependent upon the currency in which the drawing is made and is related to the local short-term bank indicator rate for such currency plus a predetermined margin. We had no borrowings December 29, 2012 and December 31, 2011 under this Asia-Pacific financing program.

Our ability to access financing under all our trade accounts receivable-backed financing programs in North America, Europe and Asia-Pacific, as discussed above, is dependent upon the level of eligible trade accounts receivable as well as continued covenant compliance. We may lose access to all or part of our financing under these programs under certain circumstances, including: (a) a reduction in sales volumes leading to related lower levels of eligible trade accounts receivable; (b) failure to meet certain defined eligibility criteria for the trade accounts receivable, such as receivables remaining assignable and free of liens and dispute or set-off rights; (c) performance of our trade accounts receivable; and/or (d) loss of credit insurance coverage for our European and Asia-Pacific facilities. At December 29, 2012, our actual aggregate capacity under these programs was approximately $1,124,000 based on eligible trade accounts receivable available, of which $345,000 of such capacity was used. Even if we do not borrow, or choose not to borrow to the full available capacity of certain programs, most of our trade accounts receivable-backed financing programs prohibit us from assigning, transferring or pledging the underlying eligible receivables as collateral for other financing programs. At December 29, 2012, the amount of trade accounts receivable which would be restricted in this regard totaled approximately $1,529,000.

We have a $940,000 revolving senior unsecured credit facility from a syndicate of multinational banks, which matures in September 2016. In November 2012, we entered into a lender joinder agreement with an additional syndicate of multinational banks, which increased our revolving senior unsecured credit facility to $940,000 from the previous amount of $750,000. The interest rate on this facility is based on LIBOR, plus a predetermined margin that is based on our debt ratings and leverage ratio. We had no borrowings at December 29, 2012 and December 31, 2011 under this credit facility. This credit facility may also be used to issue letters of credit. At December 29, 2012 and December 31, 2011, letters of credit of $4,491 and $4,700, respectively, were issued to certain vendors and financial institutions to support purchases by our subsidiaries, payment of insurance premiums and flooring arrangements. Our available capacity under the agreement is reduced by the amount of any outstanding letters of credit.

We also have additional lines of credit, short-term overdraft facilities and other credit facilities with various financial institutions worldwide, which provide for borrowing capacity aggregating approximately $804,000 at December 29, 2012. Most of these arrangements are on an uncommitted basis and are reviewed periodically for renewal. At December 29, 2012 and December 31, 2011, respectively, we had $111,268 and $92,428 outstanding under these facilities. The weighted average interest rate on the outstanding borrowings under these facilities, which may fluctuate depending on geographic mix, was 7.9% and 8.1% per annum at December 29, 2012 and December 31, 2011, respectively. At December 29, 2012 and December 31, 2011, letters of credit totaling $30,829 and $31,405, respectively, were issued to various customs agencies and landlords to support our subsidiaries. The issuance of these letters of credit reduces our available capacity under these agreements by the same amount.

Covenant Compliance

We are required to comply with certain financial covenants under the terms of certain of our financing facilities, including restrictions on funded debt and liens and covenants related to tangible net worth, leverage and interest coverage ratios and trade accounts receivable portfolio performance including metrics related to receivables and payables. We are also restricted by other covenants, including, but not limited to, restrictions on the amount of additional indebtedness we can incur, dividends we can pay, and the amount of common stock that

Table of Contents

we can repurchase annually. At December 29, 2012, we were in compliance with all material covenants or other material requirements set forth in our trade accounts receivable-backed programs, senior unsecured notes due 2017 and 2022, revolving unsecured credit facility and other credit agreements, as discussed above.

Trade Accounts Receivable Factoring Programs

We have three uncommitted factoring programs, one in North America and two in Europe, under which trade accounts receivable of two large customers may be sold, without recourse, to financial institutions. The total amount of receivables factored under these programs, at any point in time, cannot exceed approximately $355,000 based on December 29, 2012 exchange rates. Available capacity under these programs is dependent on the amount of trade accounts receivable already sold to and held by the financial institutions, the level of our trade accounts receivable eligible to be sold into these programs and the financial institutions willingness to purchase such receivables. At December 29, 2012 and December 31, 2011, we had a total of $242,626 and $165,744, respectively, of trade accounts receivable sold to and held by the financial institutions under these programs.

Contractual Obligations and Off-Balance Sheet Arrangements

The following table summarizes our financing capacity and contractual obligations at December 29, 2012, and the effects that scheduled payments on such obligations are expected to have on our liquidity and cash flows in future periods. The amounts do not include interest. Except for interest related to our $300,000 of 5.00% and $300,000 of 5.25% senior unsecured notes, all other interest is incurred at variable rates (see Note 6 to our consolidated financial statements).

			Payments Due by Period			
Contractual Obligations	**Total Capacity**	**Balance Outstanding**	**Less Than 1 Year**	**1 3 Years**	**3 5 Years**	**After 5 Years**
Senior unsecured notes	$ 598,275	$ 598,275	$	$	$ 300,000	$ 298,275
North American revolving trade accounts receivable-backed financing program(1)	675,000	345,000		345,000		
Europe revolving trade accounts receivable-backed financing programs(1)	348,000					
Asia-Pacific revolving trade accounts receivable-backed financing program(1)	166,000					
Revolving senior unsecured credit facilities(2)	940,000					
Lines of credit and other(2)	804,000	111,268	111,268			
Subtotal	3,531,275	1,054,543	111,268	345,000	300,000	298,275
Minimum payments under:						
Operating leases(3)	448,099	448,099	96,633	141,021	96,968	113,477
Liability for unrecognized tax benefits(4)	2,580	2,580	2,580			
Total	$ 3,981,954	$ 1,505,222	$ 210,481	$ 486,021	$ 396,968	$ 411,752

(1) The aggregate capacity amount of $1,189,000 in the table above represents the maximum capacity available under these facilities. Our actual capacity is dependent upon the actual amount of eligible trade accounts receivable that may be used to support these facilities. As of December 29, 2012, our actual aggregate capacity under these programs based on eligible trade accounts receivable was approximately $1,124,000, of which $345,000 of such capacity was used.

(2) The capacity amount in the table above represents the maximum capacity available under these facilities. Certain of these facilities can also be used to support letters of credit. At December 29, 2012, letters of credit totaling $35,320 were issued to certain vendors to support payment of insurance claims or the performance by our subsidiaries with respect to certain lease agreements, vendor purchase obligations, or other operating liabilities. The issuance of these letters of credit also reduces our available capacity under the respective facilities by the same amount.

(3) We lease the majority of our facilities and certain vehicles and equipment under noncancelable operating leases. Amounts in this table represent future minimum payments on operating leases that have had original noncancelable lease terms in excess of 12 months.

(4) At December 29, 2012, our liability for unrecognized tax benefits, including interest and penalties, was $45,921, the current portion of which amounted to $2,580. We are not able to reasonably estimate the timing of payments of the long-term portion of our liability for unrecognized tax benefits, or the amount the long-term portion will increase or decrease over time; therefore, this portion of the liability was excluded in the contractual obligations table above (see Note 7 to our consolidated financial statements).

We have guarantees to third parties that provide financing to a limited number of our customers. Net sales under these arrangements accounted for less than one percent of our consolidated net sales for both 2012 and 2011. The guarantees require us to reimburse the third party for defaults by these customers up to an aggregate of $11,000. The fair value of these guarantees has been recognized as cost of sales to these customers and is included in other accrued liabilities.

Because our commitments under our employee benefit plans are not fixed amounts, they have not been included in the contractual obligations table.

Other Matters

See Part I, Item 3. Legal Proceedings for discussions of legal matters and contingencies.

New Accounting Standards

See Note 2 to our consolidated financial statements for the discussion of new accounting standards.

Market Risk

We are exposed to the impact of foreign currency fluctuations and interest rate changes due to our international sales and global funding. In the normal course of business, we employ established policies and procedures to manage our exposure to fluctuations in the value of foreign currencies using a variety of financial instruments. It is our policy to utilize financial instruments to reduce risks where internal netting cannot be effectively employed and not to enter into foreign currency or interest rate transactions for speculative purposes.

Our foreign currency risk management objective is to protect our earnings and cash flows resulting from sales, purchases and other transactions from the adverse impact of exchange rate movements. Foreign exchange risk is managed by using forward contracts to offset exchange risk associated with receivables and payables. We generally maintain hedge coverage between minimum and maximum percentages. Cross-currency interest rate swaps are used to hedge foreign currency denominated principal and interest payments related to intercompany and third-party loans. During 2012, hedged transactions were denominated in U.S. dollars, Canadian dollars, euros, British pounds, Danish krone, Hungarian forint, Israeli shekel, Norwegian kroner, Swedish krona, Swiss francs, Bulgarian lev, Polish zloty, South African rand, Australian dollars, Chinese yuan, Indian rupees, Malaysian ringgit, New Zealand dollars, Philippine pesos, Singaporean dollars, Sri Lankan rupees, Thai baht, Indonesian rupiah, Argentine pesos, Brazilian reais, Chilean pesos and Mexican pesos.

We are exposed to changes in interest rates on a portion of our long-term debt used to maintain liquidity and finance working capital, capital expenditures and business expansion. Our management objective is to finance our business at interest rates that are competitive in the marketplace while moderating our exposure to volatility in interest costs. To achieve our objectives, we may utilize both variable- and fixed-rate debt with a portion of our variable interest rate exposure from time to time mitigated through interest rate swaps.

Market Risk Management

Foreign exchange and interest rate risk and related derivatives used are monitored using a variety of techniques including a review of market value, sensitivity analysis and Value-at-Risk, or VaR. The VaR model determines the maximum potential loss in the fair value of market-sensitive financial instruments assuming a one-day holding period. The VaR model estimates were made assuming normal market conditions and a 95% confidence level. There are various modeling techniques that can be used in the VaR computation. Our computations are based on interrelationships between currencies and interest rates (a variance/co-variance technique). The model includes all of our forwards, interest rate swaps, fixed-rate debt and nonfunctional currency denominated cash and debt (i.e., our market-sensitive derivative and other financial instruments as defined by the SEC). The trade accounts receivable and accounts payable denominated in foreign currencies, which certain of these instruments are intended to hedge, were excluded from the model.

The VaR model is a risk analysis tool and does not purport to represent actual losses in fair value that will be incurred by us, nor does it consider the potential effect of favorable changes in market rates. It also does not represent the maximum possible loss that may occur. Actual future gains and losses will likely differ from those estimated because of changes or differences in market rates and interrelationships, hedging instruments and hedge percentages, timing and other factors.

The following table sets forth the estimated maximum potential one-day loss in fair value, calculated using the VaR model. We believe that the hypothetical loss in fair value of our derivatives would be offset by gains in the value of the underlying transactions being hedged.

	Interest Rate Sensitive Financial Instruments	Currency Sensitive Financial Instruments	Combined Portfolio
VaR as of December 29, 2012	$ 9,559	$ 57	$ 7,309
VaR as of December 31, 2011	9,272	105	7,168

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information concerning quantitative and qualitative disclosures about market risk is included under the captions Market Risk and Market Risk Management in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations in this Annual Report on Form 10-K.

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Table of Contents

INGRAM MICRO INC.

CONSOLIDATED BALANCE SHEET

(In 000s, except par value)

	Fiscal Year End 2012	Fiscal Year End 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 595,147	$ 891,403
Trade accounts receivable (less allowances of $78,034 and $60,236)	5,457,299	4,465,329
Inventory	3,591,543	2,942,164
Other current assets	522,390	319,506
Total current assets	10,166,379	8,618,402
Property and equipment, net	481,324	323,261
Goodwill	428,401	
Intangible assets, net	372,482	73,330
Other assets	31,862	131,523
Total assets	$ 11,480,448	$ 9,146,516
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,065,159	$ 4,893,437
Accrued expenses	585,404	524,010
Short-term debt and current maturities of long-term debt	111,268	92,428
Total current liabilities	6,761,831	5,509,875
Long-term debt, less current maturities	943,275	300,000
Other liabilities	164,089	63,864
Total liabilities	7,869,195	5,873,739
Commitments and contingencies (Note 10)		
Stockholders equity:		
Preferred Stock, $0.01 par value, 25,000 shares authorized; no shares issued and outstanding		
Class A Common Stock, $0.01 par value, 500,000 shares authorized; 188,349 and 185,127 shares issued and 150,320 and 149,484 shares outstanding in 2012 and 2011, respectively	1,883	1,851
Class B Common Stock, $0.01 par value, 135,000 shares authorized; no shares issued and outstanding		
Additional paid-in capital	1,361,650	1,316,596
Treasury stock, 38,029 and 35,643 shares in 2012 and 2011, respectively	(648,066)	(604,331)
Retained earnings	2,750,904	2,444,995
Accumulated other comprehensive income	144,882	113,666
Total stockholders equity	3,611,253	3,272,777
Total liabilities and stockholders equity	$ 11,480,448	$ 9,146,516

See accompanying notes to these consolidated financial statements.

The Spin-off of Certain Data Transmission Operations

On August 3, 2000, our former wholly owned subsidiary, Telefônica Empresas S.A., was created to provide Switched Package Network services, and, on January 30, 2001, the independent Brazilian corporation, Telefônica Data Brasil Holding S.A. (TDBH), was created through a shareholder-approved spin-off of the data transmission operations performed by Telefónica Empresas S.A. A merger of the company and TDBH became effective in July 2006. See "—The SCM Restructuring."

ANATEL Targets

Our business, services and tariffs have been regulated by ANATEL since June 16, 1997, in accordance with various decrees, decisions, plans and regulatory measures. We became the first operator to achieve ANATEL's service targets. As a result, ANATEL granted us a license to offer domestic and international long-distance services to our customers. Accordingly, on May 7, 2002, we began providing international long-distance services and, on July 29, 2002, we began providing interregional long-distance service. See "—B. Business Overview—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies—Network Expansion and Quality of Service" for information relating to ANATEL's network expansion and universal service targets.

On January 29, 2003, the board of directors of ANATEL granted us the authorization to provide SCM service nationwide. We may now offer voice and data services through various points of presence composed of networks and telecommunication circuits.

On July 6, 2003, mobile telephony operators began implementing a long-distance carrier selection, or CSP that enables customers to choose the long-distance carrier for each domestic long-distance call (VP2 and VP3) or international call, in accordance with the SMP rules. As a result, the company, having acknowledgment of the revenue from these long-distance services, started to pay the mobile telephony operators for the use of their networks.

On September 4, 2004, the rules dictated by Resolution No. 373, dated as of June 3, 2004, were implemented to carry out the reconfiguration of the local areas for the STFC. As a consequence, all calls previously billed at domestic long-distance rates (DC level – Áreas Conurbadas) are now billed at lower rates as local calls. In São Paulo, this modification involved 53 municipalities, of which 39 are in Greater São Paulo (Grande São Paulo).

IP Network Asset Acquisition

On December 10, 2002, after receiving approval from ANATEL, our Board of Directors approved a proposal to acquire certain assets from Telefónica Data S.A. (formerly T-Empresas), one of the companies of the Telefónica group, including the following services: (i) an Internet service that allows our customers to access our network through remote dial-up connection and (ii) services that allow customers of Internet Service Providers, or ISPs, to have access to broadband Internet. The purpose of this asset acquisition was to capitalize on synergies that would assist in developing our network and provide a quick response to market competitors.

Acquisition and Reorganization of Atrium

On December 30, 2004, we acquired indirect control of Atrium Telecomunicações Ltda. from Launceston Partners CV. Atrium provided various types of telecommunications services in Brazil, including Internet and intranet services, telecommunications management services and the sale and rental of telecommunications systems and related equipment. The acquisition was carried out through the purchase of the total share capital of Santo Genovese Participações Ltda., which held 99.99% of the representative share capital of Atrium.

On November 21, 2005, we approved the corporate reorganization of our former wholly owned companies, A. TELECOM S.A. (formerly Assist Telefónica S.A.), Santo Genovese Participações Ltda., or Santo Genovese, and Atrium Telecomunicações Ltda., or Atrium, which was implemented and became effective on March 1, 2006.

The SCM Restructuring

On March 9, 2006, our board of directors and the boards of directors of TDBH and Telefónica Empresas S.A., a wholly owned subsidiary of TDBH (“T-Empresas” and together with us and TDBH, the “T-Companies”), approved the restructuring of the T-Companies’ SCM and data transmission activities, or the SCM Restructuring.

The terms and conditions of the SCM Restructuring are set forth in an agreement among the T-Companies dated as of March 9, 2006. The SCM Restructuring consisted of (i) the merger of TDBH into our company (the “Merger”); and (ii) the spin-off of all T-Empresas’ assets and activities except its SCM assets and activities outside Sectors 31, 32 and 34 of Region III of Annex II of the General Concession Plan (the “Spin-off”) and assets and activities related to the data center.

Following the approval of this restructuring: (i) TDBH was dissolved; (ii) its shareholders received shares of our common or preferred stock, or ADSs, as appropriate; (iii) we succeeded TDBH in all of its rights and obligations; and (iv) T-Empresas became our wholly owned subsidiary. The transfer to TELESP of the spun-off components of T-Empresas did not result in any increase or decrease in the net equity of TELESP, nor in the number of shares that comprise its capital stock.

Table of Contents

With respect to TDBH's Merger into us, certain minority shareholders tried to suspend our general shareholders meeting by contesting the appraisal of the share exchange ratio provided by NM Rothschild & Sons (Brasil) Ltda. by obtaining an injunction from the 14th civil chamber of the central forum of the district court of São Paulo. The injunction was lifted on July 28, 2006, and the merger became legally effective. The main action (Ação Ordinária No. 583.00.2006.156920-5) has not yet been resolved in the lower court.

On January 31, 2008, the shareholder of Telefônica Empresas S.A., which is the company, resolved to change Telefônica Empresas S.A.'s corporate name to Telefônica Data S.A.

Agreement of Convergence, Purchase and Sale of Operations, Assets, Stock and Other Obligations with the Abril Group

On October 29, 2006, we entered into an agreement with Abril Comunicações S.A., TVA Sistema de Televisão S.A., Comercial Cabo TV São Paulo Ltda., TVA Sul Paraná Ltda., and TVA Radioenlaces Ltda. (the "Abril Group"), whereby we combined our telecommunications and broadband services with the broadband and cable services of Tevecap S.A., or TVA, the second largest Brazilian pay TV provider with operations in the states of Paraná, Rio Grande do Sul, São Paulo and Rio de Janeiro. Through this transaction, we broadened our services to meet our users' increasing demand, combining the Abril Group's expertise in content and media production and placement with the expertise of the Telefónica Group in the telecommunications segment.

On October 31, 2007, the board of directors of ANATEL concluded the regulatory review of the association between Grupo Abril and the company, approving the transaction, which involves (i) the acquisition of all of the operations of MMDS (Multichannel Multipoint Distribution Service) and broadband, and (ii) the acquisition of a significant stake, within the limit of the foreseen effective laws and regulations, in the cable television dealers controlled by Grupo Abril within and outside of the State of São Paulo. This decision was published on November 19, 2007. The transaction was fully cleared by regulatory and antitrust agencies.

On November 23, 2007, our shareholders ratified the Agreement, its amendments and annexes, and approved the implementation of the deal and the signing of all documents necessary for its complete formalization.

As a result of this transaction, Navytree Participações S.A., or Navytree became a wholly owned subsidiary of TELESP, and our provision of broadband services became centralized.

On June 10, 2008, our shareholders approved a change in the corporate name of Navytree to Telefônica Televisão Participações S.A., or TTP.

Corporate Reorganization involving Ajato

On October 14, 2008, Telefonica Sistema de Televisão S.A., TST and TTP purchased from Abril Comunicações S.A. all shares of Mundial Voip Telecomunicações Ltda., EPP, which had its corporate name changed to Ajato Telecomunicação Ltda., or Ajato. As a result of the merger of TTP into the company on November 11, 2008, Ajato's shares were held by us and TST prior to the restructuring described in item 3.A.

Corporate Reorganization involving DABR and TTP

On October 21, 2008, our board of directors and the shareholders of TTP and Telefônica Data Brasil Participações Ltda., or DABR approved a corporate reorganization that consisted of the merger of TTP and DABR into us.

On November 11, 2008, the merger of TTP and DABR was approved by our shareholders. As a result of this restructuring, TTP and DABR were dissolved and we assumed all the rights and obligations of TTP and DABR.

The reorganization allowed us to increase synergies, reduce managerial risk, simplify the corporate administrative structure and reduce costs, while also providing tax benefits expected to reduce TELESP's income tax and other taxes assessed on revenue and income, thereby improving our cash flows. The reorganization and the goodwill amortization were structured so as to avoid any assumption of indebtedness by us and to minimize any negative impact on our future results.

Corporate Restructuring involving TS Tecnologia

On May 22, 2009, Telefônica Data S.A., our subsidiary, merged with its controlled subsidiary, TS Tecnologia da Informação Ltda., or TS Tecnologia, in accordance with the values recorded on the books and an appraisal report. This merger caused TS Tecnologia to be extinguished, and Telefônica Data S.A. became the successor to all of the assets and liabilities of TS Tecnologia.

Corporate Restructuring involving A.TELECOM S.A.

On December 9, 2009, our Board of Directors approved the submission to a shareholder vote of the corporate reorganization proposal consisting of the partial spin-off of A.TELECOM S.A., or A.TELECOM, and the subsequent merger of the spun-off part of A.TELECOM into us.

On December 30, 2009, A.TELECOM’s shareholders approved the spin-off of part of A.TELECOM and the subsequent merger of the spun-off part into us. On the same date, our shareholders approved the merger of the spun-off part into us.

This corporate restructuring created synergies for us and A.TELECOM providing both of us with better administrative, operating and regulatory efficiencies regarding telecommunication integrated services, thus benefiting both of us and our respective shareholders.

Corporate Restructuring involving Brasilcel

Acquisition of Brasilcel N.V. stocks by Telefónica S.A.

On July 28, 2010 Telefónica S.A. and Portugal Telecom SG SGPS, S.A. entered into an agreement for the acquisition by Telefónica of 50% of shares of Brasilcel N.V, or Brasilcel, owned by Portugal Telecom. As a result, Telefónica indirectly acquired the shares of Vivo Participações held by Portugal Telecom. Prior to this agreement, Brasilcel’s shares were held by Telefónica (50%) and by Portugal Telecom (50%) and, in 2002, it was used for the joint venture between both shareholders to jointly hold shares and control of Vivo Participações and other mobile phone companies which were later added under Vivo Participações and in Vivo.

On December 21, 2010, Brasilcel was merged into Telefónica, which held direct and indirect stakes in Vivo Participações’ capital stock representing approximately 60%.

Due to the acquisition of control of Vivo Participações and pursuant to the terms provided for in Article 254-A of Brazilian Corporate Law and the procedures established in article 29 of CVM Instruction 361 applicable to tender offers (OPA) by sale of control, as defined by item III of article 2 of CVM Instruction 361, on February 17, 2011 Telefónica through its subsidiary SP Telecomunicações Ltda., or SPTelecom, launched a public tender offer for the shares with voting rights of Vivo Participações (common shares) held by noncontrolling interests. Those shares were acquired at 80% of the value paid by Telefónica to Portugal Telecom SG SGPS S.A., for each common share with voting rights of Vivo Participações owned by Brasilcel.

On March 18, 2011, when the public tender offers were made, SP Telecom acquired 10,634,722 common shares of Vivo Participações, representing 2.65% of its shares, resulting in the Telefonica group’s ownership of 62.1% of Vivo Participações.

Introduction of the Vivo Brand

In April 2003, Brasilcel launched in Brazil the brand name “Vivo,” under which TCP, TCO, TLE, TSD and Celular CRT operate. The creation of the Vivo brand constituted a consolidation of the commercial models throughout the entire country into a common commercial strategy and replaced the different brands under which the different companies offered their services in their respective states. The commercial strategy of Vivo is to increase its customer base as well as revenues by retaining customers and maintaining their distribution channels. The launching of the Vivo brand was accompanied by customer loyalty programs and other measures designed to contribute to the success of the commercial strategy. Guided by a common management team, Vivo designs marketing, promotional and other initiatives common to all companies in the Vivo group and then tailors those activities to the particular markets of those companies.

Table of Contents

Agreement with Telefónica and Telecom Itália

TELCO S.p.A. (in which Telefónica S.A. held a 46.18% interest) has a 22.4% interest with voting rights in Telecom Italia, and is the major shareholder of that company. The Company is an indirect subsidiary of Telefónica S.A., and Telecom Italia holds an indirect interest in TIM Participações S.A. (TIM), a Brazilian telecommunications company. Neither Telefónica S.A., nor Telefônica Brasil or any other affiliate of Telefónica S.A. interfere in, are involved with or have decision-making powers over TIM's operations in Brazil. They are also lawfully and contractually forbidden from exercising any voting rights derived from holding an indirect interest with respect to operations in Brazil, directly related to TIM operations. TIM (Brazil) and Telefônica Brasil compete in all markets in which they operate in Brazil and, in this context, as well as in relation to the other economic players in the telecommunications industry, maintain usual and customary contractual relations with one another (many of which are regulated and reviewed by ANATEL) and/or which, as applicable, are informed to ANATEL and Brazil's Administrative Council for Economic Defense (CADE), concerning the commitments assumed before these agencies so as to ensure total independence of their operations.

On September 24, 2013, Telefónica S.A., entered into an agreement with the other shareholders of the Italian company TELCO SpA (which holds a 22.4% voting in Telecom Italia SpA), whereby:

1) Telefónica S.A. subscribed and paid up capital in TELCO, SpA through a contribution of 324 million euros, receiving shares without voting rights of TELCO, SpA. As a result of this capital increase, the share capital of Telefónica S.A. voting in Telco, SpA remaining unchanged (remaining at 46.18%), although their economic participation rose to 66%. Thus, the governance of TELCO S.p.A., as well as the obligations of Telefónica S.A. to abstain from participating in or influencing the decisions that impact the industries where they both operate, remained unchanged.

2) Subject to obtaining the required previous approvals from antitrust authorities and telecommunications regulatory agencies as applicable (including Brazil and Argentina), Telefónica S.A. conducted another capital increase in TELCO S.p.A. amounting to 117 million Euros, receiving shares with no voting rights of TELCO, SpA. As a result of this capital increase, the share capital of Telefónica S.A. voting in Telco, SpA increased its total interest to 70%, with the 46.18% interest held in shares with voting rights remaining unchanged.

3) Beginning as of January 1st, 2014, following approvals from antitrust authorities and telecommunications regulatory agencies as applicable (including Brazil and Argentina), Telefónica S.A. will be entitled to convert all or part of nonvoting shares into common shares with voting rights, limited however to a 64.9% interest in TELCO S.p.A. voting capital.

4) Italian shareholders of TELCO S.p.A. granted Telefónica S.A. an option to purchase all of their shares in TELCO S.p.A.. Our ability to excercise this call option is subject to approvals from the applicable antitrust authorities and telecommunications regulatory agencies as applicable (including in Brazil and Argentina). The call option has been available since January 1, 2014 and will remain available as long as the Shareholders' Agreement remains in effect, except (i) between June 1 and June 30, 2014 and between January 15 and February 15, 2015; and (ii) during certain periods in case the Italian shareholders of TELCO S.p.A. request the entity's spin-off.

On December 4, 2013, the Brazilian Antitrust Enforcement Agency (CADE) announced the following decisions:

1) Approve, subject to the limitations described below, the acquisition, by Telefónica S.A., of the total interest held by Portugal Telecom, SGPS SA e PT Móveis – Serviços de Telecomunicações, SGPS, SA (PT) in Brasilcel NV,

which controlled Brazilian mobile telecommunications operator Vivo Participações S.A. (Vivo Part.).

The transaction has been approved by ANATEL and its completion (requiring no prior approval from CADE at the time) took place immediately after approval from ANATEL, on September 27, 2010.

The limitations imposed by CADE on its decision are as follow:

a) a new shareholder share control over Vivo Part. with Telefónica S.A., adopting the same conditions applied to PT when it held an interest in Brasilcel NV., or

b) Telefónica S.A. shall cease to have, either directly or indirectly, an equity interest in TIM Participações S.A..

2) Impose a R$15 million fine on Telefónica S.A. for violating the will and purpose of the agreement executed by and between Telefónica S.A. and CADE (as a requirement to approve the initial purchase transaction of Telecom Italia in 2007), due to the subscription and payment, by Telefónica S.A., of TELCO S.p.A. nonvoting shares in the context of its recent capital increase. This decision also requires Telefónica S.A. to dispose of its nonvoting shares held in TELCO S.p.A.

The deadline for compliance with the conditions and obligations imposed by CADE in both decisions were classified as confidential by CADE.

At December 13, 2013, Telefónica S.A. published a material news release regarding the decisions made by CADE in the meeting held on December 4, 2013, stating that it considered the measures imposed by that agency to be unreasonable, thus considering the possibility of starting applicable legal proceedings.

In this context, and in order to strengthen its firm commitment to the obligations previously assumed by Telefónica S.A. to keep away from Telecom Italia's business in Brazil. Telefónica S.A. pointed out, in a relevant fact release that Mr. César Alierta Izuel and Mr. Julio Linares López had decided to resign with immediate effect, from the position of Directors at Telecom Italia. Additionally, Mr. Julio Linares López decided to resign, with immediate effect, from his position on the list presented by TELCO S.p.A. for potential re-election to the Board of Directors of Telecom Italia.

Likewise, Telefónica S.A., notwithstanding the rights defined in the Shareholders' Agreement of TELCO S.p.A, stated in a relevant fact that it decided not to exercise, for now, its right to appoint or suggest two Directors at Telecom Italia.

Corporate Restructuring involving Vivo Participações

On July 28, 2010, in accordance with the material fact disclosed to the public by Telefónica S.A., our controlling shareholder, Telefónica S.A. and Portugal Telecom executed a purchase agreement for the acquisition by Telefónica S.A. (directly or through any of the companies within its group) of 50% of the capital stock of Brasilcel (a company jointly owned by Telefónica and Portugal Telecom, which owns shares representing approximately 60% of the capital stock of the Brazilian company Vivo Participações).

On December 27, 2010, the company and Vivo Participações, jointly announced the approval by their respective boards of directors of a proposal for corporate restructuring involving the merger of shares of Vivo Participações into us, aiming for the consolidation of the shareholding positions of both companies.

Other than the concentration of the shareholding position herein mentioned, the purpose of the corporate restructuring was to simplify the organizational structure of the companies, both of which were publicly held companies and listed on BM&FBOVESPA and with American Depositary Receipts traded in the United States. The restructuring allowed their respective shareholders to participate in one unified company with greater liquidity and with shares traded on Brazilian and foreign stock exchanges. Moreover, the corporate restructuring provided for the rationalization of the cost structure of the two companies and facilitated the integration of businesses and the generation of synergies, thus positively impacting both companies.

The simplified organization chart below demonstrates the corporate structure of the companies before and after the implementation of this reorganization.

20

Table of Contents

The corporate structure before the merger of shares is as follows:

Upon completion of this corporate restructuring, Telefónica, S.A. held the shares of the Brazilian holding companies previously held indirectly by Telefónica, S.A., through the holding of Brasilcel, N.V., as a result of a transaction implemented abroad. The merger of shares did not change the composition of the ultimate control of the companies involved.

The corporate structure after the merger is as follows:

Vivo Participações was merged into us, and the holders of the merged shares of Vivo Participações received new shares to which they were entitled in the company. In accordance with Brazilian Corporate Law, as well as the bylaws of both companies, financial advisors and specialized companies were retained for the preparation of studies

Table of Contents

regarding the transaction and the subsequent preparation of valuation reports of the companies that were used as reference for the determination of the exchange ratio of shares and the increase in capital stock resulting from the merger of shares, as well as for the purposes of article 264 of Brazilian Corporate Law regarding the exchange ratio between the shares.

The corporate restructuring was approved by ANATEL on March 24, 2011. Before the corporate restructuring, the Brazilian entities, TBS Celular Participações Ltda., Portelcom Participações S.A. and PTelecom Brasil S.A. (jointly, the "Holdings BR"), were merged into Vivo Participações. The Holdings BR had as its main asset the shares of Vivo Participações and were controlled by Brasilcel. The merger of Holdings BR did not result in any change in the number and the composition of classes of shares of Vivo Participações, and did not affect the participation of the shareholders of Vivo Participações.

Acquisition of Vivo Participações by Telefônica Brasil and corporate restructuring

In order to unify the shareholder base of the companies in our group, simplify the organizational structure, rationalize costs, integrate businesses and, consequently, generate synergies provided for in the strategy of Telefónica, on December 27, 2010, the boards of directors of Vivo Participações and Telefônica Brasil approved the terms and conditions of a restructuring, which provided for the merger of Vivo Participações into Telefônica Brasil. Following recommendations of the CVM, independent special committees were created to negotiate the exchange ratio of shares and determine the other conditions of the corporate restructuring proposal, which was later submitted along with its recommendations to the boards of directors of both companies.

The proposal was submitted to ANATEL for authorization and was approved at a meeting of the board of directors of ANATEL on March 24, 2011.

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

Before the start of the corporate restructuring, the holding companies (composed of TBS Celular Participações Ltda., Portelcom Participações S.A. and Brazil PTelecom S.A.), controlled by Telefónica S.A. and whose main purpose was to hold shares of Vivo Participações, were merged into Vivo Participações as a preliminary phase for the first stage of the restructuring.

The first stage of the transaction consisted of the unification of the share base of the fixed and mobile operators of the Telefonica group in Brazil, through the merger of shares of Vivo Participações into Telefônica Brasil. Vivo Participações was merged in its entirety into Telefônica Brasil and holders of shares of Vivo Participações received the new shares of Telefônica Brasil. The exchange of shares of Vivo Participações for shares of Telefônica Brasil was based on the exchange share ratio of 1.55 shares of Telefônica Brasil for each share of Vivo Participações. This followed the recommendations of the independent special committees.

Due to the merger of Vivo Participações into us, our capital was increased by R$31.2 billion, reflecting the economic value of the shares issued as a result of the merger, based on an economic value appraisal of Vivo Participações prepared by Planconsult Consultoria Ltda., or Planconsult.

Telefónica's strategy in the first stage of the corporate restructuring was to maximize the potential of its operations in Brazil. Therefore, Telefônica Brasil became the direct shareholder of Vivo Participações, and indirect shareholders of

Vivo. Through the creation of this umbrella investment structure, the non-controlling shareholders of both companies were equally benefited by the added values generated by the combination of the telecommunications business. This is a basic movement in business so as to improve its converging market strategy, including combined mobile and fixed-line offers. This reorganization created the necessary conditions to begin the process of obtaining operational and financial synergies.

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

Table of Contents

The second and third stages of the corporate restructuring, disclosed to the market on June 15, 2011, sought to continue the simplification process of the organizational structure of the companies, so as to: (i) focus all authorizations for the rendering of SMP services (originally held by Vivo Participações and Vivo), and (ii) simplify the current corporate structure, eliminating the structure of Vivo Participações, which due to the concentration of commitments, became a holding company.

In the second stage, held on October 1, 2011, assets, rights and obligations of Vivo Participações relating to mobile operations in Minas Gerais were awarded to Vivo, a subsidiary of Vivo Participações. As a result, Vivo became the only mobile operator in the group.

After ANATEL's approval of the third stage of corporate restructuring, on August 16, 2011, Telefônica Brasil absorbed Vivo Participações' equity, extinguishing Vivo Participações on October 3, 2011, which simplified and rationalized our cost structures.

SMP Authorizations and Corporate Restructuring

On June 14, 2011, the board of directors of Vivo Participações approved a proposal for the merger of authorizations to provide SMP services (then owned by Vivo Participações in the State of Minas Gerais and Vivo in other Brazilian States). As a result, the operations and authorizations for the provision of SMP services were unified under Vivo. On the same date, the proposal for merger of SMP authorizations as well as for simplifying the corporate structure was filed with ANATEL. The form proposed for this simplified corporate structure was the transfer of businesses, including property, rights and obligations related to provision of SMP services, as well as the authorizations for the provision of SMP in the State of Minas Gerais held by Vivo Participações, to Vivo, which would result in Vivo being a wholly owned direct subsidiary of the company and the mobile operator group that owns the SMP authorizations in other Brazilian states. After the transfer, Vivo Participações was to become a holding company and immediately merge into us, thus simplifying and rationalizing the cost structure of the companies involve and subsequently extinguish its corporate existence. On August 16, 2011, ANATEL approved the corporate restructuring pursuant to Act. No. 5,703, published on August 18, 2011.

On September 12, 2011, in compliance with Brazilian Corporate Law, an independent firm prepared a valuation report of Vivo Participações' net assets based on its book value as of August 31, 2011 containing part of Vivo Participações' assets relating to the operations of SMP in the state of Minas Gerais that were transferred to Vivo and the assets of Vivo Participações merged into us. Vivo Participações' valuation as of August 31, 2011 was R$10.3 billion.

On September 13, 2011, the board of directors of Vivo Participações approved, ad referendum of the shareholders: (1) the valuation report of Vivo Participações, containing part of the assets corresponding to the SMP operations in the State of Minas Gerais, which led to a capital increase in Vivo in the amount of R$833.0 million, through the subscription of shares of Vivo Participações; and (2) the Protocol of Merger and Instrument of Justification of Vivo Participações into Telecomunicações de São Paulo S.A. – TELESP, for the merger of Vivo Participações into us, preceded by the transfer of commercial establishments, including the assets, rights and obligations related to provision of SMP, as well as authorizations for the provision of SMP in the state of Minas Gerais held by Vivo Participações.

On October 1, 2011, our shareholders approved the valuation report of Vivo Participações. The net assets of Vivo Participações in Minas Gerais transferred to Vivo amounted to R$833.0 million, which were used for the capital increase in Vivo through the subscription of shares by Vivo Participações, paid via the transfer of assets.

On October 3, 2011, our shareholders approved the merger of Vivo Participações into us. On the same date, we changed our name from Telecomunicações de São Paulo S.A. – TELESP to Telefônica Brasil S.A., to reflect its nationwide operations.

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

Provision of STFC outside the state of São Paulo by Vivo

On August 18, 2011, ANATEL approved the authorization for Vivo to provide STFC services to the general public. On October 7, 2011, Vivo began providing fixed-line services through mobile technology, or FWT outside the state of São Paulo.

On August 18, 2011, ANATEL consented to the transfer of our authorization for STFC services in local, domestic long-distance and international long-distance modes outside the state of São Paulo in Regions I and II to Vivo, which authorization was published on September 8, 2011. As a result, Vivo began to offer STFC across its area, except for the state of São Paulo, using the network elements and some radio frequencies that support the provision of SMP.

Plan for the purchase of shares issued by us

On August 11 and 15, 2011, we informed our shareholders and the market in general, respectively, of approval by the Board of Directors, of the acquisition of preferred and common shares issued by us for subsequent cancellation, disposal or maintenance in treasury, without capital reduction, in order to add value for shareholders. For this repurchase, there was use of part of the capital reserve existing as of June 30, 2011, excepting the reserves mentioned in article 7, letter (a) to (d) of CVM Rule No. 10/80.

The repurchase started on the date of the resolution, and remains effective until October 20, 2011, and acquisitions are on BM&FBOVESPA, at market prices. The Executive Board was responsible for establishing the maximum quantity of shares to be acquired, whether in a sole or a series of transactions, as well as the definition of the parameters to carry out the acquisitions, observing applicable legal limits and the established maximum number of up to 2,700,000 preferred shares and 2,900,000 common shares.

On November 5, 2012, we announced our shareholders and the market in general that our board of directors had approved a plan for repurchase of preferred and common shares issued by us, without a capital reduction, to add value to shareholders. On June 30, 2012, we used a portion of our capital reserves for this repurchase, pursuant to Article 7 sections (a)-(d) of CVM Rule No.10/80.

The repurchase started on the date of the resolution, and remained effective until November 4, 2013, and acquisitions were on BM&FBOVESPA, at market prices. Our board of executive officers was responsible for establishing the maximum quantity of shares to be acquired, whether in a sole or a series of transactions, and defining the parameters used to carry out the acquisitions, observing applicable legal limits and the established maximum number of up to 24,257,777 preferred shares and 2,894,534 common shares.

Call option of the remaining shares of Lemontree and GTR-T

On June 6, 2012, the company exercised its call option in relation to (1) the remaining 71,330,508 common shares corresponding to 51% of the voting capital of Lemontree Participações S.A., or Lemontree, which holds Commercial Cabo TV São Paulo S.A., a company engaged in cable TV services in the state of São Paulo; and (2) the remaining 923,778 common shares of GTR Participações Ltda., or GTR-T, which holds 50.9% of the common shares of TVA Sul Paraná S.A., a company engaged in cable TV services outside the state of São Paulo, these shares were previously held by the Abril Group.

The call option represents the closing of the acquisition process of the remaining shares of Lemontree and GTR-T, which started with the partial exercise of the option on September 29, 2011 and the acquisition of the common shares of Lemontree, representing 49% of its voting capital.

The call option was provided for in the Private Agreement for Convergence, Purchase and Sale of Businesses, Assets, Shares and Other Covenants, entered into on October 29, 2006 between us and the Abril Group, which approved by our shareholders on November 23, 2007. The exercise of the call option was subject to the reduction or elimination of the regulatory restrictions applicable to the company, which was granted along with the revocation of the concession agreement limitations in order to have the company and its subsidiaries authorized to provide cable TV services in the same concession area as those for which it provides STFC services in the São Paulo region.

Table of Contents

Following the exercise of the call option, Telefônica Brasil S.A. holds 100% of Lemontree and GTR-T and, indirectly, of the companies engaged in cable TV services located in São Paulo, Curitiba, Foz do Iguaçu and Florianópolis.

Restructuring involving the subsidiaries of Telefônica Brasil

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

The restructuring was implemented by means of a partial division and merger, involving only our wholly owned subsidiaries, A. TELECOM, TData, TST, Ajato and Vivo. As a result of the restructuring, value added services (such as voicemail, voicemail translation in speech-to-text (“Vivo Torpedo Recado”), caller identification, voice minutes in unlimited bundles to other mobile phones to post-paid customer, ring back tones (“Vivo Som de Chamada”), and innovative services such as multi-media backup, cloud based services to save the short messages (“Vivo Torpedo Center”) and the recently launched “MultiVivo,” that allows the customer to share a 3G, 3G+ and 4G connection with up to 5 mobile devices) provided by several wholly-owned subsidiaries of the company were unifying under Telefonica Data S.A., or TData and other telecommunications services were unifying under Telefônica Brasil, which, as a final step to the corporate restructuring, merged these subsidiaries. Following the merger, Telefonica Data S.A. provides value added service and Telefônica Brasil provides other telecommunication services.

In addition to streamlining services, the corporate restructuring (now possible because of legislative changes applicable to STFC providers) aims to simplify our current organizational structure and assist the integration of business and the generation of synergies arising therefrom. This corporate restructuring can only be implemented with consent from ANATEL, which was granted in May 2013.

On June 11, 2013, our Board of Directors approved the terms and conditions of a corporate reorganization, pursuant to which our direct and indirect subsidiaries will be spun off and merged into us. All services which are exclusively telecommunications services will be provided by us, Telefônica Brasil. Other services, including value added services described above, will be performed by our wholly owned subsidiary, TData.

We were required to separate our services into separate companies because the telecommunications laws in Brazil require that we only perform telecommunications services. In addition, we believe that concentrating all our telecommunications services in one entity will allow us to streamline our services and provide a simplified set of services to our customers, reducing our general administrative and operating costs. As a result of the corporate reorganization, we spun-off or merged each of the following subsidiaries: (1) TData, with regards to its SCM activities; (2) Vivo, with regards to SMP, SCM and STFC services for local and long distance calls under the General Concession Plan; (3) A.TELECOM, with regards to its SEAC activities, using DTH and SCM activities; and (4) TST, with regards to its SEAC and SCM services.

The corporate reorganization required a series of corporate acts, including: (1) merger of TVA and related companies with and into TST, resulting in an increase in the capital stock of TST; (2) merger of TST with and into us, where TST book value was R$226,105,582.63; (3) merger of the spun-off assets of TData into us, which assets book value were R$34,723,875.31; (4) merger of a portion of Vivo’s spun-off equity into us, the book value of which was R$10,228,352,444.32; and (5) merger of a portion of A.TELECOM's spun-off net equity into us, the book value of which was R$348,623,814.64. All of the equity and assets book value were determined based on a net assets book value report issued by Ernst Young Auditores Independentes S.S.

25

Table of Contents

The mergers described above, did not result in an increase in our capital stock or in the issuance of new shares by us, and the corporate restructuring did not give rise to a change in the equity interests held by our shareholders.

The corporate reorganization did not result in an exchange of shares held by non-controlling shareholders of the spun-off companies for shares in the surviving company because we were, at the time of the merger of the assets and/or companies, as the case may be, the sole shareholder of the companies to be spun-off/merged. Accordingly, no appraisal report of the net equity at market price were required to be prepared for calculation of the exchange ratio of shares held by non-controlling shareholders, according the applicable law.

The mergers of the companies and of the spun-off assets, as described above, were carried out without disruption to the operations and the telecommunication services provided to the clients, which services are provided by Telefônica Brasil, as successor.

Corporate Structure and Ownership

Our current general corporate and shareholder structure is as follows:

Capital Expenditures

Year ended December 31, 2013

In 2013, we invested R$6,033.2 million, a similar amount to what was invested in 2012, however we increased the capital expenditures in projects and decreased our expenditures with spectrum licenses. Investments in projects are strongly focused on network (84% of investments excluding licenses) and help sustain our commercial and revenue growth while maintaining the quality of the services provided. Investments in new projects also prepare the company for a medium-term competitive scenario.

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

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2013.

	Year ended December 31,		
Telefônica Brasil	2013	2012	2011
	(in millions of reais)		
Network	4,683.3	3,845.8	3,381.0
Technology / Information Systems	569.5	562.3	612.5
Others(1)	780.5	1,709.0	1,408.0
Total capital expenditures	6,033.2	6,117.1	5,401.5

(1) Consists primarily of free handset rentals, network construction, furniture and fixtures, office equipment and store layouts and an amount of R$451 million in 2013 (R$1,050 in 2012 and R$812 in 2011) related to the acquisition and other costs of licenses.

Year ended December 31, 2012

In 2012, we invested R$6,117.1 million in projects that sustain our current annual results and competitive position in the medium-term. A significant portion of resources was allocated to allow quality growth in our

26

services. The investments in maintaining quality and expanding our client base represented 87% of the total amount invested by us in 2012 (excluding the purchase of new licenses).

To meet the needs of an increasingly connected society, significant investments were made to support the strong growth of our fixed and mobile data users or dedicated high-speed services for our corporate clients. We continue to invest in expanding the backbone of national data transmission to meet the increase in mobile data traffic throughout the country.

Year ended December 31, 2011

In 2011, we invested in projects that support our current results and prepare the company for the competitive landscape in the medium-term. A significant proportion of resources were allocated to enable growth associated with the services we provide.

To meet the needs of an increasingly connected society, significant investments were made to support the strong growth of data customers, whether fixed and mobile data services or dedicated high-speed services to the corporate market, as well as the increase in capillarity of our fiber optics network in São Paulo. We also invested in the expansion of the national data transmission backbone to meet increasing demand for mobile data traffic nationwide.

B. Business Overview

The concessions granted by the Brazilian government in 1998 and renewed in 2005, with the effective date starting in January 2006, allow us to provide fixed-line telecommunications services to a region that includes most—approximately 95%—of the state of São Paulo. The portion of the state of São Paulo that is excluded from our concession represents approximately 1.5% of total lines in service and 2.2% of the state's population. This concession is operated by CTBC Telecom.

Our concession region is Region III, which comprises 622 municipalities, including the city of São Paulo, with an aggregate population of approximately 41.3 million. Of the municipalities in Region III, 72 have a population in excess of 100,000. The city of São Paulo has a population of approximately 11 million. According to a plan established by the federal government, whereby the government granted licenses to four providers of fixed-line telecommunications services, the state of São Paulo was divided into four sectors, including Sectors 31 (our predecessor company's area before the reorganization), 32 (the area corresponding to Ceterp before our acquisition), 33 (corresponds to the portion of the state of São Paulo that we do not serve) and 34 (area corresponding to CTBC Borda do Campo before the reorganization). Through transactions that took place in November 1999 and December 2000, CTBC Borda do Campo and Ceterp merged into our company, which now holds concessions for Sectors 31, 32 and 34. Sector 33 is held by CTBC Telecom. On November 21, 2008, the Federal government combined the three sectors for which we hold concessions into a single sector, designated as Sector 31.

On May 7, 2002, we began offering international long-distance services and on July 29, 2002, we started offering interregional service. The conditions for the provision of interregional and international long-distance services outside the concession area contemplate that providers already operating services under a selection code (a two-digit code to be input by the caller as a prefix to the number dialed, representing a long-distance operator) would keep such code under the new licenses authorizing operation outside the applicable concession area. Accordingly, we continue using the provider selection code "15" that permits our callers to make calls using our services even though they are outside our concession area. All interregional and international mobile calls, whether in our concession area or that of another provider, need to dial a carrier selection code using Personal Mobile Service—SMP, through which mobile services users choose the provider for interregional and international long-distance calls, and which requires dialing our code "15" to use our services. See "—Network Services."

Since our merger with Vivo Participações, we provide mobile telecommunications services in all of the Brazilian states and in the Federal District, representing a total of approximately 8.5 million square kilometers and a population of approximately 200 million people. Vivo became a national operator when, on September, 2007, it acquired a license to operate within 6 states located in the Northeast region (Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte) and when it acquired Telemig.

On May 29, 2013 ANATEL authorized our corporate reorganization detailed above. The new structure was formalized by our shareholders on June 11, 2013. This reorganization did not result in a capital increase or in the issuance of new shares.

Table of Contents

Areas of Operation

In Areas 1 and 2, we use a frequency range known as "A," "L" and "J" bands that covers 100% of the municipalities in its authorized areas in the state of São Paulo. On December 31, 2013, we had 21.3 million mobile lines in service in these areas, which represented a 3.8% net increase from December 31, 2012, and a market share of approximately 32.7% in São Paulo.

In Area 3, we use a frequency range known as "A," "L" and "J" bands that covers 100% of the municipalities and 100% of the population in the states of Rio de Janeiro and Espírito Santo. On December 31, 2013, we had 10.3 million mobile lines in service in this area, which represented a 0.9% from December 31, 2012, and a market share of approximately 36.1% in those states.

In Area 4, we use a frequency range known as "A," "E" and "J" bands that covers 71.7% of the municipalities and 92.6% of the population in the state of Minas Gerais. On December 31, 2013, we had 8.2 million mobile lines in service in this area, which represented a 0.7% from December 31, 2012, and a market share of approximately 31.4% in Minas Gerais.

In Area 5, we uses a frequency range known as "B" band that covers 67% of the municipalities in the states of Paraná and Santa Catarina and 94% of the population of Paraná and Santa Catarina. On December 31, 2013,we had 4.3 million mobile lines in service in this area, which represented a 5.0% from December 31, 2012, and a market share of approximately 18.6% in those states.

In Area 6, we uses a frequency range known as "A," "L" and "J" bands that covers 82.3% of the municipalities and 97.8% of the population in the state of Rio Grande do Sul. On December 31, 2013, we had 6.6 million mobile lines in service in this area, which represented a 3.3% net increase from December 31, 2012, and a market share of approximately 40.5% in that state.

In Areas 7 and 8, we are the leading mobile operator, by number of customers, in our authorization area and we use a frequency range known as "A," "B," "L" and "J" bands that covers 61.8% of the municipalities in the states of Acre, Federal District, Goiás, Mato Grosso, Mato Grosso do Sul, Rondônia, Tocantins, Amazonas, Amapá, Maranhão, Pará and Roraima which covers 87.4% of the population in these states. On December 31, 2013, we had 17.1 million mobile lines in service in these areas, which represented a 0.7% net increase from December 31, 2012, and a market share of approximately 34.1% in those states.

In Area 9, we use a frequency range known as "A," "L" and "J" bands that covers 69.3% of the municipalities and 89.5% of the population in the States of Bahia and Sergipe. On December 31, 2013, we had 6.0 million mobile lines in service in this area, which represented a 1.1% net increase from December 31, 2012, and a market share of approximately 28.8% in those states.

In Area 10, we use a frequency range known as "L" and "J" bands that covers 38% of the municipalities and 73.8% of the population in the States of Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte. On December 31, 2013, we had 3.4 million mobile lines in service in this area, which represented a 9.6% net increase from December 31, 2012 and a market share of approximately 8.4% in those states.

On September 18, 2007, with ANATEL's approval, Vivo acquired the "L" band lots, except for lot 16 (area of Londrina, Paraná, in Region V) and lot 20 (area of Northern Brazil in Region VIII). The "L" band comprises lots in frequency ranges 1895 to 1900 MHz and 1975 to 1980 MHz, with 5 + 5 MHz bandwidth. As a result, Vivo managed to complete its last coverage gap and will soon be operating in the entire Brazilian territory. On December 20, 2007, with ANATEL's approval, Vivo acquired the "J" band lots with 10 + 10 MHz bandwidth, with the exception of the lots in the state of Minas Gerais then acquired by Telemig Celular and now operated by Vivo.

On December 14 and 15, 2010, Vivo acquired 23 lots in the remaining SMP band auction. Vivo acquired lots in almost all regions of Brazil, which allowed us to reach spectrum capacity of 70 Mhz or higher in all regions where we operates (excluding 23 municipalities in and around Franca in the state of São Paulo, where the spectrum is 50 Mhz). On the same date, Vivo also acquired 23 lots in the "H" band. As a result, Vivo improved its capacity to provide services throughout the national territory and now operates in the 900 MHz and 1,800 MHz frequencies in a broad way.

Table of Contents

On June 12 and 13, 2012, Vivo acquired the "X" band lot in an auction held by ANATEL, for a total amount of R$1.05 billion. As a result, Vivo will enhance its ability to provide service with 4G technology in all of Brazil and will be operating in the frequency range of 2,500 MHz with band of 20 + 20 Mhz. In addition to the 2,500 MHz band, the lot also includes the 450 MHz band for the rural areas of the states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, São Paulo and Sergipe.

The following table sets forth population, gross domestic product, or GDP, and per capita income statistics for each state in former Vivo's service regions (currently Telefônica Brasil service regions) at the dates and for the years indicated:

		On December 31, 2013			Last Available IBGE Data from 2011		
Area	Frequency Range (MHz)	Population (in thousands)(1)	Percent of Brazil's population(1)		GDP (in millions of reais) (2)	Percent of Brazil's GDP (2)		Per capita income (in reais) (2)
São Paulo State	450, 850, 900, 1800, 1900, 2100 and 2500	41,262	21.63	%	1,349,465	32,57	%	32,704
Paraná State	850, 900, 1800, 1900, 2100 and 2500	10,445	5.48	%	239,366	5.78	%	22,916
Santa Catarina State	850, 900, 1800, 1900, 2100 and 2500	6,248	3.28	%	169,050	4.08	%	27,056
Goiás State	850, 900, 1800, 1900, 2100 and 2500	6,004	3.15	%	111,269	2.69	%	18,532
Tocantins State	850, 900, 1800, 1900, 2100 and 2500	1,383	0.73	%	18,059	0.44	%	13,057
MatoGrosso State	850, 900, 1800, 1900, 2100 and 2500	3,035	1.59	%	71,418	1.72	%	23,531
Mato Grosso do Sul State	850, 900, 1800, 1900, 2100 and 2500	2,449	1.28	%	49,242	1.19	%	20,106
Rondônia State	850, 900, 1800, 1900, 2100 and 2500	1,562	0.82	%	27,839	0.67	%	17,822
Acre State	850, 900, 1800, 1900, 2100 and 2500	734	0.38	%	8,794	0.21	%	11,980
Amapá State	850, 900, 1800, 2100 and 2500	670	0.35	%	8,968	0.22	%	13,385
Amazonas State	850, 900, 1800, 2100 and 2500	3,484	1.83	%	64,555	1.56	%	18,528
Maranhão State	850, 900, 1800, 2100 and 2500	6,575	3.45	%	52,187	1.26	%	7,937

Pará State	850, 900, 1800, 2100 and 2500	7,581	3.97	%	88,371	2.13	%	11,656
Roraima State	850, 900, 1800, 2100 and 2500	450	0.24	%	6,951	0.17	%	15,446
Federal District	850, 900, 1800, 1900, 2100 and 2500	2,570	1.35	%	164,482	3.97	%	64,000
Bahia State	850, 900, 1800, 1900, 2100 and 2500	14,017	7.35	%	159,869	3.86	%	11,405
Sergipe State	450, 850, 900, 1800, 1900, 2100 and 2500	2,068	1.08	%	26,199	0.63	%	12,668
Rio de Janeiro State	850, 900, 1800, 1900, 2100 and 2500	15,990	8.38	%	462,376	11.16	%	28,916
Espírito Santo State	850, 900, 1800, 1900, 2100 and 2500	3,515	1.84	%	97,693	2.36	%	27,793
Rio Grande do Sul State	850, 900, 1800, 1900, 2100 and 2500	10,694	5.61	%	263,633	6.36	%	24,652
Alagoas State	450, 900, 1800, 1900, 2100 and 2500	3,120	1.64	%	28,540	0.69	%	9,147
Ceará State	450, 900, 1800, 1900, 2100 and 2500	8,452	4.43	%	87,982	2.12	%	10,409
Pernambuco State	450, 900, 1800, 1900, 2100 and 2500	8,796	4.61	%	104,394	2.52	%	11,868
Piauí State	450, 900, 1800, 1900, 2100 and 2500	3,118	1.63	%	24,607	0.59	%	7,891
Paraíba State	450, 900, 1800, 1900, 2100 and 2500	3,767	1.97	%	35,444	0.86	%	9,409
Rio Grande do Norte State	450, 900, 1800, 1900, 2100 and 2500	3,168	1.66	%	36,103	0.87	%	11,396
Minas Gerais State	450, 850, 900, 1800, 2100 and 2500	19,597	10.27	%	386,156	9.32	%	19,704
Total		190,756	100.00	%	4,143,013	100.00	%	21,718

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

(2) According to the most recent IBGE data (2011). Nominal Brazilian GDP was R$4,143,013 million as of December 2011 calculated by IBGE, subject to revision.

29

Table of Contents

As of December 31, 2013, we had 312 of our own sales outlets throughout Brazil, which also provide customer support for our existing customers. In addition, we also have 11,866 sales outlets run by authorized dealers. As of December 31, 2013, we had the highest number of sales outlets among all our competitors.

We aim to increase our services in strategic cities and locations where there are currently no sales outlets for our services. As of December 31, 2013, we had 79 partners, including Telesales and Door to Door services, with approximately 1,150 salespeople reaching out to potential customers, in particular for Vivo fixed-line, post-paid and data services.

We also have an on-line store and an authorized e-commerce operation for the sale of services over the Internet.

In 2013, prepaid mobile service customers counted on approximately 600 thousand points of sale to purchase credit, including our own stores, authorized agents, lottery stores, post offices, bank branches and small retailers, such as pharmacies, newspaper stands, libraries, bakeries, gas stations, bars and restaurants. Pre-paid phones can be charged by purchasing cards with credit or digitally. Recharge is also offered through credit and debit cards, call center, Vivo PDV (M2M using a cell phone for transferring the recharge credit), personal recharge (recharge of the cell phone itself), as well as certain accredited Internet websites.

Overview

Our services consist of:

- voice services, including activation, monthly subscription, measured service and public telephones;
- interconnection charges (or network usage charges), which are amounts we charge other mobile and fixed-line service providers for the use of our network;
- intraregional, interregional and international long-distance voice services;
- data services, (including broadband services) and mobile value added services;
- Pay TV services through DTH (direct to home), a satellite technology, IPTV and cable;
- the sale of wireless devices and accessories;
- network services, including rental of facilities, as well as other services; and
- digital services, including financial services, M2M, e-health solutions, security, video and advertising.

In March 2002, ANATEL certified our compliance with the 2003 universal service targets and authorized us in April 2002 to start providing local and intraregional services in certain regions in which we were not operational and interregional and international long-distance services throughout Brazil. See "—Competition" and "—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies."

We provide interconnection services to mobile service providers and other fixed telecommunications companies through the use of our network. On April 1999, we also began to sell handsets and other telephone equipment through A. TELECOM S.A. (formerly Assist Telefônica S.A.), our wholly owned subsidiary at that time. Until January 2001, we provided data transmission services, but spun-off our data transmission operations into TDBH. In March 2006, we began the restructuring of our multimedia communications services (serviços de comunicação multimidia) and data transmission activities. See “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

The monthly and usage fees for our fixed services (local and long-distance) were initially determined in our concession agreements. From March 2007 until July 31, 2007, the billing system was converted to a minute basis and the former measurement based on pulses was discontinued for all customers. Our concession agreements also set forth criteria for annual fee adjustments. We derive a substantial portion of our revenue from services subject to this price adjustment. The method of price adjustment is essentially a price cap. ANATEL annually applies a price index correction that reflects the inflation index of the period and a productivity factor to our local and long-distance fees. Since 2006, the inflation index has been replaced by the IST, which reflects variations in telecommunications companies' costs and expenses. ANATEL has complied with the fee range set by the concession agreements.

Our mobile portfolio embraces not only voice and broadband internet access - through WAP protocol, 3G and 4G- but also value-added services, including voicemail, voice mail translation in speech-to-text ("Vivo Torpedo Recado"), caller identification, voice minutes in unlimited bundles to other mobile phones to post-paid customer, ring back tones ("Vivo Som de Chamada"), and innovative services such as multi-media backup, cloud based services to save the short messages ("Vivo Torpedo Center") and the recently launched "MultiVivo," that allows the customer to share a 3G, 3G+ and 4G connection with up to 5 mobile devices. All these services can directly be bought by the client through Vivo Service Store ("Loja de Serviços Vivo").

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

Local Service

Fixed local service includes activation, monthly subscription, measured service and public telephones. Measured service includes all calls that originate and terminate within the same local area or municipality of our concession region, which we refer to as "local calls." Excluding the portion of our region that was serviced by Ceterp before its acquisition in December 1999, we were the only supplier of local fixed-line and intraregional long-distance telecommunications services in our region until July 1999. At that time, licenses were auctioned to permit a competitor to provide local fixed-line and intraregional long-distance telecommunications services in our region, including the area formerly served by Ceterp. Vésper São Paulo S.A. received authorization and began operations in December 1999. Embratel, GVT, Oi and Tim also provide local services in our concession region. See "—Competition."

We became the first telephone service concessionaire in Brazil to offer fixed local services outside its concession region (the State of São Paulo). In May 2003, we achieved the network expansion and universal service targets established by ANATEL, and began providing fixed local services to six other states in Brazil, including Sergipe, Espírito Santo, Rio Grande do Sul, Paraná, Santa Catarina and certain areas in Rio de Janeiro. In May 2004, we began providing local fixed telephone services in seven other states in Brazil, including those in the capitals of Pará, Roraima, Amapá, Rondônia, Maranhão, Tocantins and Acre. In May 2005, we also began to provide fixed local telephone services in the capitals of the following states: Ceará, Amazonas, Pernambuco, Rio de Janeiro, Bahia, Mato Grosso do Sul and Mato Grosso. Since May 2006, we have also been providing fixed local telephone services in Brasília (Federal District) and Goiânia, the capital of the State of Goiás. Currently, our main Market aside our concession region are Rio de Janeiro, Espírito Santo, Minas Gerais, Bahia, Pernambuco, Ceará, Federal District, Goiás, Rio Grande do Sul, Paraná and Santa Catarina.

Intraregional Long-Distance Service

Intraregional long-distance services consists of all calls that originate in one local area or municipality and terminate in another local area or municipality of our concession region. We were the sole provider of intraregional long-distance services in our region until July 3, 1999, when the federal government also authorized Embratel and Intelig to provide intraregional long-distance services. Currently, our main competitors in this service are Embratel, Tim, Oi and GVT.

Table of Contents

Interregional and International Long-Distance Fixed Service

On March 1, 2002, ANATEL acknowledged that we had satisfied its network expansion and universal service targets two years before the scheduled date. As a result, on April 25, 2002, ANATEL published an order that allowed us to be the first fixed-line telephone company to provide the full range of STFC and granted us a concession to develop interregional long-distance services in Region III and an authorization to develop services in the local, intraregional, interregional and international markets throughout Brazil.

We began operating international long-distance services in May 2002 and interregional long-distance services in July 2002. Interregional long-distance services consists of state-to-state calls within Brazil. International long-distance services consists of calls between a point in Brazil and a point outside Brazil.

Data Services—Fixed Broadband

The fixed broadband service was launched in 1999 with the Speedy brand, initially with ADSL technology, which uses the same copper pair that is used in the provision of voice services, to provide fast Internet service.

In 2010, Telefônica Brasil began selling the product Popular Broadband (Banda Larga Popular), which is an initiative in the State of São Paulo to deliver affordable broadband for low-income populations. This product has a speed of 1 Mbps.

In 2011, the company and the Ministry of Communications signed the National Broadband Plan (Plano Nacional de Banda Larga) commitment which defines conditions for the provision of broadband retail and wholesale customer, as well as the conditions of communication, quality and supervision.

Broadband services provided under the National Broadband Plan should be provided starting with 90 days after it becomes effective. However, the company voluntarily launched its services under the National Broadband Plan in July 2011 in municipalities where our mobile 3G network was already available. On September 28, 2011, the company began providing fixed broadband services for retail and wholesale customers. The Company also agreed to offer retail broadband for a price of up to R$35.00 to the consumer or a broadband and fixed telephony package for a price of up to R$65.00 to the consumer. Broadband services offered under the National Broadband Plan for retail customers have a minimum speed of 1 Mbps and may have limits on the amount of downloads available. Wholesale services were available in 350 municipalities and can be used by local governments and companies registered under the tax system called "SIMPLES." Broadband services offered under the National Broadband Plan for wholesale customers are available in multiples of 2 Mbps, limited to 8 Mbps for local governments and 20 Mbps for corporate users.

We also provide fixed broadband services through cable internet and optical fiber (FTTH). Optical fiber is the most advanced technology currently available and it allows for speeds of up to 200 Mbps.

In 2013 Telefônica Brasil has 100% coverage of the municipalities in its concession area reaching more than 3.9 million customers of broadband.

Pay TV services

On March 14, 2007, ANATEL has granted A. TELECOM S.A., one of our wholly-owned subsidiaries at that time, the license to offer pay TV services via DTH. We began offering pay TV services on August 12, 2007.

On October 31, 2007, ANATEL's council approved, from a regulatory perspective, the agreement between us and the Abril Group, which involved, among other transactions, the acquisition by us of all of the Abril Group's MMDS operations (a special license that allowed us to offer pay TV through our subsidiary at that time, Telefonica Sistemas de Televisão S.A.). In November 2012, ANATEL authorized our provision of conditional access services to subscribers of our TV services. The provision of conditional access service to TV subscribers and the revisions to the concession agreement for such services were ratified by the Brazilian government on February 5, 2013.

On December 31, 2013, we owned 641 thousand TV users, through both DTH, cable and IPTV technologies. We currently offer DTH to the entire state of São Paulo, and IPTV and cable in the metropolitan area of São Paulo.

Network Services

Brazil is divided into four regions in relation to fixed telecommunication services with the following incumbent service providers (which initially received concessions from ANATEL): (i) Region I, that encompasses the North, Northeast and Southeast regions of Brazil, except the State of São Paulo, where concessions are granted to Oi (Telemar) and CTBC Telecom; (ii) Region II, that encompasses the South and Center-West regions of Brazil, where concessions are granted to Oi (Brasil Telecom), CTBC Telecom and Sercomtel; (iii) Region III, that encompasses the State of São Paulo, where concessions are granted to us and CTBC Telecom; and (iv) Region IV, that encompasses the whole country and in which the concession for long-distance calls is granted to Embratel.

In 2005, after meeting the targets imposed in the concession agreement two years before the expected date, Telefonica started to operate long-distance services in every municipality in Brazil. For the operation of local services in Regions I and II, the company expanded its network to the main Brazilian cities, providing services in these markets with infrastructure based on new-generation platforms.

In 2007, the company developed solutions and invested significant resources to adapt its network to the requirements of Number Portability determined by ANATEL. Number Portability is a service mandated by ANATEL that provides customers with the option of keeping the same telephone number when switching telephone service providers. The implementation of Number Portability in the State of São Paulo was effectively initiated in September 2008 and fully implemented in March 2009.

By the end of 2011, for local services, we were present in the main cities of Regions I and II, namely: Porto Alegre, Curitiba, Brasília, Rio de Janeiro, Vitória, Belo Horizonte, Salvador, Florianópolis, Fortaleza, Recife, Goiânia and Uberlândia. For the provision of data services, we had networks in fourteen cities in these regions.

We have continuously adapted and expanded our network topology aiming to develop new business opportunities in the State of São Paulo through offering services to other telecommunications companies. The result was a significant increase in the number of providers that use our wholesale services.

Other important adaptations have been implemented in the network topology to meet the regulatory requirements and to integrate several calling areas in the State of São Paulo, thus allowing customers to make local calls that had previously been categorized as long-distance calls. The integration of new cities into local areas is annually determined by ANATEL and we are fully complying with ANATEL’s determinations.

Competition for long-distance services has continuously increased and by the end of 2013 there were a total of 55 different operators available through the Service Provider Selection Code (Código de Seleção de Prestadora), or CSP. Satellite services for providing circuits in remote areas for wholesale and large customers have been also implemented.

Other Services

Currently, we provide a variety of other telecommunications services that extend beyond basic telephone service, including extended maintenance, caller identification, voicemail, cell phone blockers, computer support, antivirus software for our Internet service subscribers, and posto informático (a solution with a fixed monthly fee consisting of a computer, broadband access and technical support twenty-four hours, seven days a week), among others.

Digital Services

We have made strides in 2013 in the process of becoming a digital telecommunications company in areas such as financial services, machine-to-machine operations, e-health solutions, safety, video and advertising. In the e-health area, we have over 2.4 million clients as well as a wide portfolio of products directed towards the B2B segment. With these new developments, we aim to provide technology and innovation to the health services sector.

Interconnection

In July 2005, ANATEL published new rules regarding interconnection systems that substantially changed the interconnection model. These changes include: (i) an obligation to publish on the Internet an interconnection public offer for all types of interconnection services, in addition to the interconnection between fixed-line service providers and mobile service providers; (ii) offers of interconnection for Backbone Internet Providers; (iii) the establishment of criteria for the treatment of fraudulent calls; and (iv) the reduction of time in which new interconnection solicitations are answered. These reforms have facilitated market entry for new operators.

The interconnection public offer had been amended following negotiations with providers and changes in the services rendered and regulatory requirements. We have adopted procedures to reduce the time necessary to answer customers' interconnection requests, as well as to monitor and comply with quality levels set by ANATEL for interconnection services with a current availability level of 99.8%.

In 2006, we completed the implementation of the interconnection with mobile service providers in the most intensive traffic areas, assuring the proper billing for such calls and reducing interconnection costs.

In 2007, ANATEL published the new version of the Regulation of Fixed Network Compensation Rates, which primarily modified the rules for interconnection rates and calculation methods. Local and long-distance tariffs that were flat at all times became variable according to the rules for public service tariffs. A 20% increase was applied to tariffs of non incumbents.

In addition to the necessary adaptations in its network concerning the Number Portability, the company, in conjunction with other operators, implemented a systematic solution including several interoperable processes which enables the correct forwarding of calls.

According to SMP regulations, the VU-M price is subject to free negotiation between parties and once an agreement is reached it must be homologated by ANATEL to take effect. The agreement currently in effect was executed in 2009.

Starting in November 2009, the licenses of each mobile operator were consolidated by region, resulting in the consolidation of tariffs and in the reduction of interconnection fees for long-distance traffic within its network.

On May 7, 2012, the Brazilian government published Resolution No. 588/2012, which approved the new Regulation Compensation Network. Among the main changes compared to its predecessor resolution include the change in collection of the TU-RL on time considering the low incidence of 2 minutes per call TU-RL, changes in the interconnection regime for the partial Bill and Keep 25 % to 75% through December 31, 2013 and integral Bill and Keep beginning on January 1, 2014 and change in value of the TU-RIU to 25% of the fare LDN step 4 in 2012 and 20% after 2013.

On November 12, 2012, the Brazilian government published Resolution No. 600/2012 approving the General Competition Plan, or PGMC, which introduced the study of relevant markets in Brazil and applied asymmetric measures to the companies considered to have significant market power. It focused on the wholesale market, introducing new obligations regarding network desegregation, infrastructure sharing and interconnection. Particularly with regard to interconnection, the PGMC introduced a new tariff reduction schedule for use of mobile networks for 2014 (75% of value of 2013) and 2015 (50% of 2013), and programming the adoption of the RIC model in 2016. In terms of balancing traffic model, the PGMC kept the full Bill and Keep model with operators that have significant market power and established a partial Bill and Keep model with operators without significant market power through 2016, at which time all operators will follow the full Bill and Keep model.

At the end of 2013, Telefonica had 227 local and long-distance interconnection agreements and 108 agreements for provision of local traffic and long-distance.

I-Telefónica

I-Telefónica is a free Internet access service provider launched in September 2002 by our subsidiary at that time A.TELECOM S.A. (formerly Assist Telefónica). The service, available throughout Brazil, delivers high-quality, stable Internet access that is structured to ensure that our clients do not encounter a busy signal when connecting to the Internet. I-Telefónica permits us to increase the range of our services and better supply our customers by offering an entry-level option to the Internet market.

Table of Contents

Authorization to Provide Multimedia Services

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

Authorizations for pay TV via satellite

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

Authorization for Multichannel Multipoint Distribution Service (MMDS)

On October 31, 2007, the board of ANATEL concluded its regulatory review of the agreement between Grupo Abril and the company, approving the transaction from a regulatory perspective, which involved, among other transactions, the acquisition of all of the operations of MMDS. The approval was granted on November 19, 2007 and the transaction was fully cleared by regulatory and antitrust agencies.

In November 2012, ANATEL approved the adoption of service licenses for subscription television by the Telefonica group to the conditional access service.

On February 16, 2009, ANATEL extended the authorization until 2024 for the use of the spectrum frequencies associated with the MMDS in São Paulo, Curitiba, Rio de Janeiro and Porto Alegre. These authorizations were converted into SEAC (Paid TV license) in 2013 but due specific requirements set forth in the 4G bid notice, the Group shall transfer or waive such radio frequency authorizations until May 2014.

The STFC Concession Agreement

The company is authorized to provide STFC services to render local and domestic long-distance call originated in Region III, which comprises the State of São Paulo, except for Sector 31, established in the General Plan of Grants.

The current concession agreement, dated December 22, 2005, was renewed on January 1, 2006, and will be valid until December 31, 2025. On December 15, 2010, ANATEL released a public consultation proposing the amendment of clause 3.2 of the concession agreement, which resulted in the approval of Resolution No. 559 published on December 27, 2010. Resolution No. 559 establishes that the current concession agreement can be reviewed by ANATEL on May 2, 2011, December 31, 2015, and December 31, 2020. Based on the amended clause 3.2, ANATEL may establish new requirements and targets for universal and high-quality telecommunication services, according to the conditions present at the time of review.

On June 30, 2011, the company renewed its concession agreement and entered into new contracts for local and long-distance services with ANATEL pursuant to the concession agreement, with new conditions imposed on the company to change the basis of calculation of the biannual concession costs. The most relevant modifications discussed by ANATEL's board include: (i) suppression of clause 14.1 which prohibits service providers from controlling cable TV operators within their concession area; (ii) amendment of clause 3.2, which provides for a biennial concession fee, to include interconnection revenue in its calculation basis; (iii) broadening of ANATEL's supervisory powers; (iv) the possibility of off-setting cost of universalization in the calculation of the concession burden; (v) the inclusion of the AICE tariff adjustment formulas; (v) the possibility of remote monitoring of services; (vi) limiting the price of AICE subscription to 60% of the basic subscription; and (vii) free price determination.

The concession agreement establishes that all assets owned by the company and which are indispensable to the provision of the services described in such agreement are considered reversible assets and are deemed to be part of the concession assets. These assets will be automatically returned to ANATEL upon expiration of the concession agreement.

Every two years, during the agreement's new 20-year period, publicly held companies will have to pay a renewal fee which will correspond to 2% of the revenue of the previous year, resulting from the application of basic service plans and alternative STFC, net of taxes and social contributions. The first payment of this biennial fee occurred on April 30, 2007, based on 2006 revenue, the second payment occurred on April 30, 2009, based on 2008 revenue, the third payment occurred on April 30, 2011, based on 2009 revenue and the fourth payment occurred on April 30, 2013, based on 2012 revenue. The next payment is scheduled for 2015 based on 2014 revenue. See Note 1 to our Consolidated Financial Statements.

On April 8, 2008, we signed an amendment to the concession contracts to substitute the obligation to install telecommunications service posts with an obligation to roll out broadband network infrastructure throughout the municipalities serviced by such concessionaires.

ANATEL granted on August 18, 2011 consent to the transfer from the company to Vivo of the concessions for the provision of local STFC services, domestic long-distance and international long-distance services in Regions I and II of the General Plan of Grants (outside São Paulo). On September 8, 2011, the extract of the authorization term was published on the D.O.U. for the transfer of STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer the STFC through the GSM technology across its area, except for the State of São Paulo.

Services for Corporate Customers

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

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

Rates and Taxes

Rates

Overview

We generate revenue from (i) activation and monthly subscription charges, (ii) usage charges, which include measured service charges, and (iii) network usage charges and other additional services.

Rates for telecommunications services are subject to comprehensive regulation by ANATEL. See "—Regulation of the Brazilian Telecommunications Industry." Since the relative stabilization of the Brazilian economy in mid-1994, two major changes in rates for local and long-distance services have occurred: in 1996 to compensate for accumulated effects of inflation and in 1997 to eliminate the cross-subsidy between local and long-distance services.

Concession agreements, which were valid from 1998 until December 31, 2005, and subsequently renewed under a new contract for an additional 20 years until 2025 (all of our relevant concession agreements were renewed), establish a price cap for annual rate adjustments.

According to the new contract, we readjust charges based on a service basket of fees, as follows:

- Local services, where rates are established pursuant to a service basket of fees that includes rates for the measured traffic and subscription fees. In the case of a price adjustment, each one of the items within the local fee basket has a different weight and, as long as the total local fee price adjustment does not exceed the rate of increase in the Telecommunication General Price Index, or IST, minus a productivity factor as established in the concession agreements, each individual fee within the basket can exceed the IST variation by up to 5%.

- Installation of residential and commercial lines and public telephone services, with adjustments limited to the rate of increase in the IST minus a productivity factor as established in the concession agreements.

Table of Contents

- Domestic long-distance services, with rate adjustments divided into intraregional and interregional long-distance services, which are calculated based on the weighted average of the traffic, and taking into account time and distance. For these categories, each fee may individually exceed the rate of increase in the IST by up to 5%; however, the total adjustments in the basket of fees cannot exceed the rate of increase in the IST minus a productivity factor as established in the concession agreements. See "—Regulation of the Brazilian Telecommunications Industry."

Our rates for international services are not subject to regulation and are not required to follow the price cap for annual rate adjustment described above for other services. Therefore, we are free to negotiate our fees for international calls based on the international telecommunications market, where our main competitor is Embratel.

Local Rates

Our revenue from local service consists principally of activation charges, monthly subscription charges, measured traffic charges and public telephone charges. Users of measured traffic, both residential and non-residential, paid for local calls depending on usage, which until July 2007 was measured in pulses and from then on has been measured in minutes. The first minute is accounted for at the moment a call is connected to its destination.

Under current ANATEL regulations, residential customers who sign up for the basic plan monthly fee receive an allowance of 200 minutes per month.

Our local concession contracts set forth two mandatory plans for local fixed service, and allow for the concession company to design other alternative pricing plans of its own. Customers will have a choice between the two mandatory plans, any other alternative plan or a combination of basic and alternative plans. The main differences between the two main mandatory plans are as follows:

- Local Basic Plan: for clients that make mostly short-duration calls (up to three minutes), during regular hours; and

- Mandatory Alternative Plan (PASOO): for clients that make mostly longer-duration calls (above three minutes), during regular hours and/or that use the line for dial-up service to the Internet.

- Individual Special Class Access (AICE) – plan created specifically for families enrolled in the Brazilian government's social program.

The following table outlines the basic billing requirements and gross rates for the local Basic Plan and the Mandatory Alternative Plan:

Characteristics of Plan	Basic Plan	Mandatory Alternative Plan
Monthly Basic Assignment		
Allowance (minutes included in the Residential Assignment)	200 minutes	400 minutes
Commercial Assignment Allowance (minutes included in the Commercial Assignment)	150 minutes	360 minutes
Local Call Charges		

Regular Hours		
Completing the call (minutes deducted from the allotment)	–	4 minutes
Completing the call after the terms of the allotment Sector 31	–	R$0.16072
Local Minutes–charges in excess use of the allotment Sector 31	R$0.10482	R$0.04018
Minimum time billing	30 seconds	–
Reduced Hours		
Charge per answered call (minutes deducted from allotment)	2 minutes	4 minutes
Charge per answered call after the allotted duration Sector 31	R$0.20965	R$0.16072

The fees for Local Basic Plan Service were approved by ANATEL's Act No. 5,834 of August 24, 2011 and readjusted through Act 762, dated February 1, 2013. The Alternative Plan under Mandatory Service Provisions (Oferta Obrigatória), or PASOO, was approved by Resolution No. 450, on December 7, 2006, being that the readjustment of the tariffs follows the same rule established for the local basic plan.

37

In addition, Resolution No. 547, published on November 29, 2010, established that the company's fees for both the Local Basic Plan and Mandatory Alternative Plan (PASOO) should be unified following the unification of sectors 31, 32 and 34 into one single sector (sector 31), as defined by the Presidential Decree regarding the new General Plan of Grants published in the D.O.U. on November 21, 2008. This unification also applies to Basic Plan tariffs of fixed-to-mobile calls and long-distance calls and presumes the preservation of revenue earned on each item of the Basic Plan.

Resolution No. 586 established that families enrolled in the Brazilian government's social program may have access to fixed telephone services under the special class individual access plan (Acesso Individual de Classe Especial), or AICE. The subscription to the plan costs R$9.67 (excluding tax) and allows for 90 minutes of local fixed line calls. Any exceeding fixed calls or calls to mobile or long distance phones may be made once pre-paid credits are purchased. The price of mobile and long distance calls are determined pursuant to a standard plan.

Besides the Basic Service Plans, the company may offer alternative plans with any pricing design it chooses. However, ANATEL must be notified of these alternative plans before the publication and implementation of any such plan.

Clause 12.1 of the STFC concession agreement provides that the Local Basic Plan can be readjusted for periods of not less than 12 months taking into consideration the inflation index "IST" reduced by a fraction of the company's productivity (named "Fator X," which is calculated by ANATEL based on Resolution No. 507/08). The Mandatory Alternative Plan (PASOO) follows the same readjustment formula as the Local Basic Plan. Other alternative service plans are readjusted based on the IST.

On February 1, 2013, ANATEL issued Act No.762, which approved new local tariffs for concession areas. The average readjustment in the local service basket was 0.553%. Our readjustment totaled 0.568%. The tariffs were applied to customers as demonstrated below:

- Residential customers were charged a monthly subscription fee for the provision of service of R$41.62;
- Commercial clients and nonresidential customers (PBX) were charged a monthly subscription fee for the provision of service of R$71.17;
- Local minute tariffs were charged at R$0.10482 per minute in Sector 31; and
- Activation fees of R$114.46 were charged in Sector 31.

Intraregional and Interregional Long-Distance Rates

Intraregional long-distance services consists of all calls that originate in one local area or municipality of our concession region and terminate in another local area or municipality of our concession region. All other calls are denominated interregional long-distance calls. Rates for intraregional and interregional long-distance calls are computed on the basis of the time of day, day of the week, duration and distance of the call, and also may vary depending on whether special services, including operator assistance, are used.

On July 29, 2002, after we received the concession from ANATEL to provide interregional long-distance services in Region III and authorization to provide interregional long-distance services throughout Brazil, we launched several new options of interregional calling plans relating to consumer "Code 15," which is the selection code dialed by customers who may choose a long-distance provider with each call and may result in different prices based upon frequency of use and customer calling patterns.

International Long-Distance Rates

On May 7, 2002, we began operating international long-distance services. International long-distance call charges are computed on the basis of the time of day, day of the week, duration and destination of the call, and also may vary depending on whether special services are used or not, including operator assistance.

We have developed alternative rate plans for our residential and corporate customers.

Network Usage Charges

We earn revenue from any fixed-line or mobile service provider that either originates or terminates a call within our network. We also pay interconnection fees to other service providers when we use their network to place or receive a call. Under the General Telecommunications Law, all fixed-line telecommunications service providers must provide interconnection upon the request of any other fixed-line or mobile telecommunications service provider. The interconnection agreements are freely negotiated among the service providers, subject to a price cap and in compliance with the regulations established by ANATEL, which includes not only the interconnection basic principles covering commercial, technical and legal aspects, but also the traffic capacity and interconnection infrastructure that must be made available to requesting parties. If a service provider offers to any party an interconnection fee below the price cap, it must offer the same fee to any other requesting party on a non-discriminatory basis. If the parties cannot reach an agreement on the terms of interconnection, including the interconnection fee, ANATEL can establish the terms of the interconnection. See "—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies."

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

- Fee for the use of our local network—we charge local service providers a network usage charge for every minute used in connection with a call that either originates or terminates within our local network.

- Fee for the use of our long-distance network—we charge long distance service providers a network usage charge on a per-minute basis only when the interconnection access to our long-distance network is in use.

- Fee for the rental of certain transmission facilities used by another service provider to place a call.

Beginning in 2006, with the 20-year renewal of the concession contracts, the rules in respect of local network fees, or TU-RL, were changed. Beginning on January 1, 2008, local network fees were supposed to be calculated based on a long-term cost model (LRIC—Long Run Incremental Costs).

Through Resolution No. 464, published on April 27, 2007, ANATEL postponed the adoption of the LRIC model to April 30, 2009. Nevertheless, ANATEL is still working on the necessary studies to implement this cost model, as this model is part of its General Plan for Updating the Telecommunications Regulations in Brazil, published on November 12, 2008.

On May 7, 2012, ANATEL published Resolution No. 588/2012, which approved the change in TU-RL rate during the reduced rate period and considering the 2-minute TU-RL per call, in addition to the change in TU-RIU value to 25% of the LDN rate in 2012 and 20% in 2013. Furthermore, through December 31, 2013, rates will only be charged on calls that exceed the 75% limit of traffic between networks. Beginning in 2014, service providers' will no longer pay other companies for calls made between networks.

Mobile telecommunications services in Brazil, unlike those in the United States, are offered on a "calling party pays" basis, under which the subscriber pays only for calls that he or she originates. Additionally, a subscriber pays roaming charges on calls originated and terminated outside his or her home registration area. Calls received by a subscriber are paid for by the party that places the call in accordance with a rate based on per-minute charges. For example, a fixed-line service customer pays a rate based on per-minute charges for calls made to a cellular service subscriber. The lowest base rate per minute, or "VC1," applies to calls made by a subscriber in a registration area to persons in the same registration area. Calls to mobiles outside the registration area, but within the mobile authorization area, are charged at a higher rate, “VC2.” Calls to mobiles outside the mobile authorization area are billed at the highest rate, “VC3.” When a fixed-line service customer calls a mobile subscriber, we charge the fixed-line service customer per-minute charges based on VC1, VC2 or VC3 rates. In turn, we pay the mobile operator a charge for the use of its network.

Resolution No. 576/2011 established rules for adjusting the VC fees, by approving rates for VU-M (mobile termination rate). It has also determined gradual annual percentages decreases from 2012 to 2014 for these fees. On April 5, 2013, ANATEL published Act 2222 in the Official Gazette, which led to a reduction of 8.77% on the value of our mobile termination rate.

Our revenue from network services also includes payments by other telecommunications service providers for the use of part of our network arranged on a contractual basis. Other telecommunications service providers, including providers of trucking and paging services, may use our network to connect a central switching office to our network. Some operators use our network to connect cellular central switching offices to the cellular radio-based stations. We also lease transmission lines, certain infrastructure and other equipment to other providers of telecommunications services.

On November 12, 2012, the Brazilian government published Resolution No. 600/2012 approving the General Competition Plan, or PGMC, which introduced the study of relevant markets in Brazil and applied asymmetric measures to the companies considered to have significant market power. It focused on the wholesale market, introducing new obligations regarding network desegregation, infrastructure sharing and interconnection. Particularly with regard to interconnection, the PGMC introduced a new tariff reduction schedule for use of mobile networks for 2014 (75% of value of 2013) and 2015 (50% of 2013), and programming the adoption of the RIC model in 2016. In terms of balancing traffic model, the PGMC kept the full Bill and Keep model with operators that have significant market power and established a partial Bill and Keep model with operators without significant market power through 2016, at which time all operators will follow the full Bill and Keep model.

Data Transmission Rates

We receive revenue from charges for data transmission, which includes our fixed broadband, the rental of dedicated analog and digital lines for privately leased circuits to corporations and others services. See "—A. History and Development of the Company—Historical Background—The Spin-off of Certain Data Transmission Operations" and "—A. History and Development of the Company—Historical Background—The SCM Restructuring."

Taxes

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

- Federal Social Contributions: Contribuição para o Programa de Integração Social or "PIS," and Contribuição para o Financiamento da Seguridade Social or "COFINS," are imposed on gross operating revenue at a combined rate of 3.65% for telecommunications services (consisting of the COFINS amounts of 3.0% and PIS amount of 0.65%) and 9.25% for other services (consisting of the COFINS amounts of 7.6% and PIS amount of 1.65%). PIS is a tax designed to share business profits with employees through a mandatory national savings program, and is financed by monthly deposits collected as a percentage of gross operating revenue. COFINS is a tax designed to finance special social programs created and administered by the Brazilian government. Revenue related, among other things, to investments, dividends and sales of fixed assets are not subject to PIS and COFINS.

- Contribution for the Fund for Universal Access to Telecommunications Services—"FUST." FUST was established in 2000 to cover the cost exclusively attributed to fulfilling obligations (including free access to telecommunications services by governmental institutions) of universal access to telecommunications services that cannot be recovered with efficient service exploration or that are not the responsibility of the concessionaire. Contribution to FUST are due at the tax rate of 1% of gross operating telecommunications services revenue (except for interconnection revenue and excluding ICMS, PIS and COFINS), and it may not be passed on to customers.

- Contribution to the Fund of Telecommunications Technological Development—"FUNTTEL." FUNTTEL is a federal social contribution and was established in 2000, to stimulate, among others, technological innovation and to enhance human resources development so as to increase the competitiveness of the Brazilian telecommunications industry. Contribution to FUNTTEL is due at the tax rate of 0.5% of gross operating telecommunications services revenue (except interconnection revenue and excluding canceled sales, discounts, ICMS, PIS and COFINS), and it may not be passed on to customers.

- Contribution to the Fund for Telecommunications Regulation—“FISTEL.” FISTEL is a federal tax applicable to telecommunications transmission equipment which serves to provide funds to cover the expenses incurred by the Federal Government in performing inspections of telecommunication services and in developing the means and improving the techniques necessary for carrying out these inspections. The fees owed to FISTEL, known as the FISTEL Taxes, are: (i) an installation inspection fee assessed on telecommunications central offices upon the issuance of their authorization certificates and (ii) an annual operations inspection fee that is based on the number of authorized central offices in operation at the end of the previous calendar year.

Exemptions for telecommunications infrastructure

In connection with the Plano Brasil Maior, a policy instituted to promote the Brazilian technology industry and foreign trade, the Brazilian Government established the special tax regime for the taxation of national broadband plans (Regime Especial de Tributação para o Plano Nacional de Banda Larga), or RePNBL. This regime provides tax exemptions for telecommunications companies for broadband network expansions. We have submitted certain projects for qualification under this exemption, in compliance with the July 2014 deadline, which are currently being evaluated by authorities.

Another initiative set forth by the Plano Brasil Maior established exemptions for machine-to-machine services. We are currently waiting for the government to take action with respect to M2M.

Billing

We send each customer a monthly bill covering all of the services provided during the prior period. Telephone service providers are required under Brazilian law to offer their customers the choice of at least six different payment dates for each month.

We have a billing and collection system with respect to local, national and international long-distance voice, subscriptions, broadband, data, IT services, outsourcing, television and third-party services. Payments of bills are effected under agreements with various banks. The types of payments are by debit the customer's account, direct payment to a bank, Internet and other collection agencies (including lottery-playing facilities, drugstores and supermarkets). We aim to avoid losses in the implementation of new processes and the roll-out of new products through the monitoring of billing, collection and recovery controls. The billing process is audited by the Associação Brasileira de Normas Técnicas (Brazilian Association of Technical Standards), or ABNT, under the applicable rules of the Sarbanes Oxley Act. The actions are followed closely by our Revenue Assurance Team, which measures every risk of loss of revenue detected along the billing and collection chain. These risks are managed to minimize revenue losses.

It was started in 2012 a several initiatives to integrate fixed and mobile processes and systems. The first was part of our organizational structure when in the first quarter of 2012, we combined both fixed and mobile departments optimizing and focusing resources. In that year we also certificated mobile billing processes by the ABNT.

Another strong initiative related to process and system integration was the traffic mediation system project. Started during the last semester of 2012 and launched in operation in 2013, it was integrated all operation of fixed lines traffic to the same platform as the mobile lines, reducing the risk of revenue loss, achieving better operational levels and unifying best practices.

Co-billing

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

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

Value Added Services (VAS)

Entertainment, information and online interactivity services are available to all customers through agreements with content suppliers. These agreements are based on a revenue-sharing model through the processes of billed and prepaid categories, with all divergences between these categories being demonstrated to the content suppliers.

Third-party Services

In fixed as well as mobile billing process is made inclusion third-party services into the bill, collection and transfer. This service is charged to the contractor.

Collection

We have policies dealing with accounts of defaulting customers according to each ANATEL regulation. For mobile service, we apply the SMP regulation, for fixed service we apply the STFC and for TV we apply Resolution No. 488 “Protection and defense of the rights of subscription TV service subscribers.”

For mobile customers, as a general rule, if the payment is more than 15 days overdue, service can be partially suspended by blocking calls that generate costs to the user. If payment is more than 30 days overdue after the partial suspension, the service can be fully suspended, disabling all call services, until payment is made. We offer an installment payment plan for those clients with past due balances. However, if accounts are not paid after 45 days after the total suspension, the contract can be cancelled and reported to credit protection agencies.

For fixed customer, as a general rule, if the payment is more than 30 days overdue, service can be partially suspended. If payment is late for more than 30 days after the partial suspension, service can be fully suspended until payment is made. We offer an installment payment plan for those clients with past due balances. However, if accounts are not paid after 30 days of total suspension, the contract can be cancelled and reported to credit protection agencies.

For TV customer, as a general rule, if the payment is late, service can be fully suspended 15 days after the customer is notified of the overdue bill. If payment is more than 15 days overdue, after the suspension, service can be cancelled and reported to credit protection agencies.

The collection process involves several steps, from an internal interactive voice response, or IVR to make sure payment is made on time, followed by a phone call when a payment is late, followed by a late payment notice, and finally reporting customer information to an external credit bureau. Customer risk profile, days past due and debt balance are used to increase strategy efficiency and maximize debt recovery efforts. Amounts overdue by over 105 days, except for accounts receivables from interconnection fees, government and corporate customers, are considered provisions for doubtful accounts. The write-offs are made in accordance with Brazilian regulations, which permits a bad debt write-off for late payments of zero to R$5,000 if they are over 180 days late or R$5,001 to R$30,000 if they are over 365 days late. Write-offs of late payments of over R$30,001 that are open for more than 365 days require the commencement of a lawsuit.

During 2013, the monthly average of partial suspensions, for both mobile and fixed services, was 2,449,320 lines and the monthly average of total suspensions was 445,547 lines. For TV services, the monthly average of suspension was

16,419 terminals. The provision for doubtful accounts in 2013 was 1.43% of the total gross revenue.

Network and Facilities

Our network consists of an access layer that connects our clients through our metal or optical networks, which are connected to voice and data centers. These centers are interconnected locally or remotely through transmission equipment connected predominantly with fiber optics and occasionally through a microwave network, which together form a network layer that enables connectivity between the various central aggregate services platforms as well as interconnection with other carriers. Our network strategy is based on the expansion of the Access Network (fiber optics) to allow greater coverage and broadband (high-speed) services for our customers, as well as to develop an integrated multiservice network and multimedia applications. As a telecommunication service provider, we do

Table of Contents

not manufacture equipment for the construction of our networks and facilities. We buy the equipment from qualified suppliers and through this equipment we implement our networks and facilities through which we supply our services. The following table sets forth selected information about our network in aggregate:

	At and for the year ended December 31,									
Wireline access lines	2013		2012		2011		2010		2009	
Installed access lines (millions)	15.1		14.8		14.7		14.6		14.5	
Access lines in service (millions) (1)	10.4		10.5		11.0		11.3		11.3	
Average access lines in service (millions)	10.4		10.7		11.1		11.3		11.5	
Access lines in service per 100 inhabitants	23.7		25.1		26.5		27.5		27.1	
Percentage of installed access lines connected to digital switches	100.0	%	100.0	%	100.0	%	100.0	%	100.0	%
Number of public telephones (thousands)	199.1		199.2		215.8		250.7		250.5	
Broadband access lines (millions)	3.9		3.7		3.6		3.3		2.6	
Access lines in service out of São Paulo (FWT) (millions)	0.4		0.1		-		-		-	

	Year ended December 31,									
Mobile access lines	2013		2012		2011		2010		2009	
Cellular lines in service at year-end (in millions)	77.2		76.1		71.5		60.3		51.7	
Contract customers (in millions)	23.7		18.8		16.1		12.6		9.8	
Prepaid customers (in millions)	53.6		57.3		55.4		47.7		42.0	
Growth in cellular lines in service during year	1.4	%	6.4	%	18.7	%	16.5	%	15.1	%
Churn(2)	45.6	%	41.9	%	34.2	%	32.0	%	30.5	%
Estimated covered population (in millions)(3)	201.0		193.9		192.4		190.7		191.5	
Penetration at year-end(4)	136.4	%	132.7	%	123.9	%	104.6	%	90.5	%
Market share(5)	28.5	%	29.1	%	29.5	%	29.7	%	29.7	%

(1) Data includes public telephone lines.
(2) Churn is the number of customers that leave us during the year, calculated as a percentage of the simple average
(3) Number of people within our region that can access our cellular telecommunications signal.
(4) Number of cellular lines in service in our region, including those of our competitors, divided by the population of our Region.
(5) Percentage based on all lines in service in our region at year-end.

Technology

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

Voice network is being modernized with the use of new generation technology that enables redundancy and reliability needed to meet all voice services for both fixed and mobile terminals. In addition, we are deploying IMS Core and allowing the inclusion of new convergent services.

An example of this evolution is a new service called “Hosted Voice,” in which customers will have basic features and advanced PBX and also Unified Communication through the data network (IP/VPN). This solution reduces the amount of equipment in the customer environment by centralizing control and intelligence service.

There are great market opportunities for service convergence in Brazil. Products like cellular based residential phones were the first step towards seamless interactions among mobile, landlines, data services and television. As almost every service is evolving to IP Technology, IP Backbones became a strategic asset to support convergence initiatives.

To reach this goal, the integration of mobile and fixed Backbones IP were essential. We have designed a very robust architecture, unifying our mobile and fixed IP/MPLS infrastructures, using two physically distinct Backbones to guarantee service reliability to our clients. Moreover, absorbing other existing networks into both backbones, we have been able to simplify the network and reduce operational costs.

As content gains importance in the data world, it becomes more challenging to design a network able to meet the demand for content. High definition content has increased successfully among customers and 4K programming is coming fast, CDN assumes a key role in IPTV evolution, as it provides a better user experience and saves bandwidth at the same time.

With regards to Local Area Network, or LAN, as there is an increase in IP services, we aim to create a design that can absorb an exponential port growth for services without increasing operational costs. The result was the adoption of a new network implementation, using top of rack, or TOR and end of row, or EOR architecture. The technology reduces the amount of equipment on site and drastically decreases the use of cables, by placing small switches inside server racks, where cables are kept confined. From the rack to the site's core switches, only one pair of fiber is sufficient. The result is a significant savings in operating expenditures, as well as space, energy and air conditioning, despite the significant increase of network ports on site.

We have coped with various security threats in 2013, many of them very sophisticated to the average customer, whose business isn't network security. We have been able to expand our own network knowledge and infrastructure to protect customers from such threats. These initiatives have not only provided investments in internal security solutions that made our operations more reliable, but also leveraged new business opportunities in the managed security segment.

One of the main threats we have faced in 2013 has been Distributed Denial of Service attacks, or DDOS, as hackers attempt to shut down services by consuming all resources. DDOS counter-measures deployed in 2011 for internal protection has been widely expanded to corporate customer protection, generating new revenue and cross-selling and loyalty, as it demands Telefonica IP Internet services.

In the Value Added Services, we have been adopting new technologies to increase the speed with which we market new and enhanced services. Since 2009, we have deployed a new Service Delivery Platform, or SDP into the network, to evolve our environment through a secure and scalable solution that offers the most different value added services, including eHealth and Financial services. In 2011, we gave another step towards the evolution of our value added services environment, with the implementation of the Next Generation Intelligent Network platform, or ngIN, enabling voice call notification and call handling based services. Through the exposure of WebServices and application programming interfaces, or APIs, we introduced the Telecommunications market to Service Providers that have no Telecom specific knowledge, which explains the increasingly rapid growth of the quantity and quality of our Value Added Service offering. In addition, for the delivery of valued added services into the enterprise market, also offer another platform named Torpedo Empresas, which allow the Brazilian Banks and Financial Entities to deliver their own services, such as bank accounts notifications, financial transaction notifications and the delivery of access tokens to their customers.

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

In 2014, we plan to continue the improvements in global video platforms aiming to increase competitiveness in the ITS market. New features like Timeshift and Catchup TV will be implemented and we will expand all the services to other cities of São Paulo.

The IPTV platform also offers games, interactive and connectivity services through third party contents, furthermore offers Over The Top (OTT) contents, for the broadband users, through the applications developed for smart TVs, smart phones with Google's Android and Apple's iOS, besides STBs and PCs. A new service OTT Live will deliver broadcast channels to those devices.

We also offer digital television service via satellite (DTH) to the subscribers in the State of São Paulo that receive broadcast/PPV content through a Ku band antenna and standard Set Top Box (with Smart Card), also available with a Personal Video Record (PVR) service.

Our development plan contemplates the use of the most advanced technology available, focusing on integration with the Internet and an increase in the number of multimedia transmission services, with an emphasis on xDSL,

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FTTH (GPON), NGN, DWDM, ROADM and retransmittal technologies of TV over IP protocol (IPTV), satellite (DTH), and the continuous evolution of TV services.

In 2012, we had a breakthrough in the M2M market, with the deployment of a new and revolutionary solution within the Brazilian market, introducing an M2M Global Platform that allows our B2B customers to have access to a Management Web Portal user interface in the internet to access online and real-time information regarding their devices. Some of the competitive advantages of the deployed solution against our previous service and those of our competitors are the Self-management of the acquired SIM Cards, to control, assign plans and tariffs or even block the use of the network by the device. In 2014, we will continue to evolve the offer, adding new functionalities.

Since 2012, “Speedy” is also offered under the Very-High-Speed Digital Subscriber Line technology (VDSL2), which allows broadband accesses of up to 25Mbps. These technologies provide high-speed Internet access through regular telephone lines. Yet in 2012, we started the implementation of Multi-Service Access Nodes (MSAN) in order to modernize the wireline network of some distant areas, integrating voice, broadband and data services on a single cabinet. We also offer broadband services using coaxial cable at speeds between of 8 Mbps up to 100 Mbps. In 2013, the product “Banda Larga Popular,” which has a speed of 250 kbps to 1 Mbps, reached 1 million and 388 thousand customers.

Through platform called DLM ASSIA, which improves the diagnosis and stability of service to customers, we increased the number of correct recommendation speed upgrade, over 410 million upgrades were made during 2013, looking for loyalty of the customer base and increased revenue.

In 2007, we initiated the implementation of the FTTH network (available through fiber optic cables running to the subscriber’s home – GPON technology) with coverage of 1.9 million homes. With this service, we reach a range of different speeds up to 200Mbps, and high definition IPTV service (HDTV).

In 2013, we surpassed the mark of 3.9 million broadband clients connected served via xDSL, fiber and coaxial cable. To reach this number of clients, we constantly search for market differentials such as new integrated services, speed upgrades and servicing of new localities, among others.

In 2011, we launched the HSPA+ technology, commercially known as 3GPlus. This technology was firstly commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11) but now is offered in 100% across our WCDMA coverage, allowing customers who have compatible terminals to achieve up to three times the value of traditional 3G’s rate. In 2013, we launched the LTE system in a new spectrum (2600 Mhz). 73 Brazilian cities were covered with 4G in 2013 (including those hosting World Cup games in 2014). Over the next years, we expect the 4G coverage will mainly support the requirements of the Brazilian Regulatory Agency.

Competition

In 2013, competition continued to increase in the market for small/medium enterprises and in the residential market due to an expansion of the coverage area realized by the main competitors, improvements on their portfolios, and also due to an increase in their commercial activity and offers for both fixed and mobile services, adding downward pressure to prices and insisting on higher discounts.

The telecom scenario in 2013 as in previous years remained very competitive and showed good progress in mobile broadband, especially for the commercial launch of 4G LTE technology in compliance with the schedule established by the Government for the cities hosting of Confederations Cup games. We played a prominent role reaching the leadership of the 4G market through December with over 73 municipalities having coverage and remained a leader in 4G coverage by population, with 30% of the total population in the covered area.

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

Our main mobile service competitor in the states of Paraná, Santa Catarina, Pará, Ceará, Rio Grande do Norte, Pernambuco and Alagoas is TIM Celular or TIM, a Brazilian telephone company, subsidiary of Telecom Italia.

In the states of Maranhão e Paraíba the principal mobile competitor is Oi, previously formed by Telemar Norte Leste SA and Brasil Telecom SA. The group has a concession of fixed telephony in all States and, through TNL PCS authorization to offer mobile services.

Rio de Janeiro, Rondônia, Goiânia, Distrito Federal, Bahia, Piauí and Tocantins are states where Claro is our main competitor. Claro is a mobile operator that was created in Brazil, resulting from the six regional operators: Americel, ATL, Nordeste BCP, BCP SP, Claro Digital and Tess. In September 2003 Claro announced the consolidation of all these operators under a single brand, Claro. It is controlled by a Mexican company, America Movil Group.

In the other 11 Brazilian states (São Paulo, Acre, Amazonas, Roraima, Sergipe, Amapá, Mato Grosso, Mato Grosso do Sul, Minas Gerais, Espírito Santo and Rio Grande do Sul) we are the leader in the mobile market.

Our main competitors for the provision of fixed services are: America Móvil / Telmex group (which includes NET, Claro and Embratel), TIM (which is commercially represented by Live TIM), GVT and SKY. Our competitors employ varied strategies to gain market share. For instance, GVT expanded its operations to the city of São Paulo, with a strategy based on ultra-broadband services, high-quality customer service, and a new TV product, targeting high-income residential clients and small and medium businesses. NET restructured its portfolio TV with a focus in HD channels and kept the aggressive pricing strategy of broadband, offering 30 Mb promotionally priced at10 Mb. Live TIM had a significant growth and reached 60k customers by the end of 2013. In the segment of low-income customers, we face competition from Embratel in TV services and NET in both TV and broadband services. SKY provides satellite pay-TV service and offers from low to high prices packages to its targets.

One of the main trends in the Brazilian telecom market is the increase of offers composed by both mobile and fixed services. NET and Claro (two companies of America Móvil group) launched “Combo Multi”, an offer with ultra-broadband, pay-TV, fixed and mobile lines all together in one package. Just as NET and Claro, Oi remains focused on the convergence strategy between fixed and mobile services.

We continue to develop and expand our product offerings, particularly those with great potential for future growth, such as broadband Internet services, pay-Tv, and information technology services beyond the creation of convergence fixed-mobile deals among services. In fixed broadband, the company has expanded its portfolio of speeds according to each customer need by offering packages of 1Mbps to 200Mbps with “Vivo Internet Casa.” We emphasize the “Vivo Internet Box” option for broadband product areas where other technologies are not available with plans starting at R$ 52.90 per month. The Company has invested heavily in expanding the fiber optic network to within the client's home in order to reach over 1.9 million homes in 25 cities in the State of São Paulo, as the only operator in São Paulo along with NET using the FTTH - Fiber to the Home technology (NET has launched FTTH for the 500Mbps speed in January of 2014, at São Paulo and Rio de Janeiro cities). In the last quarter of 2013, Vivo launched the new portfolio of Internet service Vivo Fiber, 50, 100 and 200 Mbps, with plans starting from R$79.90/month, this ensuring that only our customers have the highest speeds of São Paulo, with competitive prices.

We have also launched a FWT service which offers fixed-phones using the wireless network. With our FWT service, we aim to leverage the fixed-phones sales, mainly outside the state of São Paulo, where we have reduced fixed network capacity. This solution can also reduce the cost of providing this service to enterprises located nationwide, such as banks, which we already have in our portfolio of clients.

The year 2013 was also marked by the resumption of investments and growth in the pay-TV market. In the first quarter the Vivo TV Fiber was launched, providing the most watched channels allied to unique features enabled by fiber optic technology and the Mediaroom platform. The service offers thousands of content which can be watched when the customer desires and unique applications that ensure greater interactivity. A massive campaign was also launched in the first half of the year in the state capital, leveraging the growth of 6x the monthly sales of the product, especially for customers who had already experienced Vivo's ultrabroadband.

We continue with our strategy in the corporate market as a provider of complete infrastructure solutions for information technology customers, integrating hardware packages, voice, data, Internet and network services.

To conclude, in 2013 ANATEL kept monitoring closely the quality goals of all telecom services, establishing along the period new rules and public consultation in order to increase the quality pattern. Vivo remains with its strategy focused on quality and profitability, already recognized by the market, and at the same time launching innovative services and products.

Table of Contents

Seasonality

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

Regulation of the Brazilian Telecommunications Industry

General

Our business, including the services we provide and the rates we charge, is materially affected by comprehensive regulation under the General Telecommunications Law and various administrative rules thereunder. Our companies that operate under a concession are authorized to provide specified services and have certain obligations, according to the Plano Geral de Metas de Universalização (PGMU), or General Plan on Universal Service Targets and the Plano Geral de Metas de Qualidade (PGMQ), or General Plan on Quality Targets.

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

Concessions and Authorizations

Concessions are licenses to provide telecommunications services that are granted under the public regime, while authorizations are licenses to provide telecommunications services granted under the private regime.

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

Companies that provide services under the private regime, known as the authorized companies, are generally not subject to the same requirements regarding continuity or universality of service; however, they may be subject to certain network expansion and quality of service obligations set forth in their authorizations.

Companies that operate under the public regime are Telefonica, Embratel, Oi, CTBC Telecom and Sercomtel. The primary public regime companies provide fixed-line telecommunications services in Brazil that include local, intraregional, interregional and international long-distance services. All other telecommunications service providers, including the other companies authorized to provide fixed-line services in our concession region, operate under the private regime.

Public regime companies, including us, can also offer certain telecommunications services in the private regime, of which the most significant are data transmission services.

Fixed-line Services—Public Regime. Our current concession agreements for the local, intraregional and interregional long-distance services were extended on December 22, 2005, for an additional period of 20 years.

Our current concession agreements contain a provision, amended by ANATEL on June 30, 2011, providing that they may be amended on December 31, 2015, and December 31, 2020 to establish new conditions and new targets for universal access and quality, taking into consideration the conditions prevailing at the time, and defining, in the case of universal access targets, complementary resources, as provided by article 81 of Law No. 9,472 of 1997.

Under the renewed concession agreements and during the 20-year renewal period, we are required to pay a biennial fee equal to 2% of the gross revenue of the previous year, net of taxes and social contributions, arising from the rendering of basic service plans and alternative STFC in our concession area . See "—Obligations of Telecommunications Companies." Each of the foregoing regulatory terms and conditions affecting (or potentially affecting) the current concession agreements, as well as current obligations under the existing concession agreements, may impact our business plan and results of operations.

Fixed-line Services—Private Regime. The Brazilian telecommunications regulation delegates to ANATEL the power to authorize private regime companies to provide local and intraregional long-distance services in each of the three fixed-line regions and to provide intraregional, interregional and international long-distance services throughout Brazil. ANATEL has already granted authorizations to private regime operators to operate in Region III, our concession region. ANATEL also granted other private regime companies authorizations to operate in other fixed-line regions and authorizations to provide intraregional, interregional and international long-distance services throughout Brazil in competition with Embratel. Several companies have already applied for authorization, and ANATEL may authorize additional private regime companies to provide intraregional, interregional and international long-distance services. See "—Competition."

Since 2002 we provide local and interregional services in Regions I and II and Sector 33 of Region III, and international long-distance services in Regions I, II and III.

In accordance with the General Telecommunications Law, a concession relates to the provision of telecommunication services under the public regime, as determined by the public administration. A concession may only be granted upon a prior auction bidding process. As a result, regulatory provisions are included in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. In addition, ANATEL is empowered to direct and control the performance of the services, to apply penalties and to declare the expiration of the concession and the return of assets of the concessionaire to the government authority upon termination of the concession. Another distinctive feature is the right of the concessionaire to maintain certain economic and financial standards. The concession is granted for a fixed period of time and is generally renewable only once.

An authorization is a permission granted by the public administration under the private regime, which may or may not be granted upon a prior auction bidding process, to the extent that the authorized party complies with the objective and subjective conditions deemed necessary for the rendering of the relevant type of telecommunication service in the private regime. The authorization is granted for an indeterminate period of time. Under an authorization, the government does not guarantee to the authorized company the economic-financial equilibrium, as is the case under concessions.

SMP Licenses

Before January 2000, ANATEL had only authorized two mobile service providers in each of the ten franchise areas under "A" band and "B" band. "A" band and "B" band mobile service providers were granted concessions pursuant to the Lei Mínima, or the Minimum Law. Each concession was a specific grant of authority to supply mobile telecommunications services, subject to certain requirements contained in the applicable list of obligations appended to each concession. If a mobile service provider wishes to offer any telecommunications services other than those authorized by its authorized concession, it may apply to ANATEL for an authorization to offer such other services.

In November 2000, ANATEL adopted certain regulations for the issuance of new licenses, which are authorizations to provide wireless communication services through SMP, personal mobile service, to compete with the existing mobile operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunication services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1800 MHz radio frequency bands which were denominated as the "C" band (which was later transformed into extension bands), the "D" band, "E" band and "M" band. These licenses were auctioned by ANATEL and awarded during the first quarter of 2001, at the end of 2002, in September 2004, in March 2006, in September 2007, in December 2007 and in December 2010. In September 2007, ANATEL organized auctions for 15 new licenses in the 1900 MHz radio frequency bands which were denominated Band "L." Vivo acquired 13 spectrum licenses in band "L." In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses) which were denominated bands “F,” “G,” “I” and “J.” Vivo acquired seven spectrum licenses in Band “J” and Vivo Participações acquired two spectrum licenses in Band “J.” In December 2010, ANATEL organized auctions for 165 new licenses in the “H” band, extension bands, and available frequencies at “A,” “D,” “E,” “M” and TDD bands. Vivo was awarded 23 license (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and 9 spectrum licenses in 900 MHz extension bands).

On February 3, 2003, TCO replaced its SMC Concession Contracts for Personal Mobile Service Agreements (Termos de Autorização do Serviço Móvel Pessoal) in Regions I (sub range of “B” frequencies) and II (sub range of

"A" frequencies) of the General Plan of Grants. On December 10, 2002, Telerj Celular, Telest Celular, Telebahia Celular, Telergipe Celular, Celular CRT, Global Telecom and TELESP Celular replaced its SMC Concession Contracts for Personal Mobile Service Agreements, or SMP, in Regions I (sub range of "A" frequencies), II (sub range of "A" and "B" frequencies) and III (sub range of "A" frequencies) of the General Granting Plan. On July 27, 2006, ANATEL published Act 59867 authorizing the incorporation of TCO, Teleacre, Telegoiás, Teleron, Telems, Telemat, NBT, Telerj, Telest, Telebahia, Telergipe, Celular CRT and TC by GT, as well as the transfer of the respective SMP service authorization titles and of the SMP radio-frequency rights-of-use titles. Act 59867 also provides for the automatic termination of the authorizations for Multimedia Communication Services (Serviços de Comunicação Multimídia, or SCM) of TCO, Teleacre, Telegoiás, Teleron, Telems, Telemat, NBT, Telerj, Telest, Telebahia, Telergipe, Celular CRT and TC, upon each of their respective incorporations.

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

Our authorizations consist of two licenses—one to provide mobile telecommunications services, and another to use the frequency spectrum for a period of 15 years. The frequency license is renewable for another 15-year period upon the payment of an additional license fee.

Our new SMP licenses include the right to provide mobile services for an unlimited period of time but restrict the right to use the spectrum according to the schedules listed in the old licenses (Vivo-Rio Grande do Sul ("A" band) until 2022 (renewed in 2006); Vivo-Rio de Janeiro ("A" band) until 2020 (renewed in 2005); Vivo-Espírito Santo ("A" band) until 2023 (renewed in 2008); Vivo-Bahia ("A" band) and Vivo-Sergipe ("A" band) until 2023 (renewed in 2008); Vivo-São Paulo ("A" band) until 2023 or 2024, for the cities of Ribeirão Preto and Guatapará (renewed in 2008); Vivo-Paraná/Santa Catarina ("B" band) until 2028 (renewed 2013); Vivo-Federal District ("A" band) until 2021, (renewed in 2006); Vivo-Acre ("A" band), Vivo-Rondônia ("A" band), Vivo-Mato Grosso ("A" band) and Vivo-Mato Grosso do Sul ("A" band) until 2024 (renewed in 2008); Vivo-Goiás/Tocantins ("A" band) until 2023 (renewed in 2008); Vivo-Amazonas/Roraima/Amapá/Pará/Maranhão ("B" band) until 2028 (renewed 2013); Vivo (Minas Gerais) ("A" band) until 2023 (renewed in 2007) and Vivo (for the cities where CTBC Telecom operates in the state of Minas Gerais) ("E" band) until 2020). Spectrum rights may be renewed only once over a 15-year period.

In September 2007, ANATEL organized auctions of new SMP licenses in the remaining radio frequency bands "D" and "E," in the 1.8 GHz frequency band "M," and fifteen licenses in the 1.9 GHz frequency band "L," previously allocated to fixed operators. Vivo acquired 13 spectrum licenses in band "L." The following Terms of Authorization for band "L" have been signed: Vivo-Rio Grande do Sul ("L" band) until 2023 (renewed in 2006) and 2022 for the cities of the metropolitan area of Pelotas; Vivo-Rio de Janeiro ("L" band) until 2023 (renewed in 2005); Vivo-Espírito Santo ("L" band) until 2023 (renewed in 2008); Vivo-Bahia ("L" band) and Vivo-Sergipe ("L" band) until 2023 (renewed in 2008); Vivo-São Paulo ("L" band) until 2023 or 2022 for the cities where CTBC Telecom operates in the state of São Paulo; Vivo-Paraná (excluding the cities of Londrina and Tamarana)/Santa Catarina ("L" band) until 2023; Vivo-Federal District ("L" band) until 2023, (renewed in 2006); Vivo-Acre ("L" band), Vivo-Rondônia ("L" band), Vivo-Mato Grosso ("L" band) and Vivo-Mato Grosso do Sul ("L" band) until 2023 (renewed in 2008) or 2022 for the city of Paranaíba of Mato Grosso do Sul; Vivo-Goiás/Tocantins ("L" band) until 2023 (renewed in 2008) or 2022 for the cities where CTBC Telecom operates in the state of Goiás and Vivo-Alagoas/Ceará/Paraíba/Piauí/Pernambuco/Rio Grande do Norte ("L" band), until 2022. Spectrum rights may be renewed only once over a 15-year period.

In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses), denominated as bands F, G, I and J. Vivo was awarded seven spectrum licenses in band "J" and Vivo

Participações was awarded two licenses, covering all the country until 2023 with 2100 MHz radiofrequency. Spectrum rights may be renewed only once over a 15-year period.

In December 2010, ANATEL organized auctions for 165 new licenses in the "H" band, extension bands, and available frequencies at "A," "D," "E," "M" and TDD bands. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands ("D," "E," "M" and extension bands) and 9 spectrum licenses in 900 MHz extension bands), expiring in 2023:

Table of Contents

- "M" band (1800 MHz) of the Federal District and the states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia and Acre;
- 1800 MHz extension band of the state of São Paulo;
- "D" band (1800 MHz) of the cities of Pelotas, Morro Redondo, Capão do Leão and Turuçu in the state of Rio Grande do Sul;
- "E" band (1800 MHz) of the states of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte;
- 900 MHz extension band of the state of Rio de Janeiro;
- 900 MHz extension band of the state of Espírito Santo;
- 900 MHz extension band of the states of Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District, with the exception of the cities of Paranaíba, in the state of Mato Grosso do Sul, and the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
- 900 MHz extension band of the state of Rio Grande do Sul, with the exception of the cities of Pelotas, Morro Redondo, Capão do Leão and Turuçu;
- 900 MHz extension band of the cities of the registration area number 43 of the state of Paraná, with exception of the cities of Londrina and Tamarana;
- 900 MHz extension band of the states of Paraná and Santa Catarina, with exception of the cities of the registration area number 43 of the state of Paraná and the cities of Londrina and Tamarana;
- 900 MHz extension band of the state of Bahia;
- 900 MHz extension band of the state of Sergipe;
- 900 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
- 1800 MHz extension band of the state of São Paulo, with exception of the cities of the metropolitan region of São Paulo and the cities where CTBC Telecom operates in the state of São Paulo;
- 1800 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
- 1800 MHz extension band of the city of Paranaíba, in the state of Mato Grosso do Sul;
- 1800 MHz extension band of the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
- other 1800 MHz extension band of the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;

- 1800 MHz extension band of the states of Rio de Janeiro, Espírito Santo, Bahia and Sergipe;
- 1800 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
- 1800 MHz extension band of the states of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte;
- 1800 MHz extension band of the city of Paranaíba, in the state of Mato Grosso do Sul, and the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;

- 1800 MHz extension band of the cities of Londrina and Tamarana, in the state of Paraná; and
- 1800 MHz (extension sub bands in Region II, within the states of São Paulo and Espírito Santo, Ceará and Pernambuco) and TDD (National coverage).

On December 1, 2011 ANATEL carried out the bidding of frequency blocks (Notice No. 001/2011/PVCP/SPV-ANATEL), divided into 54 lots, in the bands: 800 MHz (Band A in the North), 1800 MHz (sub bands extension in Region II, within the states of São Paulo and Espírito Santo, Ceará and Pernambuco) and TDD (national coverage), totaling approximately R$592 million, considered the minimum biding price. This auction offered remaining lots from Notice No. 002/2010/SPV-ANATEL, held in December 2010, in which Vivo was one of the largest winners in the auction by acquiring radio frequency bands 900 MHz and 1,800 MHz.

Of the 54 lots under auction, 15 were sold, totaling revenue of R$237 million to the government, representing a premium of 0.69%.

Vivo was unable to participate in this auction because it has already reached maximum spectral capacity in most concession areas. As a result, if Vivo had purchased any lot in these areas, it would have exceeded its spectrum cap as established by applicable regulations. Under these new licenses:

- services are to be provided using the 1800 MHz frequency bands (“D” band, “E” band and “M” band), 1900 MHz frequency bands (“L” band), 1900–2100 MHz frequency bands (“F” band, “G” band, “H” band, “I” band and “J” band) and extension bands;
- each operator may optionally provide domestic and international long-distance services in its licensed area;
- existing mobile service providers as well as new entrants into the Brazilian telecommunications market can bid for “D” band, “E” band, “M” band, “L” band, “F” band, “G” band, “I” band and “J” band licenses;
- according to the Invitation Document 002/2010/ANATEL, a single SMP operator in one geographic area will only be authorized to have radio frequency bands up to the total maximum limit of 80 MHz or 85 MHz, depending on the circumstances, while observing the following limits for each band:

I – (12.5 + 12.5) MHz, for the 800 MHz bands;

II – (2.5 + 2.5) MHz, for the 900 MHz bands;

III – (25 + 25) MHz, for the 1800 MHz bands;

IV – (15 + 15) MHz, for the 1900 MHz and 2100 MHz bands;

V – 5 MHz, for the TDD extensions of 1900 MHz band;

- as a result, Nextel and other new 3G operators were given preferential status in the “H” band ((10 + 10) MHz) segment of the auction. Vivo, TIM and Claro were eligible to enter bids for the remaining SMP frequencies. Oi acquired the band “H” lot 8 (for the cities in the states of Mato Grosso do Sul and Goiás). CTBC acquired the band “H” lot 5 (for the cities in the state of Minas Gerais) and Nextel acquired the other band “H” lots; and

- a mobile operator, or its respective controlling shareholders, may not have geographical overlap between licenses.

In 2013, we changed the terms of our authorization regarding Band "G" (1.9 GHz) in certain locations, adapting their blocks of frequencies to 2.1 GHz and aligning them with the band "J" (3G) which provides a more efficient use of the spectrum. The alignment has not occurred in the following areas: Northeast, with exception to Bahia and Sergipe; Pelotas, Morro Redondo, Capão do Leão and Turuçu, in Rio Grande do Sul; Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in Goiás; and Paranaíba in Mato Grosso do Sul. This change is foreseen in the bidding document No 001/2007. Telefonica has no band “G” in northeast region and in Londrina and Tamarana, Paraná.

On June 12 and 13, 2012, ANATEL held a public bidding for 273 4G lots in the 2,500 to 2,690MHz frequencies. We acquired the “X” band, with a nationwide coverage, for R$1.05 billion. Given the rules of the public bidding process, which limited the total spectrum each service provider could hold within this frequency, we agreed to relinquish bands “P,” “T” and “U” used for MMDS services within 18 months of obtaining the “X” band. Sky and TIM will have preferred rights for the acquisition of the “T” and “U” and for the “P” bands, respectively in the cities of Curitiba and Rio de Janeiro and Oi will have preferred rights for the acquisition of the “P” band in the cities of São Paulo and Porto Alegre.

In order to meet the coverage obligations and the schedule defined by ANATEL, we have already made the 4G service available in the cities that hosted the 2013 FIFA Confederations Cup and that will host as well as sub-host cities for the 2014 FIFA World Cup. To complete the coverage requirements, for the next years we will meet the following coverage requirements:

- by May 31, 2014: state capitals, the Federal District and cities with over 500,000 residents;
- by December 31, 2015: cities with over 200,000 residents;
- by December 31, 2016: cities with over 100,000 residents;
- by December 31, 2017: cities with between 30,000 and 100,000 residents; and
- by December 31, 2019: cities with fewer than 30,000 residents.

ANATEL also held a public bidding for the 450 MHz frequency, in order to meet voice and data demand with mobile technology in rural areas. In the absence of interested participants, those granted rights under the 4G bid were required to take over the infrastructure set up in rural areas, which will be regulated in 2013 according to the frequency acquired.

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 interior of São Paulo, for a total of 2,556 municipalities. The timetable for providing infrastructure in the rural areas requires that 30% of municipalities have infrastructure set up by June 2014, 60% by December 2014 and 100% by December 2015, with a transmission rate of 256Kbps and by December 31, 2017, all of these municipalities will be expected to have 1Mbps. Service providers will be allowed to use other frequencies previously granted to it to meet these requirements.

On July 18, 2012, ANATEL notified us that we would be required to present an improvement plan for SMP services. We presented our plan and it was approved by ANATEL on September 10, 2012.

After receiving the ANATEL study on the occupation of the 700 MHz frequency, published in early January 2013, the Brazilian Ministry of Communications, issued Ordinance No. 14, with guidelines for accelerated access to the Brazilian System of Digital Terrestrial Television - SBTVD-T and to broaden the availability of the radio frequency spectrum for meeting the goals set forth by the National Broadband, or PNBL. The ordinance also establishes that the ANATEL develop a proposal to regulate use of the band. Between February and May 2013, the proposal was taken to a public consultation and the discussion, which led to Resolution No. 625/2013, which approves the allocation of the 700 MHz band to the fixed and mobile services of telephony and broadband. However, the completion of the allocation process requires the migration of the TV channels that currently occupy the band as well as the conclusion of studies regarding spectrum interference between mobile and TV services that are currently being performed by

ANATEL.

Obligations of Telecommunications Companies

We and other telecommunications service providers are subject to obligations concerning quality of service, network expansion and modernization. The concession telecommunication companies are also subject to a set of special restrictions regarding the services they may offer, which are listed in the Plano Geral de Outorgas (PGO), or General Plan of Grants, and special obligations regarding network expansion and modernization contained in the General Plan on Universal Service Targets.

In 2008, the presidential decree published with the General Plan of Grants increased the flexibility of telecommunications provider groups as STFC concessionaires by allowing such providers to provide services in up

Table of Contents

to two General Plan of Grants regions. Before this decree, telecommunications provider groups holding STFC concessions could offer STFC services in only one region under the public regime.

Any breach by the companies of telecommunications legislation or of any obligation set forth in their authorizations may result in a fine of up to R$50 million.

The mobile service authorizations of Vivo involve obligations to meet quality of service standards the system's ability to make and receive calls, call failure rates, the network's capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL published the method for collecting these quality service standards data on April 23, 2003 (ANATEL Resolution No. 335/03 and 317/02). In July 2010, ANATEL published Public Consultation No. 27/2010, revising the General Plan of Standards of Quality of the SMP.

To restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to check the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL issued on October 28, 2011 (published in the D.O.U. on October 31, 2011), Resolution No. 575/2011, which approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (SMP-RGQ).

The new Regulation provides for the assessment of the network connection and their respective data transmission rate, assessing aspects of availability, stability and connection speed for the data network. In addition, the rule established the formation of GIPAQ (Deployment Group of Quality Measurement Process), which is responsible for implementing the processes on the quality indicators for the "Instant Transmission Rate Guarantee "and "Average Transmission Rate Guarantee."

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

Initially, targets were defined by at least 60% of the speed hired by users and 20% of the instant speed. On November 2013, ANATEL raised the target values and in 2014 and 2015 there will be new raises.

In July 2012, ANATEL suspended the sale and activation of the mobile lines of three major Brazilian operators. Vivo was not affected by this measure. Since then, ANATEL has requested from operators, the submission of an Action Plan for Quality Improvement of the Mobile Telephony. Vivo had its plan approved on September 10, 2012. As of early 2013, ANATEL has been regularly publishing measurement results for predefined indicators.

Restrictions on Companies to Provide STFC in the Public Regime

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

- a prohibition on holding more than 20% of the voting shares in any other public regime company, unless previously approved by ANATEL, according to ANATEL's Resolution No. 101/99; and
- a prohibition on public regime companies to provide similar services through related companies.

Network Expansion and Quality of Service

We are subject to the General Plan for Universal Service Targets (Plano Geral de Metas para a Universalização) and the General Plan of Quality Targets (Plano Geral de Metas de Qualidade), each of which respectively requires that we undertake certain network expansion activities with respect to our fixed-line services and meet specified quality of service targets. The timing for network expansion and benchmarks for quality of service are revised by ANATEL from time to time.

The decree altering the General Plan for Universal Service Targets rescinded in 2008 the obligation of telecommunications concessionaires to install telecommunications service centers (providing calling and data access to walk-in customers) and substituted such obligation with an obligation to roll out broadband network infrastructure

Table of Contents

throughout the municipalities serviced by such concessionaires. In compliance with the decree, in 2011, all municipalities in Brazil had infrastructure for broadband networking. This obligation made us implement an additional network infrastructure in 257 of the 622 municipalities in our concession region.

Moreover, we have, as have other telecommunications concessionaires, committed to provide free Internet access to public schools during the term of our concession grant (until 2025).

If a public regime company does not fulfill its obligations under the General Plan for Universal Services and the General Plan for Quality Targets, there are various monetary penalties that may be imposed by ANATEL. A company may lose its license if ANATEL considers it incapable of providing basic services under the two General Plans.

General Plan for the Universalization of the Fixed Switched Service (PGMU III)

On June 30, 2011 the Brazilian government published Decree No. 7,512 related to the General Plan for the PGMU III. The PGMU III sets new targets for Telefone de Uso Público (public phones) density in rural and poor areas and goals related to AICE and bidding for the 450 MHz and 2500 MHz spectrum ranges (to, respectively, meet the needs of rural regions and develop fourth generation mobile telephony). Also according to the new PGMU, the backhaul used to meet the commitments of universalization was characterized as a reversible asset.

On October 25, 2012, ANATEL published Resolution No. 598/2012, which addresses population density, setting deadlines to meet access requests and benchmarks for use of the public telephone plant and the establishment of a list of agencies that can request access to its location. Review of deadline for proposing service plans and the establishment of universal obligations disclosure.

ANATEL approved other resolutions and consents in 2013:

- Resolution No. 607/2013: Amends the Fixed Telephony Numbering Regulation, enabling the efficient allocation of Provider Selection Codes (CSP).

- Resolution No. 608/2013: Amends the Account Separation and Allocation Regulation (RSAC) in order to make Accounts Document Separation and Allocation (DSAC) simpler and aligned to international standards.

- Resolution No. 614/2013: Establishes the new Regulation for Multimidia Communications Service (“Serviço de Comunicação Multimidia – SCM).

- Resolution No. 615/2013: Amends the Fixed Telephony Service Regulation (STFC), in order to align it with the other regulations regarding fixed telephony.

- Resolution No. 619/2013: Amends the Account Separation and Allocation Regulation (RSAC) in order to standardize the allocation of historical and current costs of operators.

- Resolution No. 622/2013: Creates conditions to enable the provision of fixed telephony in rural areas, as foreseen in the General Plan for the PGMU III.

- Resolution No. 623/2013: States that, telecommunications services providers with more than 1 million customers must create councils with society representative to discuss proposals for improving the services quality.

- Resolution No. 629/2013: Approves the Conduct Adjustment Regulation, that set the rules for the operators to swap fines for investment.

Other Regulatory Issues

In 2007, ANATEL published Resolution No. 477/2007, effective on February 13, 2008, relating to alterations in the regulation of SMP, which has contributed to an increase in our operating costs. In the new regulation, ANATEL

Table of Contents

notes areas of vital importance for mobile business, such as the necessity for retail stores in the cities within an operator's coverage areas, increases in the validity periods of prepaid cards and places limits on the period of time during which customers may not leave service plans. These new regulations may have an adverse effect on our revenues and results of operations. To minimize the impacts resulting from these regulatory changes, we had already prepared ourselves during the last quarter of 2007, to meet and comply with the terms set forth by the new regulation, mainly those related to the customer service which affect procedures and required significant changes to our systems. In 2009, we continued establishing retail stores in the cities within our coverage areas, pursuant to the provisions of Resolution No. 477/2007. In 2009, we also established mediation centers to attend to users with hearing and speech impediments, pursuant to the provisions of Resolution No. 477/2007. Our plans for achieving the goals set by this new regulation was extend to August 13, 2011 and all goals relating to Resolution No. 477/2007 were achieved by the company and certified by ANATEL.

On November 21, 2008, the Brazil Government published decree 6,654/2008, for the revision of the fixed-line General Plan of Grants, allowing fixed-line concessionaires to operate in more than one region of the country. This change allowed Telemar Norte Leste S.A.—Telemar or Oi— to acquire Brasil Telecom.

ANATEL granted on August 18, 2011 prior consent to the company to transfer to Vivo its authorizations for STFC service in local mode, domestic long-distance and international long-distance in Regions I and II of the General Plan of Grants (outside of São Paulo). On September 8, 2011 the Extract of the Authorization Term was published in the D.O.U. with the transfer of the STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer the STFC across its area, except for the State of São Paulo, using basically the network elements and some radio frequencies that support the provision of the SMP.

Under the SMP regime, we receive revenues from interconnection fees paid to us by wire line long-distance operators due to long-distance traffic originating and terminating on our network. On March 24, 2011, ANATEL approved the corporate restructuring of Vivo Participações and Vivo, which are now controlled by the company and not by Brasilcel. The operation resulted in the final merger of shares of Vivo Participações into the company. See "Item 4. History and Development of the Company–A. Historical Background–Corporate Restructuring Involving Vivo Participações".

On August 18, 2011, through Act 5,703/2011, dated August 16, 2011, ANATEL approved the merger of Vivo Participações into the company, with the transfer of the SMP authorizations and respective authorizations terms held by Vivo Participações to Vivo, as well as the resignation by Vivo of its SCM authorization.

On October 2012, the board of directors of ANATEL approved the inclusion of interconnection, facilities, operational and other commodity revenues to the basis for calculating the amount owed in the renewal of the authorization terms for radio frequencies. In addition, according to the concession agreements for fixed line services, we are required to pay an amount equal to 2% of our net revenues for basic and alternative service plans, every two years.

On July 2012, we received notice that a cost model was being revised for fixed-line as well as mobile operations. Concurrently, ANATEL published a request for comments and suggestions regarding the preparation and implementation of the cost model. Resolution No. 608/2013 began with that consultation and was published on April 2013, simplifying the accountability process and adapting the Regulatory Chart of Accounts. In August 2013, ANATEL approved Resolution No.619/2013 that standardized information about the historical and current costs of operators.

Between September and November, 2013 a Public Consultation was held by ANATEL to discuss the determination of the maximum use fees for the fixed and mobile telephony and EILD (Industrial Use of Dedicated Lines), based on the Cost Model (DSAC). The subject is now being studied by ANATEL.

New Regulations for Restricted Access Services– SeAC

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

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

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

As a result of Law No. 12,485/2011, the National Cinema Agency (Agência Nacional do Cinema), or Ancine issued one public consultation by the end of 2011 and one public consultation in 2012 to regulate the registration of economic agents.

In 2013, we had our licenses adapted to the new regulation and was recognized as an economic agent by ANCINE.

Interconnection Regulation

Under the General Telecommunications Law, all mobile telecommunications service providers must provide interconnection upon the request of any other mobile or fixed-line telecommunications service provider. More specifically, telecommunications service providers are classified as providers of either collective or restricted services. All mobile operators, including SMP service providers, are classified by ANATEL as collective service providers. All providers of collective services are required to provide interconnection upon request to any other collective service provider. Since 2005, telecommunications service providers have been permitted to freely negotiate the terms and conditions upon which interconnection will be provided, subject to price caps and other rules established by ANATEL. For example, providers must enter into agreements regarding, among other things, tariffs and technical issues with all parties on a nondiscriminatory basis and starting in 2005, to have a more homogeneous system and to accelerate the negotiation of interconnection contracts, ANATEL has required a standard interconnection network from STFC and SMP Operators through an offer made publicly and equitably.

If parties to an interconnection agreement cannot agree upon the terms and conditions of interconnection, ANATEL may determine those terms and conditions by arbitration. Interconnection agreements must be approved by ANATEL and may be rejected if they are contrary to the principles of free competition and the applicable regulations. ANATEL has adopted, from time to time, various regulations governing interconnection rules. The following are the material regulations currently applicable to our business:

- the new General Regulation of Interconnection (“Regulamento Geral de Interconexão”–Resolution No. 410/2005, or “RGI”);
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the Regulation of Separation and Allocation of Costs (approved by Resolution No. 396/2005) and its annexes (approved by Resolutions No. 480/2007, 483/2007, 503/2008, 608/2013 and 619/2013);

- Resolution No 590/2012 – Regulates the use of industrial dedicated lines and sets forth new rules for providers with significant market power and reduces the standard circuit reference rate by approximately 30%. These reference rates are used in instances arbitration or other forms of alternative dispute resolutions. In addition, ANATEL granted service providers a four month period during which to adopt these rules. We have filed a claim against ANATEL to question the legality of retroactively applying this new regulation and to address ANATEL's definition of significant market power as we understand there to be competition in the areas indicated by them.

- the Regulation of Remuneration of Use of SMP Providers Networks (Resolution No. 438/2006). In November 2010, ANATEL published Resolution No. 549/2010 modifying Resolution No. 438/2006 and

Table of Contents

providing that the groups that include SMP operators with participation rates lower than 20% in the market of mobile telephony combined in each one of the regions of the General Plan of Authorizations of SMP (PGA-SMP), are considered groups who lack significant market power in the offer of mobile interconnection, in their respective areas of authorization;

- the Regulation of Fixed and Wireless Number Portability (Resolution No. 460/2007, effective March 2009);
- the new Regulation of SMP (Resolution No. 477/2007, effective February 13, 2008);
- the general plan of update of the regulation of the telecommunications in Brazil ("Plano Geral de Atualização da Regulamentação das Telecomunicações do Brasil" – Resolution No. 516/2008, or "PGR");
- the general norms of customer interaction service by telephone, with the objective of improving the quality of services (Decree No. 6523/2008);
- the Methodology of the Calculation of the WACC (Resolution No. 535/2009);
- amendment of the regulation of the 3400 MHz to 3600 MHz band, allowing it to apply additionally to mobile services (Resolution No. 537/2010);
- the regulation of the Broadband Power Line (BPL), allowing this service to apply to multimedia communication (SCM) (Resolution No. 527/2009);
- related Invitation Document No. 002/2007/SPV-ANATEL regarding the auction organized in December 2007 of new licenses for the 1900-2100 MHz radio frequency bands (3G licenses), denominated bands "F," "G," "I" and "J," which stated that, within a maximum allowed period of eighteen months from the publication of the Terms of Authorization (it occurred on April 30, 2008), the authorizations resulting from this auction would be combined with the existing SMP authorizations of the bid winners when pertaining to the same region of the general authorization plan of SMP. In accordance with this Invitation Document, in January 2010, ANATEL published an act determining the unification of our SMP authorizations in Regions II (states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with only one SMP authorization for each of these Regions (Terms of Authorization No. 005/2010 and 006/2010, signed in January 2010, for Region II and III, respectively). Vivo acquired spectrum licenses in band "J" in regions where it possesses SMP licenses. Moreover, the Invitation Document modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
- related Invitation Document No. 002/2010/ANATEL, regarding the auction organized in December 2010 of new licenses for the 1900-2100 MHz radio frequency band denominated the "H" band, for extension bands and for available frequencies at "A," "D," "E," "M" and TDD bands, which modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
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the regulation for the exploration of SMP by means of Virtual Network, which makes possible the creation of the "agent" and the Authorized of Mobile Virtual Network (Resolution No. 550/2010). In accordance with this regulation approved by ANATEL, Mobile Virtual Network Operators may operate either as agents or as virtual network licensees. An agent represents the personal mobile service provider through the establishment of a representation agreement, which must be ratified by ANATEL. The agent's activity is not defined as a "telecommunications service" so this is of significant interest to companies that operate in other sectors such as large retailers, banks and football teams. However, the activity of the virtual network licensee does fall within the definition of "telecommunications service" and is thus subject to all applicable rules;

- the assignment of the bands of 451 MHz to 458 MHz and 461 MHz to 468 MHz to the Personal Mobile Service, Fixed Switched Telephone Service and to the Multimedia Communication Service, for access to the services of telephony and data in broadband, particularly in rural areas (Resolution No. 558/2010);

Table of Contents

- the assignment of the bands of 2500 MHz to 2690 MHz to the Personal Mobile Service and Fixed Switched Telephone beyond Multimedia Communication Service and Pay Television by means of Multichannel Multipoint Distribution Service (MMDS) for which it was previously assigned (Resolution No. 544/2010);

- the regulation for evaluation of the efficiency of use of the radio frequency spectrum (Resolution No. 548/2010); and

- the addition of a ninth digit in the numbers of the mobile telephones of area 11, raising the capacity of numeration in the metropolitan region of São Paulo and eliminating definitively the problem of scarcity of numeration in this area (Resolution No. 553/2010).

- Resolution No. 588/2012 – Regulates network compensation for the STFC. This regulation revised the method of charging for TU-RL during the reduced time period for calls under two minutes of duration, and the change in Bill and Keep regime.

- Resolution No. 600/2012 – Approved the competition goals plan (PGMC). The main goals of PGMC are focused on the wholesale marked and network infrastructure sharing, including: (1) passive infrastructure for transport and access networks; (2) call termination in mobile networks; (3) roaming (4) fixed network infrastructure for the transmission of date through copper cables in transmissions of 10mbps; and (5) wholesale fixed network infrastructure for local and long distance transmission of data under 35mbps.

- with an aim to restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to verify the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL issued on October 28, 2011 (published in the D.O.U. on October 31, 2011), Resolution No. 575/2011, which approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (SMP-RGQ). The new Regulation innovates by providing assessments of the network connection and their respective data transmission rate, especially aspects of availability, stability and connection speed data network. In addition, the resolution established the formation of "GIPAQ" (Group Deployment Process Quality Measurement), which will be responsible for implementing the processes on the quality indicators for the "Guaranteed Instant Transmission Rate" and "Guaranteed Average Transmission Rate." The methodology and procedures regarding the collection of indicator data for data connections will be defined by this group, composed of providers, ANATEL and a "Quality Measurement Authority" (EAQ), which shall be responsible for implementing these processes and will be hired by the service providers until February 29, 2012. All costs associated with implementing the new procedures for measuring quality will be paid by providers of the SMP and the impacts of the Regulations are still being evaluated, mainly its financial aspect. Also, through the issuance of Resolution No. 574/2011, which approved the Rules of Quality Management (SCM-SCM RGQ) on October 28, 2011 (published in the D.O.U. on October 31, 2011), ANATEL set targets for service quality, as well as updated definitions for indicators and their calculation methods.

- the Regulation on criteria for adjustment of tariffs for calls from the STFC involving access the SMP or SME, approved by Resolution No. 576/2011, dated October 28, 2011, establishes criteria for the gradual readjustment of VCs until 2014. With respect to VU-M fees, for the period before the effectiveness of the cost model established by this Resolution, ANATEL defined transition rules if no pact is reached regarding the VU-M fees. A reduction factor (R) to be applied in the formula for readjustment of the calls involving the PSTN access the Personal Mobile Service.

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VCt≤VCt0 x (1-R-FA) x (ISTt / ISTt0), where R corresponds to the “Reduction Factor” (Fator de Redução) and FA to the “Damping Factor” (Fator de Amortecimento), the percentage of which depends on inflation in the corresponding period.

The Reduction Factor to be applied in the next readjustment of the VC rate for fixed-mobile calls is following the schedule below:

- for the first readjustment, ANATEL applied a Reduction Factor of 18% on April 2012;
- for the second readjustments, ANATEL applied a Reduction Factor of 12% on April 2013; and
- if the cost model has not yet produced results, the third readjustment will be subject to a Reduction Factor of 10% by April 2014.

Table of Contents

The "Damping Factor" has the following scale: 0 if inflation is less than 10%; 0.01 if inflation is between 10% and 20% and 0.02 if inflation is above 20%.

For the VU-M fees, they remain freely negotiated and in case there is no agreement as a result of the new VC determined according the formula above, any reduction of these fees will be applied to the VU-M fee up to the VU-M / VC1 ratio to achieve 70%. From this level, the reduction will also be assessed in other components of the VCs, maintaining this ratio. As an example, in 2013, since the concessionaries and the mobile operators did not reach an agreement, ANATEL has determined that values for VC-1, VC-2 and VC-3 must be reduced by 8.77%.

According to Resolution No. 600, ANATEL established that the RVU-M 2014 should be at most 75% of the amount applicable at the end of 2013 and the RVU-M 2015 should be at most 50% of the amount applicable at the end of 2013. Beginning in February 2016, VU-M will be determined based on cost modeling.

Mobile Rate Regulation

With respect to our Basic Plan and certain roaming charges incurred in connection with alternative service plans, our authorizations continue to provide for a price cap mechanism to set and adjust rates on an annual basis. The cap is the value with the rate of inflation deducted from the productivity estimated by ANATEL. The price cap is revised annually to reflect the rate of inflation as measured by the IGP DI. However, mobile operators are able to freely set the rates for alternative service plans.

The initial price cap agreed to by ANATEL and us in our authorizations had been based on the previously existing or bidding prices, and was adjusted annually on the basis of a formula contained in our authorizations. The price cap has been revised to reflect the rate of inflation as measured by the IGP DI.

Other telecommunications companies that interconnect with and use our network must pay certain fees, primarily an interconnection fee. The interconnection fee is a flat fee charged per minute of use. Since 2005, ANATEL has permitted free negotiations for mobile interconnection, or VU-M, fees and by July 2005, local-fixed concessionaires and mobile operators had reached a provisional agreement with respect to VU-M fees for local calls, or VC1 (the agreement guaranteed a 4.5% increase in fees). ANATEL approved that provisional agreement, and in March 2006, approved another provisional agreement for VU-M fees for long-distance calls, VC2, VC3 and international, among the same operators that made the VC1 agreement.

In July 2007, ANATEL approved a provisional agreement among the fixed-line operators Telefônica, Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of 1.97143% to interconnection fees in Region I (Telemar's Region) and an annual adjustment of 2.25356% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

In January 2008, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, taking into consideration the period since January 2004, that provides for an annual adjustment of 4.5% as of March 2006 and an annual adjustment of 1.97143% or 2.25356% as of July 2007.

In July 2008, ANATEL approved a provisional agreement among the fixed-line operators Telefônica, Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of 1.89409% to interconnection fees in Region I (Telemar's Region) and an annual adjustment of 2.06308% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

In March 2009, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, for the period from 2007 to 2008, that provides for an annual adjustment of 1.89409% in Region I (Telemar's Region) or 2.06308% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region) as of July 2008.

In September 2009, even though it had a provisional agreement between the fixed-line operators Telefônica, Telemar, Brasil Telecom and Sercomtel and the mobile operators, without CTBC Celular, ANATEL decided not to approve the readjustment of the local (VC1) and long-distance (VC2 and VC3) fixed-to-mobile calls. In February 2010, this readjustment of the VC1, VC2 and VC3, relative to the period from 2008 to 2009, was approved by

ANATEL and the provisional agreement of VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC1) could be applied.

In June 2010, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, for the period from 2008 to 2009, for the application of the VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC2 and VC3).

By the end of 2011, Vivo entered into an agreement with Oi (Regions I and II) and us (Region III) for the recognition of the VU-M fee paid at the time and agreed to maintain this amount for an additional 24 months, based on the VC1 readjustment pleaded by both these companies to ANATEL. However, these fees were not approved by ANATEL due to the publication of ANATEL's Resolution No. 576/2011, which addresses the criteria for adjustment of fees for calls from fixed-lines involving access to the SMP or SME. On January 25, 2012, ANATEL published Act No. 486, with the new fees for VC1, VC2 and VC3 (with an average reduction of 10.78%) and, on February 22, 2012, ANATEL published Act No. 1,055 with new VU-M fees (with an average reduction of 14%). However, Oi obtained an injunction in Federal Court to have its readjustment request analyzed by ANATEL. This decision is subject to appeal. See "—Interconnection Regulation."

Also, ANATEL published the Invitation Document No. 002/2007/SPV-ANATEL, which relates to the December 2007 auction of new licenses for the 1900-2100 MHz radio frequency bands (3G licenses). Under this Invitation Document, the authorizations resulting from the auction of will be combined with the existing authorizations belonging to the bid winners when pertaining to the same region of the general authorization plan of SMP (PGA-SMP) in the period of eighteen months from the publication of the Terms of Authorization (which occurred on April 30, 2008).

As a result, ANATEL published in January 2010 an act determining the merger of our SMP authorizations in Regions II (State of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with an SMP authorization for each one of these Regions (Terms of Authorization No. 005/2010 and 006/2010, signed in January 2010 for Regions II and III, respectively).

Moreover, ANATEL determined that the value of the VU-M fee should be unified for each Region of the PGA-SMP and freely negotiated beginning on November 1, 2009 (eighteen months from April 30, 2008). Until this date, mobile operators charged a VU-M fee for authorization of the SMP. In February 2010, ANATEL defined the VU-M fee to be paid for Oi (fixed and mobile operators) and Brasil Telecom (fixed and mobile operators) to Claro, TIM, Vivo and Vivo Participações (the latter being the result of the ANATEL-authorized merger of Telemig Celular S.A. into Vivo Participações in March 2010), for the region of the PGA-SMP, as a result of the unification of the SMP authorizations.

ANATEL launched on August 25, 2011 the "Project Cost Model" (Projeto Modelo de Custos). The project is associated, among other things, with determining fees for the use of the fixed telephony network and the calculation of reference values of the VU-M fee and EILD (Industrial Use of Dedicated Lines) for telecommunications service providers.

At launch, ANATEL signed a US$8.22 million agreement with the consortium of Advisia, Analysis Mason and Grant Thornton, which has two years to perform work in support of ANATEL. This consortium won the international bidding process conducted by the International Telecommunication Union (ITU).

The cost model is of great relevance to ANATEL in carrying out public sector policies, as its development will allow access to cost management information of the different business areas and product lines of telecommunications services providers, contributing to the improvement of regulation of the sector as a whole.

In 2012, and according to Resolution 600/2012, ANATEL established that the mobile termination rate of reference for providers having significant market power based on a Cost Model would become effective on February 24, 2016. This termination rate was established by Resolution 438/2006 and will be used only in cases where an arbitration proceeding is necessary.

Internet and Related Services in Brazil

In Brazil, Internet service providers, or ISPs, are deemed to be suppliers of value-added services and not telecommunications service providers. ANATEL's Resolution No. 190 requires cable operators to act as carriers of third-party Internet service providers. The Brazilian House of Representatives is considering a law that would penalize Internet service providers for knowingly providing services that allow illegal goods or services to be sold on the Internet, and would impose confidentiality requirements on Internet service providers regarding nonpublic information transmitted or stored on their networks.

Customer Service

In 2012 Telefônica Brasil expanded its differentiation customer service model by initiating a large segmentation process that recognizes customer decision of keeping both connections, fixed and mobile, into the same company, delivering a unique experience. This model is operating since the first half of 2013.

Customer service segmentation model allows the company to improve its multichannel strategy. In 2013 there was a substantial progress regarding electronic channels adoption such as Vivo SMS, which was used by more than 3.5 million customers per month. Numbers kept on growing at the same speed of previous years, reaching 79% share of received contacts.

Concerning customer service quality, PROCON-SP's ranking demonstrated that Telefônica Brasil reached the best position among its largest competitors, which shows that the company is taking the right decisions to ensure customers' satisfaction. Moreover, in the last three years the company has been presenting meaningful improvements on internal processes that led to a positive impact on the volume of requests received by Market Regulatory Agencies, such as Fundação PROCON-SP.

According to the last data published by ANATEL, Vivo managed to continue as the top telecommunications mobile company in Brazil by having the smallest complaint ratio between the national reach telecommunications groups, as well as reaching number 1 position in regards to Attendance Performance Index (IDA) – the company placed best in 54 out of 55 months of evaluation. Similar results were reported by SINDEC (National System of Consumer Protection Information), which gathers information of Procons from all over the country and that showed a 10% substantiated complaints reduction in comparison to the previous year. Not enough, it has the best KPIs among its competitors as stated by the second edition of the project "Consumer Defense Public Indicators", published by Ministry of Justice. Furthermore, it was considered the company with the best resolution rate in relation to other players in the telecom industry reaching 89.64%.

All these results were supported by Telefônica Brasil actions towards quality and expansion of the customer service channels, aiming to improve customers experience and get closer to their needs, therefore keeping its leadership position in the telecom market.

Marketing and Sales

During 2013, we integrate channels to offer standardized solutions and customer service along with innovation and best practices for the sale of fixed and mobile services.

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

- Vivo Own Stores: focused on individual clients and located on strategic points, our own stores provide a highly trained team built up to guarantee the best sales experience for the customer. The main drive of this channel is innovation. As a result, most stores have available self assistance services for value added

61

services and recharges. We also offer special treatment for Premium clients with scheduled appointments via the Internet to assure “no waiting in line.”

- Exclusive Dealers: The exclusive dealers channel is composed by companies, certified to provide our full portfolio through an adequate distribution network to cover the geographic dimensions of the country. Although the channel offers the whole portfolio, the channel is focused on the post-paid product.

- Recharge channels: Composed by around 70 distributors that deliver pre-paid product and services to small and medium companies in various market sectors throughout the country. This is the largest channel for prepaid recharge and access, with a huge growth of virtual recharge year by year.

- Retail Channel: With strong alliance with the main retailers in Brasil, focused in prepaid recharges and data services.

- Telesales: sales through active and passive telemarketing call centers, employing highly trained sales associates, focused on fixed lines, data services and migration from pre-paid to postpaid plans.

- E-commerce: As a key component of the Company’s transformation process to become a Digital Telco and to deliver more value to its customers, Telefônica Brasil has put strong focus on the Online Channels in 2013. In the web portal www.vivo.com.br, customers can obtain up-to-date information to the company´s products and services, including specific sections for corporate customers and online self-service. A total of more than 300 different services and requests can be managed online. Besides, a new mobile site tailored for smartphones was launched during the year, as well as new applications and improvements in the look and feel and functionalities of the existing online channels. The e-commerce processes are also being improved on a continued basis, to leverage on the strong e-commerce growth observed with web users in Brazil. Current e-commerce capabilities include but are not limited to the sales of mobile handsets and plans, and the portfolio of services of fixed and mobile businesses, top-ups and VAS. Some results of this strategy in 2013 were:

- Increase of 27% on customer care transactions, supported mainly by a strong focus on “Meu Vivo”, the company´s self-care service that is available on the web and also on apps;
- Partnerships with the main players of credit card and e-payments market, as well as the development of new Online channels, which increased the number of online top-ups in 500%;
- 44% increase on web and mobile portals visits, having the mobile portal surpassing the web portal for the first time, representing 58% of the overall online traffic;
- 35% increase of the online sales transactions vs. 2012, due to the good performance of innovative marketing campaigns such as the participation for the first time in the Black Friday in November, and the re-launch of the online store for mobile handsets and services;
- 59% increase on the penetration of the e-invoice, with significant cost reduction for the company;
- Vivo´s web portal renewal in October brought strong results in user satisfaction: 86% of users consider extremely easy to use the site (Source: Bridge Research).

- Door-to-door sales: aiming to approach corporate and individual clients, we dispose physical channels of assistance, such as door-to-door sales of services by outsourced small companies and own team consultants. Main focus in fixed and data services.

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

Our Network

In 2013, the company continued the consolidation of a robust network, capable of delivering to the customer its expectation. Advanced in the migration of TDM to NGN core, reaching 43% of fixed traffic, modernization of switches and adaptation of the infrastructure of datacenters. For example, we began of the implementation of project that exchange optical cabinets (ARO) for MSAN.

The FWT is the result of the integration between the mobile and the fixed environments and allowed the company to explore the fixed telephony service in regions outside São Paulo region. It grew more than 241% in 2013.

During 2013, the number of broadband accesses in the fixed network increased by 189 thousand customers. The company´s portfolio related to xDSL broadband products includes speeds from 250 kbps to 25Mbps. The product "Banda Larga Popular", which is an initiative of the state of São Paulo, provides broadband at affordable prices to low-income population, with speeds that range from 250 kbps to 1Mbps. Last year, the product reached 1 million and 388 thousand clients. The company also offers broadband services provided via coaxial cable, with speeds that range from 8 Mpbs to 100 Mbps.

Using the platform called DLM ASSIA, which improves the diagnosis and stability of our customers and to increase the index of assertiveness in recommending upgrade speed, were performed more than 410 thousand upgrades for 2013, thus seeking the loyalty of the customer base and increase the revenue.

Another important characteristic of the network is the availability of FTTH, the most advanced optical fiber broadband technology available. It allows the use of data rates until 200Mbps. By the end of 2013, the company had over 204 thousand clients using this technology. From these, over 35 thousand customers also use the IPTV service — a system through which television services are delivered using the Internet Protocol.

In 2013, the "Vivo Speedy" service reached 3.9 million customers. The service is provided using xDSL, FTTH and coaxial cables.

In 2011, we launched the HSPA+ technology, commercially known as 3GPlus, working across our 3G network. This technology was commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11). In 2012, the service was extended to national coverage 3G. The 3G Plus allowing customers who have compatible terminals to achieve even higher transmission rates, reaching up to three times the value of traditional 3G's rate. In 2013, we launched the LTE technology, commercially known as 4G Plus. This technology was commercially launched in April, 2013 in Confederations Cup host cities (Brasília, Fortaleza, Recife, Rio de Janeiro, Belo Horizonte and Salvador) and in São Paulo.

During the year 2013, we continue to expand strongly our 3G network, reaching around 3,137 municipalities or 87.96% of the population covered by this technology. With 2G technology reaching 3,754 municipalities or about 91.10% of the population at the end of 2013.

Our advanced network management technology ensures global management and supervision of all our network processes and network performance. The network management centers are located in São Paulo, Brasilia and Minas Gerais. These centers monitor all regions of the country, but with different functions.

The network management center of São Paulo monitors the critical network operational parameters of the countrywide transmission backbone, IP networks and broadband networks. The network management center in Brasília monitors the critical operational parameters of core networks and services platforms. The network management center in Minas Gerais monitors the critical operational parameters of the access network (radio network) and infrastructure. These centers are able to identify abnormalities in both our network and in third-part networks, using failure and signaling monitoring systems. In addition, quality and service standards are constantly monitored. The network management centers are integrated with maintenance and operations teams that maintain and operate cellular network elements, as well as cellular infrastructure and transmission, in addition to the radio network elements and computing bases, service platforms and communications backbones.

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

Pursuant to the terms of our authorization to perform our services, we are obligated to meet certain requirements for service quality. See "—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies."

Table of Contents

Contract Customers for Mobile Services

Since October 1994, mobile telecommunications service in Brazil has been offered on a “calling party pays” basis, under which customers pay only for calls that they originate. In addition, customers pay roaming charges on calls made or received outside their home registration area.

Customer charges are calculated based on the customer’s calling plan, the location of the party called, the place from which the call originates and certain other factors, as described below. Our Region is divided into areas designated for payment purposes, called registration areas, as follows:

- Areas 1 & 2: 9 areas in the state of São Paulo;
- Area 3: 5 areas, comprising 1 area in the metropolitan area of Rio de Janeiro, two areas in upstate Rio de Janeiro and two areas in the state of Espírito Santo;
- Area 4: 7 areas in the state of Minas Gerais;
- Area 5: 9 areas, comprising 6 areas in the state of Paraná and 3 areas in the state of Santa Catarina;
- Area 6: 4 areas in the state of Rio Grande do Sul;
- Areas 7 & 8: 18 areas, comprising 9 areas in Brasilia and the states of Goiás, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and Tocantins and 9 areas in the states of Amapá, Amazonas, Maranhão, Pará and Roraima;
- Area 9: 6 areas, comprised of 5 areas in the state of Bahia and 1 area in the state of Sergipe; and
- Area 10: 9 areas in the states of Pernambuco, Alagoas, Paraíba, Rio Grande do Norte, Ceará and Piauí.

Interconnection Charges

We earn revenue from any call that originates from another cellular or fixed-line service provider network connecting to one of our customers. We charge the service provider from whose network the call originates a network usage charge for every minute that our network is used in connection with the call. See “—Operating Agreements—Interconnection Agreements.” Tariff adjustments are subject to agreement between the operators and then subject to approval by ANATEL.

Bill and Keep

ANATEL adopted partial “Bill and Keep” rules for interconnection charges in July 2003. The rules provided that an SMP operator paid for the use of another SMP operator’s network in the same registration area only if the traffic carried from the first operator to the second exceeded 55% of the total traffic exchanged between them. In that case, only those calls that surpassed the 55% level were subject to payment for network usage.

On May 7, 2012, ANATEL approved a change in the interconnection service to a partial Bill and Keep model through the end of 2013 and an integral Bill and Keep model beginning in 2014.

On November 12, 2012, the Brazilian government published Resolution No. 600/2012 approving the General Competition Plan, or PGMC, which introduced the study of relevant markets in Brazil and applied asymmetric measures to the companies considered to have significant market power. It focused on the wholesale market, introducing new obligations regarding network desegregation, infrastructure sharing and interconnection. Particularly with regard to interconnection, the PGMC introduced a new tariff reduction schedule for use of mobile networks for 2014 (75% of value of 2013) and 2015 (50% of 2013), and programming the adoption of the RIC model in 2016. In terms of balancing traffic model, the PGMC kept the full Bill and Keep model with operators that have significant market power and established a partial Bill and Keep model with operators without significant market power through 2016, at which time all operators will follow the full Bill and Keep model.

Roaming Fees

We receive revenue pursuant to roaming agreements with other cellular service providers. When a customer of another cellular service provider makes a call within our area, that service provider pays us for the call at the applicable rate. Conversely, when one of our customers makes a cellular call outside of our Region, we must pay the charges associated with that call to the cellular service provider in whose Region the call originates. See "—Roaming Agreements."

Wireless Device Sales

Through our stores and authorized dealers we sell only GSM and WCDMA devices such as handsets, smartphones, broadband USB modems and netbooks that are certified to be compatible with our network and service. We have special offers on smartphones, USB modems and other data devices for customers of bundled packages. Our current device suppliers are Motorola, LG, Samsung, Nokia, Sony, Alcatel, ZTE, Apple, BlackBerry and Huawei.

Operating Agreements

We have agreements with major fixed-line and mobile operators in Brazil to lease physical space, real estate, air conditioning, energy, security and cleaning services. We also lease transmission capacity necessary to complete the construction of our network infrastructure.

Interconnection Agreements

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

We have adequate interconnection agreements with necessary fixed-line operators to provide services. We also have all the necessary interconnection agreements with long-distance carriers.

Roaming Agreements

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

Fraud Detection and Prevention

During 2013, we continued our work in combating the two main types of fraud, as follows:

- Subscription fraud: is a type of fraud that occurs when the issuance of one or more accesses are granted without the consent of the real "holder" of identification documents with the main objective of not paying the phone bill. Fraud can occur when a customer has its identification documents stolen and signatures are forged. We had a 9.76% decrease in subscription fraud-related expenses in 2012.

- Identity Fraud: also known as "social engineering," is identity fraud, which takes place through call centers, where a caller who has access to information belonging to our existing clients reaches out to our call centers and makes unauthorized alterations and activations. We had a 91.3% decrease in this type of fraud-related expenses compared to expenses with identity fraud in 2012. The decrease in identity fraud was a result of measures implemented to detect and prevent frauds.

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

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

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

Roaming Agreements

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

Telefônica Brasil S.A. does not have any contractual relationship with these Iranian operators; however, as part of the Telefonica Group, it adheres to the roaming agreements with Telefonica S.A.'s subsidiaries described below.

Telefonica S.A.'s subsidiaries were party to the following roaming agreements with Iranian telecommunication companies in 2013:

(1) Telefónica Móviles España ("TME"), its Spanish directly wholly-owned subsidiary, has roaming agreements with (i) Mobile Telecommunication Company of Iran ("MTCI"), (ii) MTN Irancell ("Irancell"), and (iii) Taliya ("Taliya").

The Company has been advised that, during 2013, TME recorded the following revenues related to these roaming agreements: (i) 386,817.93 euros from MTCI, (ii) 741.69 euros from Irancell, (iii) none from Taliya.

TME also holds a Roaming Hub agreement through its 55% directly-owned subsidiary, Link2One, a.e.i.e. ("L2O"). Under this agreement, L2O provides a roaming hub service to Irancell enabling the latter to maintain a relationship with other members of the hub. Some members of the hub are also entities of the Telefónica Group. Under this roaming hub service, for 2013, L2O has billed Irancell 114,764 euro.

(2) Telefónica Germany GmbH & Co. OHG ("TG"), Telefonica S.A.'s German 76.83% indirectly-owned subsidiary, has a roaming agreement with MTCI. TG recorded 147,319.39 euros in roaming revenues under this agreement in 2013.

(3) Telefónica Ireland Limited ("TIR"), Telefonica S.A.'s Irish directly wholly-owned subsidiary, has a roaming agreement with MTCI. TIR recorded 1,558.66 euros in roaming revenues under this agreement in 2013.

(4) Telefónica UK Ltd ("TUK"), TSA's English directly wholly-owned subsidiary, has a roaming agreement with Irancell. TUK recorded 840.41 euros in roaming revenues under this agreement in 2013.

(5) Pegaso Comunicaciones y Sistemas, S.A. de C.V. ("PCS"), Telefonica S.A.'s Mexican directly wholly-owned subsidiary, has a roaming agreement with Irancell. PCS recorded 62.99 U.S. dollars in roaming revenues under this agreement in 2013.

(6) Telefónica Argentina, S.A. and Telefónica Móviles Argentina, S.A. (together TA), Telefonica S.A.'s Argentinean directly wholly-owned subsidiaries, have a roaming agreement with Irancell. TA recorded 65.89 U.S. dollars in roaming revenues under this agreement in 2013.

(7) Telefónica Celular de Nicaragua. S.A. (“TCN”), Telefonica S.A.’s Nicaraguan 60% indirectly-owned subsidiary, has a roaming agreement with Irancell. TCN recorded 12.65 U.S. dollars in roaming revenues under this agreement in 2013.

The net profit recorded by Telefonica S.A.’s subsidiaries pursuant to these agreements did not exceed the related revenues recorded thereunder.

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

International Carrier Agreement

Telefónica International Wholesale Services, S.L. ("TIWS"), Telefonica S.A.'s Spanish indirectly wholly-owned subsidiary, has entered into an international carrier agreement with Telecom Infrastructure Company of Iran ("TICI").

Pursuant to this agreement, both companies interconnect their networks to allow for international exchange of traffic. TIWS recorded 13,252 euros in revenues under this agreement in 2013. The net profit recorded by TIWS pursuant to this agreement did not exceed such revenues.

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

C. Organizational Structure

On December 31, 2013, 91.58% of our voting shares were controlled by three major shareholders: SP Telecomunicações Participações Ltda. With 50.47%, Telefonica S.A. with 25.68% and Telefônica Internacional S.A. with 15.43%. Telefónica Internacional is the controlling shareholder of SP Telecomunicações and, consequently, holds directly and indirectly 65.90% of our common shares and 40.42% of our preferred shares. Telefónica Internacional is a wholly owned subsidiary of Telefônica, S.A. of Spain.

Subsidiaries

Telefonica Data S.A., or Tdata is a wholly owned subsidiary headquartered in Brazil, whose corporate purpose is to provide and operate telecommunications services; provide value added services (SVAs); provide integrated business solutions in telecommunications and related activities; manage the provision of technical assistance and maintenance services of telecommunications equipment and network, consulting services regarding telecommunications solutions and related activities, and design, implementation and installation of telecommunication-related projects; sell and lease telecommunications equipment, products and services, value-added services or any other related services, provided or supplied by third parties; provide third parties with telecommunications infrastructure; manage and/or develop activities that are necessary or useful for performing such services in accordance with applicable law; provide business trading services in general and provide technical support services in IT, including consulting, installation and maintenance of goods, applications and services, licensing or sub licensing of any kind of software, and storage and management of data and information. On July 1, 2013, part of its net assets were spun-off and merged into the Company and, on the same date, parts of the net assets of Vivo and A.TELECOM were merged into Tdata (Note 1b).

Associated Companies

Aliança Atlântica Holding B.V. (Aliança): Headquartered in Amsterdam, Netherlands, this entity has a 50% interest held by Telefônica Brasil and cash generated from sale of Portugal Telecom shares in June 2010. Through May 8, 2012, the Company held equity interest in Zon Multimédia, a Portugal Telecom group company that renders services involving pay television, Internet, distribution of audiovisual contents, cinema and telecommunication services. This equity interest was disposed of on May 8, 2012.

Companhia AIX de Participações (AIX): Headquartered in Brazil, this entity is engaged in holding an interest in Refibra consortium, and in performing activities related to the direct and indirect operation of activities related to the construction, completion and operation of underground networks or optical fiber ducts.

Companhia ACT de Participações (ACT): Headquartered in Brazil, this entity is engaged in holding an interest in Refibra consortium, and in performing activities related to the rendering of technical support services for the preparation of projects and completion of networks, by means of studies required to make them economically feasible, and monitor the progress of Consortium-related activities. From January 1, 2013 with the entry into force of IFRS 11 Joint Arrangements, investments in these entities were accounted for retrospectively using the equity method.

D. Property, Plants and Equipment

Our main physical properties for providing fixed services involve the segments of switching (public switching telephone network-PSTN), transmission (optic and wireless systems), data communication (multiplex devices, IP network), infrastructure (Energy systems and air conditioned) and external Network (fiber optic and metallic cables), which are distributed in many buildings in the State of São Paulo and in the main cities out of the State of São Paulo. Some of these buildings are also used in administrative and commercial areas.

Our properties are located throughout the State of São Paulo and in the main cities out of the State of São Paulo. At December 31, 2013, we used 2,181 properties in our operations, 1,401 of which we own, and we have entered into standard leasing agreements to rent the remaining properties.

Pursuant to Brazilian legal procedures, liens have been attached to several properties pending the outcome of various legal proceedings to which we are a party. See "Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings."

Our principal physical property for mobile services consists of transmission equipment, switching equipment, base stations, and other communication devices, such as voicemail, prepaid service, Short Message Service, Home Location Registers, Signaling Transfer Point, Packet Data Switching Network and gateways. All switches, cell sites, administrative buildings, administrative facilities, warehouses and stores are insured against damages for operation risks.

As of December 31, 2013, we had 188 cellular switches and other equipment installed in 57 owned spaces, 10 leased spaces and 26 shared spaces. We lease most of the sites in which our cellular telecommunications network equipment is installed. The average term of these leases is five years (subject to renewal for additional five-year terms) and ten years in the Northeast. Our 30,970 base stations and other network equipment are installed in cell sites, administrative buildings and administrative facilities. In addition, we own 11 administrative building and we lease 36 administrative areas, 10 kiosks and 305 retail stores.

At December 31, 2013 the net book value of our property, plant and equipment amounted R$18.4 billion (R$17.6 billion at December 31, 2012).

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

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

Overview

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

Brazilian Political and Economic Environment

The Brazilian economy has experienced different rates of growth this decade. According to IBGE, the Brazilian GDP expanded approximately 2.3% in 2013, compared to 0.9% in 2012.

Consumer prices, as measured by the IPCA, registered a variation of 5.9% in 2013. Accordingly, growth in consumer prices was higher than the inflation target established by the Central Bank, of 4.5%. In 2011 and 2012, the variations of IPCA were 6.5% and 5.8%, respectively. Inflation, as measured by the General Price Index, or the IGP-DI, calculated by Fundação Getúlio Vargas, which includes wholesale, retail and home-building prices, increased 5.0% and 8.1% in 2011 and 2012, respectively. In 2013, the IGP-DI increased 5.5%.

As inflation rates measured by IPCA still remain above inflation target, Central Bank increased the basic interest rate during 2013. The SELIC rate increased to 10.0% by the end of 2013, from 7.25% by the end of 2012.

Brazil finished 2013 with a trade balance surplus of US$ 2.6 billion, compared to US$ 19.4 billion in 2012. Exports remained at US$ 242 billion, but imports increased 7.4%, to US$ 240 billion. Foreign Direct Investments inflows into the country decreased slightly, reaching US$ 64 billion, compared to US$65.3 billion in 2012. On the other hand, portfolio investments increased to US$ 25.8 billion in 2013, in comparison to US$ 8.8 billion in 2012. As a consequence of this performance of external accounts, international reserves decreased US$3 billion compared to 2012 to US$376 billion at end of 2013.

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

As a consequence, the real depreciated against the U.S. dollar in 2013 by 14.6%. The exchange rate on December 31, 2013 was R$2.34/US$1.00, from R$2.04/US$1.00 on December 31, 2012.

Our business is directly affected by the external environment and the Brazilian economy. If the Brazilian economy enters a period of continued recession, then demand for telecommunications services is likely to decline. Similarly, depreciation of the Brazilian real against the U.S. dollar may reduce the purchasing power of Brazilian consumers and, as a consequence, negatively affect the ability of our customers to pay for our telecommunications services.

Impact of Inflation on Our Results of Operations

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

Starting in 2006, telephone fees were indexed to the IST, which is a basket of national indexes that reflect the telecommunications sector's operating costs. Such indexing will thus reduce inconsistencies between revenue and costs in our industry and therefore reduce the adverse effects of inflation on our business. The IST for the last 12 months is 4.92% according to the last data published by ANATEL with reference to December 2012.

The table below shows the Brazilian general price inflation (according to the IGP-DI, IPCA and the IST) for the years ended December 31, 2009 through 2013:

	Inflation Rate (%) as Measured by IGP-DI(1)	Inflation Rate (%) as Measured by IPCA(2)	Inflation Rate (%) as Measured by IST(3)
December 31, 2013	5.5	5.9	4.9
December 31, 2012	8.1	5.8	4.9
December 31, 2011	5.0	6.5	4.9
December 31, 2010	11.3	5.9	5.6
December 31, 2009	(1.4)	4.3	2.1

(1) Source: IGP-DI, as published by the Fundação Getúlio Vargas.

(2) Source: IPCA, as published by the Instituto Brasileiro de Geografia e Estatística.

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

Regulatory and Competitive Factors

Our business, including the services we provide and the rates we charge, is subject to comprehensive regulation under the General Telecommunications Law. As a result, our business, results of operations and financial conditions could be impacted by the actions of the Brazilian authorities, including:

- delays in the granting, or the failure to grant, approvals for rate adjustment;

Table of Contents

- the granting of licenses to new competitors in our region; and
- the introduction of new or stricter requirements for our operating concession.

A series of new regulations became effective in 2013. See “Item 4. Information on the Company—B. Business Overview.” The most important among these regulations were:

- Resolution 607/2013 - Numbering on long distance calls
- Resolution 608/2013 – Account separation and allocation (DSAC)
- Resolution 611/2013 – Billing Areas Change
- Resolution 614/2013 – Regulation of SCM
- Resolution 615/2013 – Regulation of STFC
- Resolution 617/2013 – Regulation of Private Limited Service (“Serviços Limitado Privado – SLP”)
- Resolution 619/2013 – Current and historical costs (DSAC)
- Resolution 622/2013 – FATB Regulation
- Resolution 623/2013 – Users Council
- Resolution 624/2013 –Femtocell Regulation
- Resolution 625/2013 – Allocation of the 700 MHz band
- Resolution 628/2013 –Conduct Adjustment Term Regulation

We expect the following issues to become effective as new regulations or to be subject of one or more Public Notices in 2014, with an exact timeline yet to be determined by ANATEL.

- Local Areas Regulation
- Concession Agreement Review
- 700 MHz Auction
- Productivity Factor Calculation
- Public Use Telephone Regulation
- Treatment, Collection and Offer Regulation
- Reversible Assets

- Consumer Rights
- Infrastructure Share
- Use of Spectrum Regulation
- Sanctions and Conduct Adjustment
- Cost Model (DSAC)
- Systemic Disruption Regulation

70

- WACC Regulation
- Mobile Telephony (SMP) Regulation

Number Portability came into effect in Brazil in September 2008. Number Portability allows clients within a limited geographic locale to relocate or change their telephone operator without the need to change their telephone number (for either a fixed or mobile line). Number Portability rights for all of our clients became effective in March 2009.

In addition to regulatory considerations, our business is affected by competition from other telecommunications providers. We began to face competition in our region in July 1999, and we anticipate that competition will contribute to declining prices for fixed-line telecommunications services and increasing pressure on operating margins. Our future growth and results of operations will depend significantly on a variety of factors, including:

- Brazil's economic growth and its impact on the greater demand for services;
- the costs and availability of financing; and
- the exchange rate between the real and other currencies.

Foreign Exchange and Interest Rate Exposure

We face foreign exchange risk due to our foreign currency-denominated indebtedness, accounts payable (including our capital expenditures, particularly equipment) and receivables in foreign currency. A real devaluation may increase our cost of debt and certain commitments in a foreign currency. Our revenue is earned in reais, and we have no material foreign currency-denominated assets, except income from hedging transactions, interconnection of international long-distance services and services rendered to customers outside Brazil. Equity investments in foreign companies also suffer effects with variations in the exchange rate.

On December 31, 2013, 15.9% of our R$8.753 billion of financial indebtedness was denominated in U.S. dollars and UMBNDES. See Note 18 to the Consolidated Financial Statements. Devaluation of the real causes exchange losses on foreign currency-denominated indebtedness and commitments and exchange gain on foreign currency-denominated assets and corporate stakes in foreign companies.

We use derivative instruments to limit our exposure to exchange rate risk. Since September 1999, we have hedged all of our foreign currency-denominated bank debt using swaps. Since May 2010, the company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures, or assets (issued invoices) minus liabilities (received invoices) for foreign exchange exposures, substantially reducing the company's risk to fluctuations in exchange rates. However, we remain exposed to market risk resulting from changes in local interest rates, principally the CDI – Certificate of Interbank Deposits (Certificado de Depósito Interbancário), which is an index based upon the average rate of operations transacted among the banks within Brazil). This exposure to the CDI is present in long derivatives positions and financial investments, which are indexed to percentages of the CDI. Substantially, most of our debt is exposed to long term interest rates. On December 31, 2013, R$2.442 billion of our indebtedness was subject to the variations of the TJLP. The loan with the BNDES accrues interest at the Long Term Interest Rate (acronym in Portuguese TJLP) and is fixed every quarter by the National Monetary Council (acronym in Portuguese CMN). Between July 2009 and June 2012 the rate was kept at 6.0% p.a.. From July to December 2012 it was 5.5% p.a., being lowered to 5.0% p.a. as of January 2013. Additionally, R$1.394 billion of our indebtedness was subject to the variation of the U.S. dollar and UMBNDES. However, our foreign currency debt is swapped under hedging arrangements for variable-rate real-denominated obligations based on the CDI. We invest our excess cash mainly in short-term instruments that earn interest based on the CDI. See Note 36 to the Consolidated Financial Statements and "Item 11. Quantitative and Qualitative Disclosures about Market Risk."

Since we have foreign currency derivatives with notional amounts substantially equivalent to our borrowings and invoices issued and received denominated in foreign currency, we do not have material exchange rate exposure with respect to these contracts. However, we could still continue to have exchange rate exposure with respect to our planned capital expenditures, approximately 50.0% of which are denominated or indexed in foreign currencies (mostly U.S. dollars). We systematically monitor the amounts and time of exposure to exchange rate fluctuations and may contract for hedging positions, when appropriate, at our discretion.

Table of Contents

Discussion of Critical Accounting Estimates and Policies

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

Accounting for long-lived assets

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

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

The carrying values and useful lives applied to the principal categories of property, plant and equipment, and intangibles, are disclosed in Notes 13 and 14 to our consolidated financial statements.

Impairment of nonfinancial assets, including goodwill

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

The carrying value of goodwill and the key assumptions used in performing the annual impairment assessment are disclosed in Notes 3.j) and 14 to our consolidated financial statements.

Provisions for tax, labor, civil and regulatory proceedings

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

Additional information on provisions for tax, labor, civil and regulatory proceedings is disclosed in Notes 3.p) and 20 to our consolidated financial statements.

Pension and other post-retirement benefit plan

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

The value of the net pension obligation at December 31, 2013, which is the key financial assumptions used to measure the obligation as well as the sensitivity of the IAS 19 (revised) pension liability at December 31, 2013 and of the income statement charge in 2013/14 to changes in these assumptions are disclosed in Note 35 to our consolidated financial statements.

Fair value of financial instruments

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

Additional information on fair value of financial instruments is disclosed in Notes 3 k), l) and m) and 36 to our consolidated financial statements.

Taxes

There are uncertainties regarding the interpretation of complex tax regulations and the amount and timing of future taxable income. We record provisions based on reasonable estimates for possible auditing by tax authorities from the jurisdictions in which we operate. The value of these provisions is based on several factors such as experience from previous tax audits and different interpretations of tax regulations by the taxable entity and the competent tax authority in charge. Such differences of interpretation may arise in a wide variety of subjects, depending on the prevailing conditions in the domicile of the company. As a result, we may be required to pay more than our provisions or to recover less than the assets recognized.

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

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

Additional information on taxes is disclosed in Notes 3.q), 8, 9 and 17.

Table of Contents

Revenue recognition

Customer Loyalty Program

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

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

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

Multiple-element arrangements

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

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

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

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

Provision for doubtful debts

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

Additional information on provision for doubtful debts is disclosed in Notes 3.b) and 6 to our consolidated financial statements.

Sources of Revenue

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

- Telephony services

Includes revenues from fixed and mobile telephony highlighting:

- Local: includes the sum of revenues from monthly subscription fees, installation fees, local services, public telephony and fixed-to-mobile revenues (VC1);
- Domestic long-distance: includes the sum of fixed-to-mobile revenues (VC2 and VC3), public long-distance telephony and domestic long-distance;

Table of Contents

- International long-distance: includes the sum of revenues from international public telephony and international long-distance; and
- Usage charges: which include measured service charges for calls, monthly fee and other similar charges;
- Data Transmission and value added services
- Data Transmission: includes the sum of infrastructure rental revenues and data transmission; and
- Charges for call forwarding, call waiting, text messaging (SMS), call blocking and Data Services, such as WAP and ZAP, downloads and MMS services, which are charged only when the customer's plan excludes these services.
- Interconnection charges
- Interconnection charges (or network usage charges) are amounts we charge other cellular and fixed-line service providers for the use of our network;
- Pay TV
- Includes TV services through satellite, cable or IPTV technology;
- Sale of goods and equipment
- The sale of wireless devices and accessories; and
- Other Services
- Other services include integrated solution services offered to residential and corporate clients, such as Internet access, private network connectivity and leasing of computer equipment, and
- Other telecommunications services such as extended service, detects, voice mail, cellular blocker, among others.

Results of Operations

The following table sets forth certain components of our net income for each year ended December 31, 2013, December 31, 2012 and December 31, 2011 as well as the percentage change of each component. In 2011, we acquired 100% of shares of Vivo Participações. See Note 4 to our consolidated financial statements. Our consolidated financial statements include the former operations of Vivo Participações and Vivo since April 1, 2011.

Because Vivo Participações and Vivo are included in our financial statements for nine months in 2011, our results of operations in 2013 and 2012 are not fully comparable with our results of operations in 2011. We have made certain changes to our accounting criteria and elected to apply these changes retroactively to part of our financial statements for the years 2012 and 2011 to make them comparable to our 2013 financial statements. Implementation of these accounting changes did not create any difference for our results of operations or shareholders' equity.

On July 1, 2013 our shareholders approved the corporate reorganization with the merger of Vivo S.A. into us. See Note 1.b) to our consolidated financial statements.

Table of Contents

	Year ended December 31,			Percent change	Percent change
	2013	2012 (Restated)	2011 (Restated)	2013-2012	2012-2011
	(in millions of reais)				
Net operating revenue	34,721.9	33,919.7	29,116.6	2.4 %	16.5 %
Cost of services and goods	(17,542.2)	(16,557.5)	(15,035.2)	5.9 %	10.1 %
Gross profit	17,179.7	17,362.2	14,081.4	(1.1 %)	23.3 %
Operating expenses:					
Selling	(9,686.1)	(8,693.7)	(6,948.2)	11.4 %	25.1 %
General and administrative	(2,177.9)	(2,145.3)	(1,782.9)	1.5 %	20.3 %
Other operating revenues, net	(383.4)	687.7	441.5	(155.8 %)	55.8 %
Total operating expenses, net	(12,247.4)	(10,151.3)	(8,289.6)	20.6 %	22.5 %
Equity in earnings (losses) of associates	(55.1)	0.6	4.3	-	-
Operating income before financial expense, net	4,877.2	7,211.5	5,796.1	(32.4 %)	24.4 %
Net financial expenses	(214.8)	(291.2)	(141.0)	(26.3 %)	106.6 %
Net income before income and social contribution taxes	4,662.4	6,920.3	5,655.1	(32.6 %)	22.4 %
Income and social contribution taxes	(946.5)	(2,468.1)	(1,292.9)	(61.7 %)	90.9 %
Net income	3,715.9	4,452.2	4,362.2	(16.5 %)	2.1 %
Net income attributable to:					
Shareholders of company	3,715.9	4,453.6	4,355.3	(16.6 %)	2.3 %
Noncontrolling interests	-	(1.4)	6.9	(100.0 %)	(120.3 %)
Net income	3,715.9	4,452.2	4,362.2	(16.5 %)	2.1 %

Net Operating Revenue

Net operating revenues increased by 2.4% to R$34,721.9 million in 2013 from R$33,919.7 million in 2012 mainly due to higher fixed and mobile data revenues, and increase in VAS revenues, besides some commercial initiatives that have been implemented by the Company during 2013. It was partially offset by the maturity of fixed voice and MTR reduction that affected mobile network usage. Net operating revenues grew 16.5% to R$33.919.7 in 2012 from R$29,116.6 million in 2011.

Capital Expenditures (Capex)

In 2013, we invested R$6.033 million to support our current annual results and competitive position. Excluding the capital expenditures with acquisition of licenses it represented an increase of 10.2% when compared to 2012. A significant portion of resources was allocated to the expansion of our client base while maintaining the quality of the services provided. As a percentage over net operating revenues the ratio increased from 15% in 2012 to 16% in 2013 (excluding the effect of licenses). A significant portion of resources was allocated to the expansion of our client base while maintaining the quality of the services provided.

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

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

Operating Revenue

Our gross operating revenue is presented net of discounts granted.

Our gross operating revenue increased 3.4% to R$51,965.6 million in 2013 from R$50,264.6 million in 2012, impacted by the increase in fixed and mobile data revenue, a higher mobile VAS revenue, and increase of smartphones sales. The variations are explained as follows:

	Year ended December 31, 2013	2012 (Restated)	Percent change 2013-2012
	(in millions of reais)		
Telephony services	26,428.6	26,555.1	(0.5 %)
Data transmission and value added services	16,294.9	14,389.8	13.2 %
Interconnection charges	3,820.0	4,453.4	(14.2 %)
Pay TV	645.0	805.3	(19.9 %)
Sale of goods and equipment	3,479.8	2,792.6	24.6 %
Other services	1,297.3	1,268.4	2.3 %
Gross operating revenue	51,965.6	50,264.6	3.4 %
Value-added and other indirect taxes	(17,243.7)	(16,344.9)	5.5 %
Net operating revenues	34,721.9	33,919.7	2.4 %

Telephone services: There was a decrease of R$126.5 million in revenue from telephony services, or 0.5%, explained mainly by the decrease in fixed to mobile tariff (VC) in April 2013. This decrease was partially offset by the increase in postpaid plans called “Vivo ilimitado.”

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

Interconnection charges: Revenue from interconnection charges decreased by R$633.4 million, a 14.2% decrease in relation to 2012. This variation is mainly related to the decrease in mobile termination rates.

Pay TV: Revenue from Pay TV totaled R$645 million in 2013, a decrease of 19.9% in the Pay TV’s gross revenue in relation to 2012. This variation is mainly related to the disconnection of MMDS customers due to the occupation of the spectrum by 4G operators. It was partially offset by the acceleration of DTH sales since June 2013, reflecting the selective relaunching of DTH TV services in some regions of São Paulo.

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

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

Cost of Services and Goods

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

	Year ended December 31, 2013	2012	Percent change 2013-2012

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

Table of Contents

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

Cost of goods sold: Cost of wireless devices and accessor