WINN DIXIE STORES INC
Form DEFM14A
February 03, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of

the Securities Exchange Act of 1934

Filed by the Registrant x
Filed by a Party other than the Registrant ¨
Check the appropriate box:
¨ Preliminary Proxy Statement
¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to §240.14a-12

Winn-Dixie Stores, Inc.

(Name of Registrant as Specified In Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):
¨ No fee required.
¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
(1) Title of each class of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(3) Filing Party:

(4) Date Filed:

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WINN-DIXIE STORES, INC.

5050 EDGEWOOD COURT JACKSONVILLE, FLORIDA 32254-3699

February 3, 2012

Dear shareholders:

You are cordially invited to attend a special meeting of shareholders of Winn-Dixie Stores, Inc. (Winn-Dixie, we, us, our, or the Company), which will be held at our headquarters at 5050 Edgewood Court, Jacksonville, Florida 32254, at 9:00 a.m. Eastern Standard Time on March 9, 2012.

At the special meeting, we will ask you to consider and vote on a proposal to approve the Agreement and Plan of Merger, dated as of December 16, 2011, among Opal Holdings, LLC, or Holdings, Opal Merger Sub, Inc. and Winn-Dixie, providing for the acquisition of Winn-Dixie by Holdings. If the merger is completed, Winn-Dixie will become a wholly owned subsidiary of Holdings, and you will receive $9.50 in cash, without interest and less any applicable withholding taxes, for each share of our common stock that you own, and you will cease to have an ownership interest in Winn-Dixie. A copy of the merger agreement is attached as Annex A to the accompanying proxy statement and you are encouraged to read it carefully and in its entirety.

A Special Committee of our Board of Directors, comprised of eight independent directors, and advised by independent financial and legal advisors, negotiated the transaction and recommended it to our full Board of Directors. After careful consideration, our full Board of Directors has unanimously adopted and approved the merger agreement and approved the merger and determined that the merger and the merger agreement are advisable to, and in the best interests of, Winn-Dixie and its shareholders. **OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THE APPROVAL OF THE MERGER AGREEMENT. IN ADDITION, OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THE ADVISORY VOTE ON COMPENSATION THAT MAY BECOME PAYABLE TO OUR NAMED EXECUTIVE OFFICERS IN CONNECTION WITH THE MERGER AND FOR THE PROPOSAL TO ADJOURN THE SPECIAL MEETING (IF NECESSARY OR APPROPRIATE) TO SOLICIT ADDITIONAL PROXIES IF THERE ARE INSUFFICIENT VOTES AT THE TIME OF THE SPECIAL MEETING TO APPROVE THE MERGER AGREEMENT.**

The proxy statement attached to this letter provides you with information about the merger and the special meeting. Please read the entire proxy statement carefully and in its entirety. You may also obtain additional information about us from documents we file with the Securities and Exchange Commission.

YOUR VOTE IS IMPORTANT. **The merger cannot be completed unless shareholders holding a majority of the outstanding shares entitled to vote at the special meeting approve the merger agreement. If you fail to vote on the merger agreement or fail to instruct your broker on how to vote, it will have the same effect as voting against the approval of the merger agreement.**

Whether or not you plan to attend the special meeting in person, please complete, sign, date and return promptly the enclosed proxy card or follow the related Internet or telephone voting instructions. If you hold shares through a broker or other nominee, you should follow the procedures provided by your broker or nominee.

If you have any questions or need assistance voting your shares, please call Georgeson Inc., which is assisting us, toll-free at (866) 432-2791.

On behalf of the Board of Directors, I thank you for your cooperation and continued support.

On behalf of the Board of

Directors,

Peter L. Lynch
Chairman and Chief Executive Officer

Neither the Securities and Exchange Commission nor any state securities regulatory agency has approved or disapproved the merger, passed upon the merits or fairness of the merger or passed upon the adequacy or accuracy of the disclosure in this document. Any representation to the contrary is a criminal offense.

This proxy statement is dated February 3, 2012 and is first being mailed, along with the enclosed proxy card, to shareholders on or about February 7, 2012.

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WINN-DIXIE STORES, INC.

5050 EDGEWOOD COURT JACKSONVILLE, FLORIDA 32254-3699

Notice of Special Meeting of Shareholders

to be held on March 9, 2012

To all Shareholders of Winn-Dixie Stores, Inc.:

You are invited to attend a special meeting of shareholders of Winn-Dixie Stores, Inc. (Winn-Dixie, we, us, our, or the Company). The speci meeting will be held at our headquarters at 5050 Edgewood Court, Jacksonville, Florida 32254, at 9:00 a.m. Eastern Standard Time on Friday, March 9, 2012, for the following purposes:

1. **Approval of the Merger Agreement with Holdings.** To consider and vote on a proposal to approve the Agreement and Plan of Merger, dated as of December 16, 2011, among Opal Holdings, LLC, or Holdings , Opal Merger Sub, Inc., or Merger Sub, and Winn-Dixie, as it may be amended from time to time, pursuant to which each holder of shares of our common stock issued and outstanding immediately prior to the effective time of the merger (other than shares held by (i) us as treasury stock, (ii) Holdings or Merger Sub or (iii) any of our direct or indirect wholly owned subsidiaries) will be entitled to receive $9.50 per share in cash, without interest and less applicable withholding taxes, in exchange for each such share;

2. **Advisory Vote on Compensation.** To consider and vote on an advisory proposal to approve the compensation that may become payable to our named executive officers in connection with the merger;

3. **Adjournment of the Special Meeting.** To consider and approve the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the merger agreement; and

4. **Other Matters.** To consider and act upon any other business as may properly come before the special meeting or any adjournment or postponement thereof by or at the direction of the Board of Directors.

The Board of Directors has fixed January 27, 2012 as the record date for the special meeting. Only holders of our common stock at the close of business on the record date will be entitled to notice of, and to vote at, the special meeting and any adjournment of the special meeting, unless a new record date is fixed in connection with an adjournment of the special meeting. A list of shareholders entitled to vote at the special meeting will be available for inspection at our headquarters located at 5050 Edgewood Court, Jacksonville, Florida 32254 for a period of 10 days prior to the special meeting and at the place of the special meeting for the duration of the special meeting.

Your vote is important, regardless of the number of shares of our common stock you own. The approval of the merger agreement requires the affirmative vote of the holders of a majority of the outstanding shares of our common stock entitled to vote at the special meeting. The approval of the advisory proposal on the compensation that may become payable to our named executive officers in connection with the merger requires that the number of shares voted in favor of the proposal are greater than those voted against the proposal. The approval of the proposal to adjourn the special meeting (if necessary or appropriate) to solicit additional proxies requires (i) if a quorum exists, that the number of shares voted in favor of adjournment are greater than those voted against, or (ii) in the absence of a quorum, the affirmative vote of the holders of a majority of the shares of our common stock represented at the special meeting.

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Whether or not you expect to attend the special meeting, please complete, sign, date and return the enclosed proxy card promptly to ensure that your shares will be represented at the special meeting. If you decide to attend the special meeting, you may, if you wish, revoke the proxy and vote your shares in person.

If you sign, date and mail your proxy card without indicating how you wish to vote, your vote will be counted as a vote in favor of the approval of the merger agreement, in favor of the advisory vote on compensation that may become payable to our named executive officers, in favor of the proposal to adjourn the special meeting (if necessary or appropriate) to permit further solicitation of proxies, and in accordance with the recommendation of the Board of Directors on other matters, if any, properly brought before the special meeting for a vote by or at the direction of the Board of Directors.

If you fail to vote by proxy or in person, it will have the same effect as a vote against the approval of the merger agreement.

A Special Committee of our Board of Directors, comprised of eight independent directors, and advised by independent financial and legal advisors, negotiated the transaction and recommended it to our full Board of Directors. After careful consideration, the full Board of Directors has unanimously adopted and approved the merger agreement and approved the merger and the other transactions contemplated by the merger agreement and determined that the merger and the merger agreement are advisable to, and in the best interests of, Winn-Dixie and its shareholders. **OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THE APPROVAL OF THE MERGER AGREEMENT. IN ADDITION, OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THE ADVISORY VOTE ON COMPENSATION THAT MAY BECOME PAYABLE TO OUR NAMED EXECUTIVE OFFICERS IN CONNECTION WITH THE MERGER AND FOR THE PROPOSAL TO ADJOURN THE SPECIAL MEETING (IF NECESSARY OR APPROPRIATE) TO SOLICIT ADDITIONAL PROXIES IF THERE ARE INSUFFICIENT VOTES AT THE TIME OF THE SPECIAL MEETING TO APPROVE THE MERGER AGREEMENT.**

Please carefully read the proxy statement and other materials concerning Winn-Dixie, the merger and the other proposals enclosed with this notice for a more complete statement regarding the matters to be acted upon at the special meeting.

PLEASE DO NOT SEND ANY STOCK CERTIFICATES AT THIS TIME.

By order of the Board of Directors,

Timothy L. Williams

Secretary

Jacksonville, Florida

February 3, 2012

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ANNEX A	AGREEMENT AND PLAN OF MERGER
ANNEX B	OPINION OF GOLDMAN, SACHS & CO. DATED DECEMBER 16, 2011

SUMMARY

This summary highlights selected information from this proxy statement and may not contain all of the information that may be important to you. To understand the merger fully, and for a more complete description of the legal terms of the merger, you should carefully read this entire proxy statement, the annexes attached to this proxy statement and the documents to which we refer. The Agreement and Plan of Merger, which we refer to as the merger agreement, dated as of December 16, 2011, by and among Opal Holdings, LLC, or Holdings, Opal Merger Sub, Inc., or Merger Sub and Winn-Dixie Stores, Inc., or Winn-Dixie, we, us, our, or the Company, is attached as Annex A to this proxy statement. We have included page references in parentheses to direct you to the appropriate place in this proxy statement for a more complete description of the topics presented in this summary.

The Parties to the Merger Agreement (Page 19)

¡ Winn-Dixie, a corporation organized under the laws of the State of Florida, is one of the nation s largest food retailers and operates primarily under the Winn-Dixie banner. As of January 13, 2012, Winn-Dixie operated 484 retail grocery locations and approximately 380 in-store pharmacies in Florida, Alabama, Louisiana, Georgia and Mississippi. Winn-Dixie had net sales of approximately $6.9 billion and total assets of approximately $1.8 billion as of and for its fiscal year ended June 29, 2011.

¡ Holdings, a limited liability company organized under the laws of the State of Delaware, was formed for the purpose of entering into the merger agreement with Winn-Dixie and completing the merger. Holdings has not conducted any activities to date, other than activities incidental to its formation and in connection with the transactions contemplated by the merger agreement. Holdings is a wholly owned subsidiary of BI-LO, LLC, which is in turn a wholly owned subsidiary of BI-LO Holding, LLC. BI-LO Holding, LLC is a majority owned subsidiary of Lone Star Fund V (U.S.), L.P., a partnership that is a part of the group of investment funds commonly known as Lone Star Funds. We refer to the Lone Star Funds as Lone Star and we refer to Lone Star Fund V (U.S.) LP as Lone Star Guarantor. Lone Star is a global investment firm that acquires debt and equity assets including corporate, commercial real estate, single family residential and consumer debt products as well as banks and operating companies. Since the establishment of its first fund in 1995, the principals of Lone Star have organized private equity funds totaling approximately $33 billion of capital that has been invested globally through Lone Star s worldwide network of affiliate offices.

¡ Merger Sub, a corporation organized under the laws of the State of Florida, is a direct wholly owned subsidiary of Holdings, formed solely for the purpose of entering into the merger agreement with Winn-Dixie and completing the merger. Merger Sub has not conducted any activities to date, other than activities incidental to its formation and in connection with the transactions contemplated by the merger agreement.

The Merger; Effective Time of the Merger (Page 60)

¡ You are being asked to vote to approve the merger agreement. Upon the terms and subject to the conditions contained in the merger agreement, Merger Sub will be merged with and into Winn-Dixie, with Winn-Dixie remaining as the surviving corporation. As a result of the merger, we will cease to be a publicly traded company and will become a wholly owned subsidiary of Holdings.

¡ The merger will become effective upon the filing of articles of merger with the Florida Department of State or at such later time as is agreed upon by Holdings and us and specified in the articles of merger in accordance with Florida law.

¡ The closing of the merger is expected to occur on the second business day after the conditions to the merger set forth in the merger agreement have been satisfied or waived or at such other time agreed to in writing

by us and Holdings. Although we expect to complete the merger shortly after the special meeting of our shareholders, we cannot specify when, or assure you that, we and Holdings will satisfy or waive all conditions to the merger.

Merger Consideration (Page 61)

¡ If the merger is completed, each share of common stock, par value $0.001 per share, of Winn-Dixie, which we refer to as our common stock, that is issued and outstanding immediately prior to the effective time of the merger (other than shares held by (i) us as treasury stock, (ii) Holdings or Merger Sub or (iii) any of our direct or indirect wholly owned subsidiaries), will be cancelled at the effective time of the merger and automatically be converted into the right to receive $9.50 in cash, without interest and less applicable withholding taxes.

Effect on Stock Options and Restricted Stock Units (Page 61)

¡ At the effective time of the merger, all options to purchase shares of our common stock that are outstanding immediately prior to the effective time and that are vested or that, upon consummation of the merger, will automatically vest in accordance with their terms, will be cancelled by us and will be converted into the right to receive a cash payment equal to the excess, if any, of $9.50 per share in cash over the exercise price per share of the option, multiplied by the number of shares subject to the applicable option, without interest and less any applicable withholding tax. If the exercise price per share of any option is $9.50 or greater, such option will be cancelled, retired and cease to exist as of the effective time of the merger and the holder of such stock option will have no right to receive any consideration for such option. All options to purchase shares of our common stock that are unvested at the effective time and that are not automatically vested pursuant to their terms by virtue of the merger will be cancelled, retired and cease to exist as of the effective time of the merger and the holders of such stock options will have no right to receive any consideration for such options. All restricted stock units that are outstanding immediately prior to the effective time and that, upon consummation of the merger, will automatically vest in accordance with their terms, will be converted into the right to receive $9.50 per share in cash, without interest and less any applicable withholding tax. All restricted stock units subject to performance based vesting conditions that are unvested at the effective time and that are not automatically vested pursuant to their terms by virtue of the merger will be cancelled and the holders of such restricted stock units will have no right to receive any consideration for such cancellation.

Effect on Employee Stock Purchase Plan (Page 61)

¡ With respect to our Employee Stock Purchase Plan, which we refer to as the ESPP, as of the effective time of the merger, any then current offering period under the ESPP shall be terminated and no new offering periods will begin under the ESPP after such date and no further shares of our common stock will be purchased under the ESPP. Winn-Dixie will refund any unused cash (without interest) in a participant s account to such participant.

Conditions to the Merger (Page 74)

¡ We and Holdings will not complete the merger unless a number of conditions are satisfied or waived, as applicable, including the approval by our shareholders of the merger agreement and the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, which we refer to as the HSR Act. On December 30, 2011, we and Lone Star Guarantor each filed the required notification and report forms under the HSR Act with the Antitrust Division of the U.S. Department of Justice, referred to as the DOJ, and the U.S. Federal Trade Commission, referred to as the FTC, and on January 12, 2012, early termination of the applicable waiting period under the HSR Act was granted.

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Termination of the Merger Agreement (Page 75)

¡ Either we or Holdings can terminate the merger agreement under certain circumstances, including, in general, if the other party breaches any of its representations, warranties, covenants or agreements in a manner that would result in the failure of closing conditions set forth in the merger agreement and such breach is not cured within a specified time period.

¡ In addition to certain other circumstances, Holdings may also terminate the merger agreement if our Board of Directors elects to withdraw or adversely modify its recommendation of the merger or the merger agreement. We may also terminate the merger agreement, after complying with certain procedures in the merger agreement, in order to enter into a definitive acquisition agreement with a third party that our Board of Directors has determined constitutes a superior proposal. If the merger agreement is terminated as described in this paragraph, we will be required to pay Holdings a $19.6 million termination fee.

¡ In addition, if the merger agreement is terminated (i) by us as a result of the representations and warranties of Holdings or Merger Sub having become untrue or Holdings or Merger Sub breaching any of its covenants, in each case causing a failure of applicable closing conditions that are not cured during the specified time period, (ii) by us as a result of Holdings and Merger Sub failing to close the merger when they were otherwise obligated to close the merger or (iii) by us or Holdings as a result of the merger failing to close because Holdings failed to take certain actions related to antitrust matters, Holdings will be required to pay us a closing failure fee of $72,825,000.

No Solicitation of Competing Proposals (Page 68)

¡ The merger agreement contains non-solicitation provisions that prohibit us from soliciting or engaging in discussions or negotiations regarding a competing proposal to the merger. The merger agreement contains certain exceptions to these prohibitions, including if prior to the special meeting of our shareholders we receive an unsolicited acquisition proposal from a third party that meets certain conditions.

Recommendation of Our Board of Directors (Page 34)

¡ A Special Committee of our Board of Directors (the Special Committee), comprised of eight independent directors, and advised by independent financial and legal advisors, negotiated the transaction and recommended it to our full Board of Directors. After due discussion and due consideration, on the unanimous recommendation of the Special Committee, our full Board of Directors has unanimously determined that the merger agreement and the merger are advisable to, and in the best interests of, Winn-Dixie and our shareholders. Accordingly, our Board of Directors unanimously recommends that you vote **FOR** the approval of the merger agreement.

Reasons for Recommendation of Our Board of Directors and the Special Committee (Page 30)

¡ The Special Committee, in making its recommendation to our full Board of Directors that the Board of Directors approve the merger, and the Board of Directors, in making its recommendation that you vote **FOR** the approval of the merger agreement, each considered a number of factors. Please refer to the more detailed information contained in *Reasons for the Merger* on page 30.

Opinion of Goldman, Sachs & Co. as Financial Advisor to the Special Committee (Page 34 and Annex B)

¡ Goldman, Sachs & Co. (Goldman Sachs) rendered its oral opinion to the Special Committee, subsequently confirmed in writing, that as of December 16, 2011 and based upon and subject to the limitations,

qualifications and assumptions set forth therein, the $9.50 per share in cash to be paid to the holders of outstanding shares of our common stock pursuant to the merger agreement was fair from a financial point of view to such holders.

¡ The full text of the written opinion of Goldman Sachs, dated December 16, 2011, which sets forth assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with the opinion, is attached as Annex B. The summary of the Goldman Sachs opinion provided in this proxy statement is qualified in its entirety by reference to the full text of the written opinion. Winn-Dixie shareholders are urged to read the opinion carefully and in its entirety. Goldman Sachs provided its opinion for the information and assistance of the Special Committee in connection with its consideration of the merger. Goldman Sachs opinion is not a recommendation as to how any holder of shares of Winn-Dixie common stock should vote with respect to the merger or any other matter.

Special Meeting; Record Date; Quorum; Merger Vote (Page 15)

¡ The special meeting of our shareholders will be held at our headquarters located at 5050 Edgewood Court, Jacksonville, Florida 32254, beginning at 9:00 a.m., Eastern Standard Time, on Friday, March 9, 2012.

¡ The Board of Directors has fixed January 27, 2012 as the record date for the special meeting.

¡ A quorum of shareholders is necessary to hold a valid special meeting. A quorum is present at the special meeting if a majority of the issued and outstanding shares of our common stock entitled to vote at the special meeting are present in person or represented by proxy. Abstentions and broker non-votes are counted as present for the purpose of determining whether a quorum is present.

¡ The merger cannot be completed unless shareholders holding a majority of the outstanding shares entitled to vote at the special meeting approve the merger agreement. If you fail to vote on the merger agreement or fail to instruct your broker on how to vote, it will have the same effect as voting against the approval of the merger agreement.

Material U.S. Federal Income Tax Consequences of the Merger (Page 55)

¡ For U.S. federal income tax purposes, the merger will be treated as a sale of the shares of our common stock for cash by each of our shareholders. As a result, in general, a U.S. holder (as defined below) of our common stock will recognize gain or loss equal to the difference, if any, between the amount of cash received in the merger and such shareholder s adjusted tax basis in the shares surrendered. Such gain or loss will be capital gain or loss if the shares of common stock surrendered are held as a capital asset in the hands of the shareholder, and will be long-term capital gain or loss if the shares of common stock have a holding period of more than one year at the time of the merger. For U.S. federal income tax purposes, a non-U.S. holder (as defined below) will generally not be subject to U.S. federal income tax on the merger consideration such holder receives unless such holder has certain connections to the United States.

¡ **Shareholders are urged to consult their own tax advisors as to the particular tax consequences to them of the merger.**

Common Stock Ownership of Our Directors and Executive Officers (Page 80)

¡ As of the record date, our directors and executive officers beneficially owned, in the aggregate, approximately 4.36% of the outstanding shares of our common stock entitled to vote at the special meeting. We currently expect that each of these individuals will vote all of his or her shares of common stock in favor of each of the proposals.

Interests of Our Directors and Executive Officers in the Merger (Page 48)

¡ Our directors and executive officers may have interests in the merger that are different from, or in addition to, yours, including the following:

our directors and executive officers will (i) receive cash consideration for their vested stock options and stock options that will vest pursuant to their terms in connection with the merger in an amount equal to the excess, if any, of $9.50 per share in cash over the exercise price per share of the option, multiplied by the number of shares subject to the applicable option (without interest and less any applicable withholding tax); provided that if the exercise price of a stock option is equal to or greater than $9.50, such stock option will be cancelled without any cash payment being made in respect thereof and (ii) receive cash consideration of $9.50 per share (without interest and less any applicable withholding tax) for their restricted stock units that will vest pursuant to their terms in connection with the merger;

our president and chief executive officer is a party to an employment agreement which provides for enhanced payments upon the termination of his employment;

our senior vice presidents, group vice presidents, vice presidents, regional vice presidents, directors and senior directors are participants in an executive severance plan which provides for enhanced payments upon the termination of their employment;

Holdings has agreed to provide each of our employees (including our executive officers) with base salary or hourly wage rate, incentive compensation opportunities and other compensation employee benefits (excluding any equity or equity-based compensation) that are no less favorable for all employees in the aggregate than the benefits provided by us immediately prior to the merger for a period of one year after the effective time of the merger;

certain of our executive officers may receive cash or other non-equity compensation from the Company, Holdings or affiliates of Holdings for services to be rendered in the future in connection with their continued employment following the closing of the merger;

Holdings has agreed to honor all benefit plans (including all severance, change of control and similar plans and agreements) in effect for one year after the effective time of the merger;

the merger agreement provides for insurance and indemnification arrangements for each of our current and former directors and officers;

our employees (including our executive officers) will receive full service credit for all purposes under Holdings employee benefits plans, programs and arrangements (other than equity plans and benefit accrual under any pension plans), and Holdings will cause all pre-existing condition exclusions or limitations and actively-at-work requirements to be waived and to allow eligible expenses to be taken into account to satisfy deductibles, coinsurance and out of pocket requirements under applicable Holdings plans and our employees will be allowed to use accrued vacation; and

in connection with the execution of the merger agreement, we entered into an Expense Advance Agreement with each of our current directors, which agreement provides that if any director incurs any expenses in defending any civil or criminal proceeding brought in connection with such director s service on the Board of Directors, such expenses shall be advanced by us, to the fullest extent permitted by law.

¡ The Special Committee and our Board of Directors were aware of these interests and considered them, among other matters, in making their decisions.

¡ In addition, on January 11, 2012, our president and chief executive officer entered into a retention bonus agreement with BI-LO Holding, LLC that provides that a performance bonus and/or a discretionary bonus may become payable if he remains employed as an adviser to Winn-Dixie through a pre-determined period following the closing of the merger.

¡ On January 25, 2012, our chief financial officer entered into a post-closing employment agreement with BI-LO Holding, LLC that provides that he will remain employed on an at will basis as Winn-Dixie s integration lead after the closing of the merger. Prior to the closing of the merger, other of our executive officers may also enter into retention or employment arrangements with BI-LO Holding, LLC or Holdings.

Financing of the Merger (Page 47)

¡ Holdings has obtained equity and debt financing commitments, the aggregate proceeds of which will be sufficient to consummate the merger and the other transactions contemplated by the merger agreement. These commitments are described in more detail below. The funding under these commitments is subject to certain conditions, including conditions that do not relate directly to the conditions to closing in the merger agreement. Although obtaining the proceeds of any financing, including the financing under these commitments, is not a condition to Holdings obligation to complete the merger, the failure of Holdings and Merger Sub to obtain financing (whether under these commitments or otherwise) is likely to result in the failure of the merger to be completed. In that case, Holdings may be obligated to pay us a fee of $72,825,000 as described under *The Merger Agreement Termination Fee and Closing Failure Fee* beginning on page 77.

Limited Guarantee (Page 58)

¡ Lone Star Guarantor provided us with a direct guarantee of the full and prompt payment and performance of certain payment obligations of Holdings and Merger Sub arising under the merger agreement (including payment of the $72,825,000 termination fee) as limited pursuant to the terms of the merger agreement; provided that Lone Star Guarantor s liability under the guarantee will not exceed $72,825,000.

HSR Act Approval (Page 58)

¡ The merger is subject to the HSR Act. On December 30, 2011, Winn-Dixie and Lone Star Guarantor each filed the required notification and report forms under the HSR Act with the DOJ and FTC, and on January 12, 2012, early termination of the applicable waiting period under the HSR Act was granted.

Market Price of Common Stock (Page 79)

¡ The closing share price of our common stock on December 16, 2011, the last trading day prior to the announcement of the merger, was $5.43, and the merger consideration of $9.50 represents a premium of approximately 75% to this closing share price.

Procedure for Payment of Merger Consideration (Page 61)

¡ Promptly after the effective time of the merger, the paying agent will mail to each holder of record of our common stock a letter of transmittal (specifying that delivery shall be effected, and risk of loss and title to the certificates shall pass, only upon proper delivery of the certificates to the paying agent, or in the case of book-entry shares, upon adherence to the procedures set forth in the letter of transmittal) and instructions advising how to surrender the certificates or book-entry shares in exchange for the $9.50 per share merger consideration. Upon surrender of a certificate or book-entry share to the paying agent, together with such letter of transmittal, duly completed and validly executed in accordance with the instructions thereto, and any other documents as the paying agent may reasonably require, you will be entitled to receive in exchange therefor the $9.50 per share merger consideration for each share formerly represented by such certificate or book-entry. Interest will not be paid or accrue in respect of the $9.50 per share merger consideration. The paying agent will reduce the amount of any merger consideration paid to you by any applicable withholding taxes.

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No Appraisal Rights (Page 58)

¡ Under Florida law, you do not have any appraisal rights in connection with the merger.

Shareholder Litigation (Page 58)

¡ A total of eight complaints challenging the merger have been filed by plaintiffs seeking to represent a class of Winn-Dixie shareholders. Seven complaints have been filed in the Circuit Court of the Fourth Judicial District in and for Duval County, Florida, and one case filed in the United States District Court for the Middle District of Florida. The cases filed in state court have been consolidated, a Lead Plaintiff appointed, and the Lead Plaintiff has filed an amended complaint.

¡ The plaintiffs in the consolidated case pending in state court and in the case pending in federal court generally allege, among other things, that the consideration agreed to in the merger agreement is inadequate and unfair to Winn-Dixie shareholders, that this proxy statement contains materially misleading disclosures or omissions regarding the proposed transaction, and that the members of Winn-Dixie s Board of Directors breached their fiduciary duties in approving the merger agreement and issuing this proxy statement. The plaintiffs also allege that those alleged breaches of fiduciary duty were aided and abetted by Winn-Dixie and the entities affiliated with BI-LO, LLC named in the various complaints. The plaintiffs seek equitable relief, including an injunction prohibiting consummation of the merger, and rescission or rescissory damages if the merger is consummated. The defendants responses to these complaints are not yet due.

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QUESTIONS AND ANSWERS ABOUT THE SPECIAL MEETING AND THE MERGER

The following questions and answers are intended to address briefly some commonly asked questions regarding the special meeting and the proposed merger. These questions and answers may not address all questions that may be important to you with respect to the special meeting or the merger. Please refer to the more detailed information contained elsewhere in this proxy statement, the annexes to this proxy statement and the documents referred to in this proxy statement.

Q: What is the date, time and place of the special meeting?

A: The special meeting of our shareholders will be held at our headquarters located at 5050 Edgewood Court, Jacksonville, Florida 32254, beginning at 9:00 a.m., Eastern Time, on Friday, March 9, 2012.

Q: Who is soliciting my proxy?

A: This proxy is being solicited by the Board of Directors of Winn-Dixie.

Q: What am I being asked to vote on?

A: You are being asked to vote on the following:

Approval of the merger agreement (Proposal 1);

An advisory proposal to approve the compensation that may become payable to our named executive officers in connection with the merger (Proposal 2);

Approval of the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the merger agreement (Proposal 3); and

The transaction of any other business that may properly come before the special meeting or any adjournment or postponement of the special meeting by or at the direction of the Board of Directors.

Q: What is the proposed transaction?

A: Once the merger agreement has been approved by our shareholders and all of the conditions set forth in the merger agreement have been satisfied or waived, Merger Sub will be merged with and into us, and we will survive the merger as a wholly owned subsidiary of Holdings. Each holder of shares of our common stock outstanding immediately prior to the merger (other than shares owned by (i) us as treasury stock, (ii) Holdings or Merger Sub and (iii) any of our direct or indirect wholly owned subsidiaries) will receive $9.50 per share in cash, without interest and less applicable withholding taxes.

Q: How does the Board of Directors recommend that I vote?

A: Our Board of Directors unanimously recommends that you vote:

- **FOR** the approval of the merger agreement (Proposal 1);

- **FOR** the approval of the advisory vote on compensation that may become payable to our named executive officers in connection with the merger (Proposal 2); and

- **FOR** the approval of the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the merger agreement (Proposal 3).

Q: How many shares must be present or represented at the special meeting in order to conduct business?

A: A quorum of shareholders is necessary to hold a valid special meeting. A quorum is present at the special meeting if a majority of the issued and outstanding shares of our common stock entitled to vote at the special meeting are present in person or represented by proxy. Abstentions and broker non-votes are counted as present for the purpose of determining whether a quorum is present.

Q: What vote of our shareholders is required to approve the proposals?

A: The vote requirements to approve the proposals are as follows:

- the proposal to approve the merger agreement (Proposal 1) requires the affirmative vote of the holders of a majority of the outstanding shares of our common stock entitled to vote at the special meeting. **Because the required vote is based on the number of shares of our common stock outstanding, failure to vote your shares (including as a result of broker non-votes and abstentions) will have the same effect as voting against approval of the merger agreement**;

- the advisory proposal to approve the compensation that may become payable to our named executive officers in connection with the merger (Proposal 2) requires that the number of shares voted in favor of the proposal are greater than those voted against; and

- the proposal to approve the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies (Proposal 3) requires (i) if a quorum exists, that the number of shares voted in favor of adjournment are greater than those voted against, or (ii) in the absence of a quorum, the affirmative vote of the holders of a majority of the shares of our common stock represented at the special meeting.

Even if you plan to attend the special meeting, we urge you either to complete, sign, date and return promptly the enclosed proxy card or submit your proxy or voting instructions by telephone or Internet to assure your shares of Winn-Dixie common stock are represented and voted at the special meeting.

Q: Who is entitled to vote at the special meeting?

A: Only shareholders of record as of the close of business on January 27, 2012, the record date for the special meeting, are entitled to receive notice of and to vote at the special meeting. You will have one vote at the special meeting for each share of our common stock you owned at the close of business on the record date. On the record date, 56,668,025 shares of our common stock were outstanding and entitled to be voted at the special meeting.

Q: What do I need to do now? How do I vote?

A: We urge you to carefully read this proxy statement, including its annexes and any documents referred to herein in their entirety, and to consider how the merger affects you. You can ensure that your shares are voted at the special meeting by granting a proxy either by:

- ***Telephone***, by calling the toll-free number listed on the proxy card (if you are a registered shareholder, meaning you hold your stock in your name) or vote instruction card (if your shares are held in street name, meaning that your shares are held in the name of a broker, bank or other nominee and your broker, bank or other nominee makes telephone voting available);

The Internet, at the address provided on the proxy card (if you are a registered shareholder) or vote instruction card (if your shares are held in street name and your broker, bank or other nominee makes Internet voting available); or

Mail, by completing, signing, dating and mailing the proxy card or vote instruction card and returning it in the envelope provided. Proxies will be voted as specified by the shareholder or shareholders granting the proxy.

If you are a Winn-Dixie team member, and hold your shares through the ESPP, you will receive a voting instruction card in the mail. You also have the option of voting your shares over the Internet or by telephone by following the instructions that you receive with this proxy statement. You can also sign your voting instruction card and return it by mail, or attend the special meeting and vote in person.

Please do NOT send in your stock certificates at this time.

If your shares of our common stock are held in street name by your broker, bank or other nominee, be sure to give your broker, bank or other nominee instructions on how you want to vote your shares because your broker, bank or other nominee will not be able to vote on the merger agreement proposal without instructions from you. See the question below If my broker, bank or other nominee holds my shares in street name, will my broker, bank or other nominee vote my shares for me?

Q: How are votes counted?

A: For Proposal 1, the approval of the merger agreement, you may vote FOR, AGAINST or ABSTAIN. If you fail to vote your shares of our common stock or ABSTAIN from voting on the proposal, it has the same effect as if you vote AGAINST the approval of the merger agreement.

For Proposal 2, the advisory vote to approve the compensation that may become payable to our named executive officers in connection with the merger, you may vote FOR, AGAINST or ABSTAIN. An abstention will not count as a vote cast on the advisory proposal to approve the compensation that may become payable to our named executive officers in connection with the merger. If you ABSTAIN, it will have no effect on the outcome of the vote on this proposal.

For Proposal 3, the approval of the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies, you may vote FOR, AGAINST or ABSTAIN. If a quorum is present, an abstention will not count as a vote cast on the proposal to adjourn the special meeting (if necessary or appropriate) to solicit additional proxies. As a result, if a quorum is present and you ABSTAIN, it will have no effect on the outcome of the vote on this proposal. However, if a quorum is not present and you ABSTAIN from voting on the proposal, it has the same effect as if you vote AGAINST the proposal.

If you sign and return your proxy card and do not indicate how you want to vote, your proxy will be voted FOR the proposal to approve the merger agreement, FOR the advisory approval to approve the compensation that may become payable to our named executive officers in connection with the merger, FOR the proposal to approve the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies, and in accordance with the recommendation of our Board of Directors on other matters, if any, properly brought before the special meeting for a vote by or at the direction of the Board of Directors.

Q: If my broker, bank or other nominee holds my shares in street name, will my broker, bank or other nominee vote my shares for me?

A: No, unless you provide specific instructions to your broker, bank or other nominee on how to vote. You should follow the directions provided by your broker, bank or other nominee regarding how to instruct your broker, bank or other nominee to vote your shares. Unless you follow the instructions, your shares will not be voted and will have the same effect as if you voted against the approval of the merger agreement. We refer to this as a broker non-vote.

Q: What is the difference between holding shares as a shareholder of record and as a beneficial owner?

A: Many of our shareholders hold their shares through a broker, trustee or other nominee (such as a bank) rather than directly in their own name. As summarized below, there are some distinctions between shares owned of record and those owned beneficially.

Shareholder of Record. If your shares are registered directly in your name with our transfer agent, American Stock Transfer & Trust Company, you are considered to be the shareholder of record with respect to those shares and these proxy materials are being sent directly to you. As the shareholder of record, you have the right to grant your proxy directly to us or to vote in person at the special meeting. We have enclosed a proxy card for you to use.

Beneficial Owner. If your shares are held in a brokerage account, by a trustee or by another nominee (such as a bank), you are considered the beneficial owner of shares held in street name and these proxy materials are being forwarded to you, together with a voting instruction card by your broker, trustee or nominee. As the beneficial owner, you have the right to direct your broker, trustee or other nominee how to vote and may also attend the special meeting. Since a beneficial owner is not the shareholder of record, you may not vote your shares in person at the special meeting unless you obtain a valid proxy from the broker, trustee or nominee that holds your shares, giving you the right to vote at the special meeting.

Q: May I attend the special meeting?

A: You are entitled to attend the special meeting only if you were a shareholder as of the close of business on the record date or if you hold a valid proxy for the special meeting from such a shareholder. You will be required to present photo identification for admittance to the special meeting. If you are a shareholder of record, your name will be verified against the list of shareholders of record on the record date prior to your being admitted to the special meeting. If you are not a shareholder of record but hold shares in street name through a broker, bank or other nominee (such as a trustee), you should provide proof of beneficial ownership on the record date, such as your most recent brokerage account statement, a copy of the voting instruction card provided to you by your broker, bank or other nominee, or other similar evidence of ownership. If you do not provide photo identification or comply with the procedures outlined above, you will not be admitted to the special meeting.

The special meeting will begin promptly at 9:00 a.m. Eastern Time. Check-in will begin at 8:00 a.m. Eastern Time, and you should allow ample time for the check-in procedures.

We may establish additional security procedures and policies at the special meeting in addition to those described in this proxy statement.

Q: When should I return my proxy card?

A: You should return your proxy card as soon as possible so that your shares will be voted at the special meeting.

Q: Should I send in my stock certificate(s) now?

A: NO. PLEASE DO NOT SEND ANY STOCK CERTIFICATES WITH YOUR PROXY. After the merger is completed, you will receive written instructions, including a letter of transmittal, for exchanging your shares of our common stock for the merger consideration of $9.50 per share in cash, without interest and less applicable withholding tax.

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Q: May I change my vote after I have submitted my proxy?

A: Yes. If you hold your shares in your name, you have the unconditional right to revoke your proxy at any time prior to its exercise by employing any of the following three methods:

first, you can deliver to our Corporate Secretary, at our headquarters located at 5050 Edgewood Court, Jacksonville, Florida 32254, a written notice of revocation (dated later than the date of your proxy card) stating that you revoke your proxy, provided such written notice is received by our Corporate Secretary before 11:59 p.m. Eastern Time on March 8, 2012;

second, you can submit by telephone, the Internet or mail a new proxy dated after the date of the proxy you wish to revoke, provided the new proxy is received by our Corporate Secretary before 11:59 p.m. Eastern Time on March 8, 2012; or

third, you can attend the special meeting and vote in person.

Revocation of your proxy, without any further action, will mean your shares will not be voted at the special meeting or counted towards satisfying the quorum requirements. Your attendance at the special meeting will not revoke your proxy unless you vote at the special meeting. If you decide to vote by completing, signing, dating and returning the enclosed proxy card, you should retain a copy of the voter control number found on the proxy card if you later decide to revoke your proxy and change your vote by telephone or through the Internet.

If you have instructed your broker, bank or other nominee to vote your shares, you must follow directions received from your broker, bank or other nominee to change your vote. You cannot vote shares held in street name by returning a proxy card directly to us or by voting in person at the special meeting, unless you obtain a valid proxy from your broker, bank or other nominee.

Q: Who will bear the cost of the solicitation?

A: The expense of soliciting proxies in the enclosed form will be borne by Winn-Dixie. We have retained Georgeson Inc., who we refer to as Georgeson, a proxy solicitation firm, to solicit proxies in connection with the special meeting at a cost of approximately $12,000 plus reimbursement of out-of-pocket fees and expenses. In addition, we may reimburse brokers, banks and other custodians, nominees and fiduciaries representing beneficial owners of shares for their expenses in forwarding soliciting materials to such beneficial owners. Proxies may also be solicited by certain of our directors, officers and employees, personally or by telephone, facsimile or other means of communication. No additional compensation will be paid for such services.

Q: What does it mean if I receive more than one set of voting materials?

A: If you have shares of our common stock that are registered differently and are in more than one account, you will receive more than one proxy card. Please follow the directions for submitting a proxy on each of the proxy cards you receive to ensure that all of your shares are voted.

Q: What happens if I sell my shares before the special meeting?

A: The record date of the special meeting is earlier than the special meeting and the date that the merger is expected to be completed. If you transfer your shares of Winn-Dixie common stock after the record date but before the special meeting, you will retain your right to vote at the special meeting but will have transferred the right to receive $9.50 per share in cash to be received by our shareholders in the merger. In order to receive the $9.50 per share, you must hold your shares through the completion of the merger.

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Q: What is the impact of the merger on the Employee Stock Purchase Plan?

A: With respect to our ESPP, any then current offering period under the ESPP shall be terminated and no new offering periods will begin under the ESPP after such date and no further shares of our common stock will be purchased under the ESPP. Winn-Dixie will refund any remaining cash (without interest) in a participant s account to such participant and terminate the ESPP.

Q: When do you expect the merger to be completed?

A: The closing of the merger is expected to occur on the second business day after the conditions to the merger set forth in the merger agreement have been satisfied or waived or at such other time agreed to in writing by us and Holdings. Although we expect to complete the merger shortly after the special meeting of our shareholders, we cannot specify when, or assure you that, we and Holdings will satisfy or waive all conditions to the merger. See *Proposal 1 The Merger Agreement Conditions to the Merger*.

Q: When will I receive the cash consideration for my shares?

A: After the merger is completed, you will receive written instructions, including a letter of transmittal, that explain how to exchange your shares for the cash consideration to be paid in the merger. When you properly complete and return the required documentation described in the written instructions, you will receive from the paying agent a payment of the cash consideration for your shares.

Q: Am I entitled to appraisal rights?

A: You do not have appraisal rights in connection with the merger.

Q: Where can I find more information about Winn-Dixie?

A: Winn-Dixie files periodic reports and other information with the Securities and Exchange Commission (SEC). This information is available on the Internet site maintained by the SEC at ***www.sec.gov***. For a more detailed description of the information available, please refer to *Where You Can Find More Information* on page 84 of this proxy statement.

Q: Who can help answer my other questions?

A: If you have additional questions about the special meeting or the merger, including the procedures for voting your shares, or if you would like additional copies, without charge, of this proxy statement, you should contact our proxy solicitation agent, Georgeson, toll-free at (866) 432-2791. If your broker, bank or other nominee holds your shares, you may also call your broker, bank or other nominee for additional information.

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CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This proxy statement, and the documents to which we refer you in this proxy statement, contain forward-looking statements about our plans, objectives, expectations and intentions. Forward-looking statements include information concerning possible or assumed future results of our operations, the expected completion and timing of the merger and other information relating to the merger. Such statements are often expressed through the use of words or phrases such as will result, are expected to, anticipated, plans, intends, will continue, estimated, projectio preliminary, forecast and similar expressions. You should read statements that contain these words carefully. They discuss our future expectations or state other forward-looking information, and may involve known and unknown risks and uncertainties over which we have no control. In addition to other factors and matters contained in this proxy statement, those risks and uncertainties include, without limitation:

- the satisfaction of the conditions to complete the merger, including the approval of the merger agreement by our shareholders;
- the occurrence of any event, change or other circumstance that could give rise to the termination of the merger agreement, including a termination under circumstances that could require us to pay a termination fee of $19.6 million to Holdings;
- the amount of the costs, fees, expenses and charges related to the merger;
- the potential adverse effect on our business and operations due to our compliance with certain of our covenants in the merger agreement;
- the effect of the announcement of the merger on our customer and supplier relationships, operating results and business generally;
- the risk that the merger may not be completed in a timely manner or at all, which may adversely affect our business and the share price of our common stock;
- our inability to retain and, if necessary, attract key employees, particularly while the proposed merger is pending;
- the litigation in connection with the proposed merger discussed in this proxy;
- risks related to diverting management s attention from ongoing business operations;
- general economic and market conditions;
- the risk of unforeseen material adverse changes to our business and operations; and
- other risks and uncertainties detailed in our filings with the Securities and Exchange Commission, referred to as the *SEC*, including the risks set forth in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended June 29, 2011 (filed on August 29, 2011), referred to as the Form 10-K. See *Where You Can Find More Information.*

We believe that the assumptions on which our forward-looking statements are based are reasonable. However, we cannot assure you that the actual results or developments we anticipate will be realized or, if realized, that they will have the expected effects on our business or operations. All subsequent written and oral forward-looking statements concerning the merger or other matters addressed in this proxy statement and attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Forward-looking statements speak only as of the date of this proxy statement. Except as required by applicable law or regulation, we do not undertake to release the results of any revisions of these forward-looking statements to reflect future events or circumstances.

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THE SPECIAL MEETING OF SHAREHOLDERS

This proxy statement is furnished in connection with the solicitation of proxies in connection with a special meeting of our shareholders.

Date, Time, Place and Purpose of the Special Meeting

The special meeting of our shareholders will be held at our offices located at 5050 Edgewood Court, Jacksonville, Florida 32254, on Friday, March 9, 2012 beginning at 9:00 a.m., Eastern Time.

At the special meeting, we will ask you to (1) approve the merger agreement, (2) approve (on an advisory basis) the compensation that may become payable to our named executive officers in connection with the merger, (3) approve the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the merger agreement, and (4) transact other business, if any, that is properly brought before the special meeting or any adjournment or postponement thereof by or at the direction of our Board of Directors.

Recommendation of Our Board of Directors

Our Board of Directors, by unanimous vote, on the recommendation of the Special Committee, (1) approved and adopted the merger agreement and the transactions contemplated by the merger agreement and (2) determined that the merger is in the best interests of Winn-Dixie and its shareholders. Accordingly, our Board of Directors unanimously recommends that you vote **FOR** the proposal to approve the merger agreement, **FOR** the advisory proposal to approve the compensation that may become payable to our named executive officers in connection with the merger and **FOR** the proposal to adjourn the special meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the merger agreement.

Record Date; Shares Entitled to Vote; Quorum

Only holders of record of our common stock at the close of business on January 27, 2012, the record date, are entitled to notice of and to vote at the special meeting. On the record date, 56,668,025 shares of our common stock were issued and outstanding and held by approximately 2,993 holders of record. Each holder of record of our common stock will be entitled to one vote per share at the special meeting on the proposal to approve the merger agreement, the proposal to adjourn the special meeting, the advisory proposal to approve compensation that may become payable to our named executive officers in connection with the merger, and any other business that may properly come before the special meeting or any adjournment or postponement thereof by or at the direction of the Board of Directors.

The holders of a majority of the outstanding shares of common stock entitled to vote as of the record date must be present, either in person or by proxy, to constitute a quorum at the special meeting. We will count abstentions, either in person or by proxy, and broker non-votes (shares held by a broker or other nominee that does not have the authority to vote on a matter) for the purpose of establishing a quorum. If a quorum is not present at the special meeting, the holders of a majority of the common stock represented at the special meeting may adjourn the special meeting to solicit additional proxies.

Vote Required

The approval of the merger agreement requires the affirmative vote of the shares representing a majority of the outstanding shares entitled to vote at the special meeting. If you abstain from voting, either in person or by proxy, or do not instruct your broker or other nominee how to vote your shares, it will have the same effect as a vote AGAINST the approval of the merger agreement.

The approval of the advisory proposal to approve the compensation that may become payable to our named executive officers in connection with the merger requires that the number of shares voted in favor of the proposal are greater than those voted against. If you abstain from voting, either in person or by proxy, or do not instruct your broker or other nominee how to vote your shares, it will not affect the advisory vote on the compensation that may become payable to our named executive officers in connection with the merger.

The approval of the proposal to adjourn the special meeting (if necessary or appropriate) to solicit additional proxies requires (i) if a quorum exists, that the number of shares voted in favor of adjournment are greater than those voted against, or (ii) in the absence of a quorum, the affirmative vote of the holders of a majority of the shares of our common stock represented at the special meeting. If a quorum is present and you abstain from voting, either in person or by proxy, or do not instruct your broker or other nominee how to vote your shares, it will not affect the adjournment (if necessary or appropriate) to permit further solicitation of proxies. However, if a quorum is not present and you abstain from voting, either in person or by proxy, it has the same effect as a vote AGAINST the proposal.

YOUR VOTE IS IMPORTANT. The merger cannot be completed unless shareholders holding a majority of the outstanding shares entitled to vote at the special meeting approve the merger agreement. Whether or not you plan to attend the special meeting in person, please complete, sign, date and return promptly the enclosed proxy card or follow the related Internet or telephone voting instructions. If you hold shares through a broker or other nominee, you should follow the procedures provided by your broker or nominee.

Common Stock Ownership of Our Directors and Executive Officers

As of the record date, our directors and executive officers beneficially owned in the aggregate approximately 4.36% of the outstanding shares of our common stock entitled to vote at the special meeting. We currently expect that each of these individuals will vote all of their shares of common stock in favor of each of the proposals.

Solicitation of Proxies

The Board of Directors of Winn-Dixie is soliciting your proxy. In addition to the solicitation of proxies by use of the mail, directors, officers and other employees of Winn-Dixie may solicit the return of proxies by personal interview, telephone, e-mail or facsimile. We will not pay additional compensation to our directors, officers and employees for their solicitation efforts, but we will reimburse them for any out-of-pocket expenses they incur in their solicitation efforts. We will request that brokerage houses and other custodians, nominees and fiduciaries forward solicitation materials to the beneficial owners of stock registered in their names. We will bear all costs of preparing, assembling, printing and mailing the notice of special meeting of shareholders, this proxy statement, the enclosed proxy and any additional materials, as well as the cost of forwarding solicitation materials to the beneficial owners of stock and all other costs of solicitation.

We have retained Georgeson to aid in the solicitation of proxies for the special meeting. We will pay Georgeson a base fee of $12,000 plus reimbursement of out-of-pocket fees and expenses.

Voting

To vote your shares, you should follow the instructions as indicated on your proxy card if you vote over the Internet or by telephone, or you should complete, sign, date and return the enclosed proxy in the enclosed postage-paid envelope. Voting your proxy does not limit your right to vote in person should you decide to attend the special meeting. If your shares are held in the name of a broker or other nominee, you will be provided voting instructions from your broker or other nominee and, in order to vote at the special meeting, you must ask your broker or other nominee how you can vote in person at the special meeting.

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If you vote by mail and the returned proxy card is completed, signed and dated, your shares will be voted at the special meeting in accordance with your instructions. If you vote by mail and your proxy card is returned unsigned, then your vote cannot be counted. If you vote by mail and the returned proxy card is signed and dated, but you do not fill out the voting instructions on the proxy card, the shares represented by your proxy will be voted FOR the approval of the merger agreement, FOR the approval (on an advisory basis) of the compensation that may become payable to our named executive officers in connection with the merger and FOR the adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the merger agreement.

Shareholders who hold their shares of our common stock in street name, meaning in the name of a broker, bank or other nominee who is the record holder, should follow the directions provided by their broker, bank or other nominee regarding how to instruct their broker, bank or other nominee to vote their shares. Your broker, bank or other nominee will not be able to vote your shares without instructions from you.

If you are a Winn-Dixie team member, and hold your shares through the ESPP, you will receive a voting instruction card in the mail. You also have the option of voting your shares over the Internet or by telephone by following the instructions that you receive with this proxy statement. You can also sign your voting instruction card and return it by mail, or attend the special meeting and vote in person.

We do not expect that any matter other than the ones discussed in this proxy statement will be brought before the special meeting. If, however, any other matters are properly presented by or at the direction of the Board of Directors, the persons named as proxies will vote in accordance with the recommendation of our Board of Directors.

DO NOT SEND YOUR STOCK CERTIFICATES WITH YOUR PROXY. A LETTER OF TRANSMITTAL WITH INSTRUCTIONS FOR THE SURRENDER OF ANY CERTIFICATES FOR SHARES OF OUR COMMON STOCK WILL BE MAILED TO YOU AS SOON AS PRACTICABLE AFTER COMPLETION OF THE MERGER.

Revocation of Proxies

If you hold your shares in your name, you have the unconditional right to revoke your proxy at any time prior to its exercise by employing any of the following three methods:

- first, you can deliver to our Corporate Secretary, at our offices located at 5050 Edgewood Court, Jacksonville, Florida 32254, a written notice of revocation (dated later than the date of your proxy card) stating that you revoke your proxy; provided, that such written notice is received by our Corporate Secretary before 11:59 p.m. Eastern Time on March 8, 2012;

- second, you can submit a new proxy by telephone, the Internet or mail dated after the date of the proxy you wish to revoke, provided the new proxy is received by our Corporate Secretary before 11:59 p.m. Eastern Time on March 8, 2012; or

- third, you can attend the special meeting and vote in person.

Revocation of your proxy, without any further action, will mean your shares will not be voted at the special meeting or counted towards satisfying the quorum requirements. Your attendance at the special meeting will not revoke your proxy unless you vote at the special meeting.

If you have instructed your broker, bank or other nominee to vote your shares, you must follow directions received from your broker, bank or other nominee to change your vote. You cannot vote shares held in street name by returning a proxy card directly to us or by voting in person at the special meeting, unless you obtain a valid proxy from your broker, bank or other nominee giving you the right to vote the shares at the special meeting.

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Assistance

Shareholders who have questions regarding the materials, need assistance voting their shares or require additional copies of the proxy statement or proxy card, should contact or call (toll free):

(866) 432-2791

Georgeson Inc.

199 Water Street

New York, New York 10038

Shareholder List

Our list of shareholders entitled to vote at the special meeting will be available for inspection at our offices located at 5050 Edgewood Court, Jacksonville, Florida 32254 (between the hours of 9:00 a.m. and 5:00 p.m.) for a period of 10 days prior to the special meeting and at the place of the special meeting for the duration of the special meeting.

Attendance

You are entitled to attend the special meeting only if you were a shareholder as of the close of business on the record date or if you hold a valid proxy for the special meeting from such a shareholder. You will be required to present photo identification for admittance to the special meeting. If you are a shareholder of record, your name will be verified against the list of shareholders of record on the record date prior to your being admitted to the special meeting. If you are not a shareholder of record but hold shares in street name through a broker, trustee or other nominee, you should provide proof of beneficial ownership on the record date, such as your most recent brokerage account statement, a copy of the voting instruction card provided to you by your broker or other nominee, or other similar evidence of ownership. If you do not provide photo identification or comply with the procedures outlined above, you will not be admitted to the special meeting.

The special meeting will begin promptly at 9:00 a.m. Eastern Time. Check-in will begin at 8:00 a.m. Eastern Time, and you should allow ample time for the check-in procedures.

We may establish additional security procedures and policies at the special meeting in addition to those described in this proxy statement.

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THE PARTIES TO THE MERGER AGREEMENT

Winn-Dixie

Winn-Dixie, a corporation organized under the laws of the State of Florida, is one of the nation s largest food retailers and operates primarily under the Winn-Dixie banner. As of January 13, 2012, Winn-Dixie operated 484 retail grocery locations and approximately 380 in-store pharmacies in Florida, Alabama, Louisiana, Georgia and Mississippi. Winn-Dixie had net sales of approximately $6.9 billion and total assets of approximately $1.8 billion as of and for its fiscal year ended June 29, 2011.

Winn-Dixie s principal executive offices are located at 5050 Edgewood Court, Jacksonville, Florida 32254 and our telephone number is (904) 783-5000. A detailed description of our business can be found in the Form 10-K and our other filings with the SEC. See *Where You Can Find More Information.*

Holdings

Holdings, a limited liability company organized under the laws of the State of Delaware, was formed for the purpose of entering into the merger agreement with Winn-Dixie and completing the merger. Holdings has not conducted any activities to date, other than activities incidental to its formation and in connection with the transactions contemplated by the merger agreement. Holdings is a wholly owned subsidiary of BI-LO, LLC, which is in turn a wholly owned subsidiary of BI-LO Holding, LLC. BI-LO Holding, LLC is a majority owned subsidiary of Lone Star Fund V (U.S.), L.P., a partnership that is part of Lone Star.

Lone Star is a global investment firm that acquires debt and equity assets including corporate, commercial real estate, single family residential and consumer debt products as well as banks and operating companies. Since the establishment of its first fund in 1995, the principals of Lone Star have organized private equity funds totaling approximately $33 billion of capital that has been invested globally through Lone Star s worldwide network of affiliate offices.

Holdings principal executive offices are located at 208 BI-LO Blvd, Greenville, South Carolina 29607 and its telephone number is (864) 283-3574.

BI-LO, LLC operates 207 supermarkets, including approximately 116 in-store pharmacies, in North Carolina, South Carolina, Georgia and Tennessee and employs approximately 17,000 people.

Merger Sub

Merger Sub, a corporation organized under the laws of the State of Florida, is a direct wholly owned subsidiary of Holdings, formed solely for the purpose of entering into the merger agreement with Winn-Dixie and completing the merger. Merger Sub has not conducted any activities to date, other than activities incidental to its formation and in connection with the transactions contemplated by the merger agreement. Merger Sub s principal executive offices are located at 208 BI-LO Blvd, Greenville, South Carolina 29607 and its telephone number is (864) 283-3574.

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THE MERGER

Background of the Merger

Since the Company s emergence from bankruptcy protection in November 2006, the Company s Board of Directors and senior management have evaluated strategic alternatives relating to the Company s business, including growth strategies based on increased capital expenditures for a transformational store remodel program (the remodel program), as well as prospects for mergers and acquisitions, stock repurchases, dividends, debt refinancing and other potential strategic transactions, each with a view towards maximizing shareholder value.

In connection with its ongoing evaluation of strategic alternatives relating to the Company, the Company s Board of Directors has consulted with the Company s senior management regarding the Company s operational and financial performance, discussed the strategic direction of the Company and evaluated various options for growth, including the remodel program.

During the challenging economic environment prevailing since 2008, the Company has focused on strategies to improve its financial and operational performance on a stand-alone basis, and has undertaken reviews of both its retail operations and support structure in an effort to lower its cost structure and improve efficiency.

In August 2010, the Company s management began to evaluate a variety of financing alternatives in light of the November 2011 maturity of the Company s asset-based loan facility in place at that time and the capital expenditures needed for the remodel program. From August 2010 through March 2011, the Company negotiated a new asset-based loan facility and continued to evaluate additional financing sources, including a potential term loan or potential issuances of secured high yield debt securities, convertible debt securities and/or preferred equity securities. The Company entered into a new asset-based loan facility in March 2011. The new asset-based loan facility permits borrowings of up to $600 million (down from the $750 million maximum borrowings permitted under the prior asset-based loan facility). In addition, the new asset-based loan facility includes changes from the prior facility that have the net effect of reducing the Company s borrowing base as calculated under the new facility. Due to market conditions and against the background of the then ongoing discussions with the Lone Star Parties, as discussed below, the Company determined not to proceed with any additional financing transactions after the new asset-based loan facility was entered into.

On February 23, 2011, Mr. Peter Lynch, Chairman, President and Chief Executive Officer of the Company, was contacted by Mr. Randall Onstead, Chairman of the Board of Directors of BI-LO, LLC (Bi-Lo). Mr. Onstead expressed interest in a potential acquisition of the Company on behalf of Bi-Lo and its private equity sponsor, Lone Star Fund V (U.S.), L.P. (together with Bi-Lo, the Lone Star Parties), noting that the Lone Star Parties were interested in engaging in discussions with the Company. Mr. Onstead did not provide an indication of the proposed terms of any potential transaction involving the Company and the Lone Star Parties at this time.

Later on February 23, 2011, the Board of Directors held a telephonic meeting attended by members of the Company s senior management. During the meeting Mr. Lynch reported on his conversation with Mr. Onstead and the Board of Directors discussed, among other things, the process to be followed by the board in evaluating any transaction to sell or merge the Company, the impact a potential transaction to sell and/or merge the Company would have on the Company s financing options, and the due diligence process to be undertaken.

On February 28, 2011, Bi-Lo and Hudson Americas LLC, an affiliate of Lone Star Fund V (U.S.), L.P., entered into a confidentiality and standstill agreement with the Company to facilitate the exchange of confidential and proprietary information regarding the Company with the Lone Star Parties for purposes of exploring a potential transaction.

On March 2, 2011, the Company began to provide the Lone Star Parties with non-public information regarding, among other things, the Company s financial performance and operations.

On March 3, 2011, the Board of Directors held a telephonic meeting attended by members of the Company s senior management. At this meeting the Board of Directors received updates from management regarding the Company s financial and operational performance and strategy and discussed, among other things, the Lone Star Parties expression of interest regarding a potential transaction with the Company. During the discussion the Board of Directors instructed the Company s senior management to meet with representatives of the Lone Star Parties to discuss the Lone Star Parties expression of interest.

On March 7, 2011, representatives of the Company held a meeting with representatives of the Lone Star Parties, including Mr. Sam Loughlin, a senior representative of the Lone Star Parties, during which representatives of the Lone Star Parties explained that, based upon a review of non-public information provided by the Company pursuant to the confidentiality agreement, publicly available information, and its extensive knowledge of the retail and grocery sector, the Lone Star Parties would be willing to offer a price per share of $8.20 in cash to acquire all of the outstanding common stock of the Company (a premium of approximately 24% to the Company s then current share price) subject to conditions including the satisfactory completion of due diligence. At the meeting, representatives of the Lone Star Parties verbally indicated that, because of the synergies that could be achieved by combining the Company s and Bi-Lo s operations, the Lone Star Parties were offering a significant premium to the Company s shareholders. The terms of the Lone Star Parties offer were also confirmed by a letter dated the same date.

Later on March 7, 2011, the Board of Directors held a telephonic meeting to discuss the offer presented by the Lone Star Parties in the context of their evaluation of the Company s historical and prospective operating results and financial condition, as well as its growth prospects and other alternatives, including the remodel program. During the March 7, 2011 meeting, a representative of King & Spalding LLP, the Company s outside counsel (King & Spalding), advised the Board of Directors regarding its fiduciary duties and legal obligations to the Company and its shareholders in considering a potential sale of the Company.

On March 11, 2011, the members of the Board of Directors other than Mr. Lynch (the Independent Directors) held a telephonic meeting to further discuss, among other matters, the offer presented by the Lone Star Parties. During the meeting the Independent Directors also discussed the formation of a special committee consisting of only the Independent Directors (*i.e.*, all members of the Board of Directors other than the Company s Chief Executive Officer) to evaluate the Company s strategic alternatives and the retention of transaction advisors who would represent the special committee. The Independent Directors considered that forming a special committee to evaluate any potential transactions may be advisable to avoid any actual or potential conflicts of interest in circumstances where a potential buyer of the Company expressed a desire to retain or not to retain the members of the Company s management, including Mr. Lynch. At the conclusion of the March 11, 2011 meeting, the Independent Directors instructed the Company s senior management to inform the Lone Star Parties that their offer price was not sufficient, but that the Company would be willing to engage in further discussions to determine whether the Lone Star Parties would substantially increase their offer price.

On March 14, 2011, Mr. Lynch notified the Lone Star Parties in writing that the Board of Directors had determined that their offer price was not sufficient, but that the Company would be willing to engage in further discussions to determine whether the Lone Star Parties would substantially increase their offer price.

On March 17, 2011, the Board of Directors formed a special committee (the Special Committee) consisting of the Independent Directors, with Mr. Jeffrey Girard acting as chair of the Special Committee, to explore the possibility of a potential strategic transaction involving a sale of all or a substantial portion of the Company s capital stock, to negotiate and make recommendations to the Board of Directors with respect to any such transaction and to consider alternatives to any such transaction. The Special Committee then formed a subcommittee to interview potential financial and legal advisors.

Following a process of identifying potential legal advisors, on March 28 and 29, 2011, the subcommittee interviewed three law firms, including Paul, Weiss, Rifkind, Wharton & Garrison LLP (Paul, Weiss), and determined to recommend to the Special Committee that Paul, Weiss be retained to serve as its legal advisor based on experience in merger and acquisitions transactions and special committee representations and other relevant factors. The Special Committee approved the engagement of Paul, Weiss as its legal advisor at a meeting held on March 29, 2011.

Following a process of identifying potential financial advisors, the subcommittee interviewed three investment banking firms during the week of April 4, 2011, including Goldman Sachs, and determined to recommend to the Special Committee that Goldman Sachs be retained to serve as its financial advisor based on experience in merger and acquisition transactions, approach regarding the diligence and transaction evaluation process, and other relevant factors. The Special Committee approved the engagement of Goldman Sachs as its financial advisor at a meeting held on April 8, 2011.

On May 6, 2011, the Special Committee held an in-person meeting attended by representatives of Paul, Weiss and Goldman Sachs. Representatives of Paul, Weiss advised the Special Committee of its fiduciary duties and legal obligations to the Company and its shareholders in considering a sale of the Company. Representatives of Goldman Sachs reviewed financial information relating to the Company and the Lone Star Parties March 7 offer. The Special Committee discussed, among other things, the relative merits of a potential sale of the Company as compared with the benefits and risks of stand-alone strategies, including the remodel program and various debt financing alternatives. The Special Committee also discussed with its advisors the advisability of contacting other potential acquirers of the Company, considering, among other things, potential repercussions of a leak of information that a transaction may be under consideration. Representatives of Goldman Sachs discussed the likelihood as to whether or not a potential financial buyer would be able to offer a higher price for the Company than the price offered by the Lone Star Parties given the inability of financial buyers to realize synergies, expectations of negative cash flows over the course of management s projections for the Company and conditions in the debt financing markets at the time. After considering these and other factors, it was the Special Committee s view that financial buyers would not be able to offer a higher price for the Company than potential strategic buyers such as the Lone Star Parties, which the Special Committee and its advisors considered a strategic buyer because of synergies that could potentially be realized by Bi-Lo, and that Goldman Sachs should contact a limited number of potential strategic buyers. The Special Committee then discussed which potential strategic buyers may be interested in pursuing a strategic transaction with the Company, and then directed representatives of Goldman Sachs to contact such potential strategic buyers to gauge their interest in pursuing a transaction with the Company.

Between May 10, 2011 and May 17, 2011, representatives of Goldman Sachs contacted three potential strategic buyers. Party A indicated that it would evaluate the opportunity based on publicly available information to determine its willingness to explore a potential transaction with the Company. Party B indicated that it would not be interested in pursuing a transaction with the Company. Party C indicated that it would not be interested in pursuing a transaction to acquire the Company but that it may be interested in exploring asset swaps in certain markets, a proposal that the members of the Special Committee subsequently determined not to be in the interests of the Company at this time.

On May 20, 2011, Party A contacted a representative of Goldman Sachs to request access to non-public financial and operating information related to the Company.

On May 31, 2011, the Company entered into a confidentiality and standstill agreement with Party A. Following execution of the confidentiality agreement and upon the request of Party A, the Company provided Party A with non-public financial and operating information regarding the Company.

Between May 18, 2011 and June 3, 2011, upon requests from representatives of the Lone Star Parties and their advisors, the Company provided the Lone Star Parties with additional non-public due diligence information.

On June 3, 2011, the Lone Star Parties sent the Company a non-binding proposal to acquire the Company for $9.85 per share in cash (a premium of approximately 20% to the Company s then current share price) and requested a period of exclusivity to conduct further due diligence and negotiate definitive transaction documents.

On June 8, 2011, the Special Committee held a telephonic meeting attended by representatives of Paul, Weiss and Goldman Sachs during which the Special Committee discussed the Lone Star Parties revised offer and the status of discussions with Party A, Party B and Party C. Representatives of Goldman Sachs noted that although Party A had previously indicated an interest in exploring a potential transaction with the Company, Party A had indicated it could not confirm whether it would submit a preliminary proposal regarding such a transaction. Following discussion, the Special Committee instructed Goldman Sachs to continue discussions with the Lone Star Parties on a non-exclusive basis to determine if the Lone Star Parties were willing to improve the terms of their proposal.

On June 9, 2011, representatives of Goldman Sachs spoke with representatives of William Blair & Company (William Blair), the Lone Star Parties financial advisor, during which representatives of William Blair indicated that there was a possibility the Lone Star Parties would enhance their offer.

On June 11, 2011, the Special Committee held a telephonic meeting attended by representatives of Paul, Weiss and Goldman Sachs. During the meeting representatives of Goldman Sachs informed the Special Committee that William Blair had indicated that it was possible the Lone Star Parties could raise their bid. During the meeting, representatives of Goldman Sachs also reviewed financial information relating to the Company and the proposed transaction with the Lone Star Parties, and representatives of Paul, Weiss discussed with the Special Committee its fiduciary duties and legal obligations to the Company and its shareholders. The Special Committee then decided to consult with senior management to receive an update on and to discuss management s projections for the Company.

On June 12, 2011, the Special Committee met with Mr. Lynch to discuss the Company s strategic direction, projections, growth prospects and long range plans, including the remodel program, and discussed the basis of, and risks inherent in, the Company s long range plans.

On June 17, 2011, the Lone Star Parties sent the Company a revised non-binding proposal to pay $10.00 per share in cash (a premium of 30% to the Company s then current share price) to acquire the Company.

On June 22, 2011, a representative of Goldman Sachs discussed with a representative of Party A the status of its diligence investigation. The representative of Party A indicated that Party A would not be willing to submit a proposal at this time without access to additional information and discussions with the Company s management team. Based on that request, a representative of Goldman Sachs offered to make available members of the Company s management for in-person diligence discussions.

On June 23, 2011, a representative of Party A indicated to a representative of Goldman Sachs that Party A would respond the following day with a timeline for when Party A would be able to conduct in-person diligence discussions and depending on the outcome of those discussions, potentially submit a proposal to acquire the Company.

Following continued discussion between representatives of Goldman Sachs and William Blair regarding the terms of the Lone Star Parties offer, on June 24, 2011, the Lone Star Parties sent the Company a letter reaffirming their proposal to pay $10.00 per share to acquire the Company and indicating their intention to terminate discussions unless the Company entered into an exclusivity agreement with the Lone Star Parties by June 28, 2011.

Later on June 24, 2011, the Special Committee held a telephonic meeting attended by representatives of Paul, Weiss and Goldman Sachs, during which the Special Committee discussed the Lone Star Parties most

recent offer. During the meeting, the Special Committee discussed, among other things, the status of Party A s due diligence investigation and its request to meet with Company management and whether the Lone Star Parties would be prepared to increase their offer price. The Special Committee also discussed how the Company should respond to the Lone Star Parties and Party A, considering, among other factors, the uncertainty regarding whether Party A would ever submit a proposal for a strategic transaction with the Company, the Lone Star Parties demand that the Company enter into an exclusivity agreement and the uncertainty regarding whether the Lone Star Parties would be prepared to increase their offer price. At the conclusion of the meeting the Special Committee instructed representatives of Goldman Sachs to advise the Lone Star Parties that under then prevailing circumstances the Special Committee was not prepared to approve a transaction at $10.00 per share. The Special Committee also determined to continue to allow Party A to conduct due diligence and to meet with Company management in an effort to determine whether Party A would be willing to make an offer to acquire the Company.

Following continued discussions between representatives of Goldman Sachs and the Lone Star Parties, the Special Committee held a telephonic meeting on June 26, 2011, attended by representatives of Paul, Weiss and Goldman Sachs. During this meeting, a representative of Goldman Sachs reported that, based upon Goldman Sachs discussion with William Blair, while the Lone Star Parties might be willing to increase their offer price above $10.00 per share, it appeared unlikely that the Lone Star Parties would increase their offer price substantially. The Special Committee then instructed Goldman Sachs to continue discussions with the Lone Star Parties to seek clarification of the extent to which the Lone Star Parties would be prepared to increase their proposed offer price.

On June 28, 2011, the Special Committee held a telephonic meeting attended by representatives of Paul, Weiss and Goldman Sachs, during which a representative of Goldman Sachs reported that, based on discussions with a senior representative of the Lone Star Parties, the Lone Star Parties were willing to raise their offer to $10.50 per share in cash (a premium of approximately 22% to the Company s then current share price) subject to the Company entering into an exclusivity agreement with the Lone Star Parties. A representative of Goldman Sachs also reported on the status of discussions with Party A, noting that Party A had not yet affirmatively indicated whether it would submit a proposal to acquire the Company. After discussion, the Special Committee determined to instruct Goldman Sachs to continue discussions with the Lone Star Parties regarding their proposal. No further communications were received from Party A and Party A did not respond to subsequent inquiries by representatives of Goldman Sachs regarding a potential transaction.

On July 1, 2011, following further discussions between representatives of Goldman Sachs and William Blair and discussions between Mr. Girard and the other members of the Special Committee, and approval of the members of the Special Committee based on, among other things, a lack of credible alternative bidders and the ability of the Company to terminate the proposed exclusivity agreement on short notice, the Company entered into an exclusivity agreement with the Lone Star Parties, expiring on August 3, 2011 (and terminable early by the Company on five days notice or by the Lone Star Parties upon notice to the Company that it was terminating discussions).

On July 8, 2011, Gibson Dunn & Crutcher LLP (Gibson Dunn), counsel to the Lone Star Parties, sent to Paul, Weiss a draft merger agreement and ancillary documents.

Between July 8, 2011 and July 29, 2011, the Special Committee and Paul, Weiss engaged in negotiations with the Lone Star Parties and Gibson Dunn regarding the terms of the proposed transaction, including, among other things, negotiations regarding the conditionality of the Lone Star Parties proposal, the terms of the Lone Star Parties financing obligations in light of the proposed financing structure (which contemplated a combination of equity financing and debt financing including a high yield bond offering) and the Company s limited remedies against the Lone Star Parties if it breached its obligations. Throughout this period, Paul, Weiss briefed King & Spalding on negotiations with respect to the merger agreement and the transaction and received comments from King & Spalding on the merger agreement and the transaction on behalf of the Company. Paul, Weiss also consulted with Greenberg Traurig, P.A. (Greenberg Traurig), Florida counsel to the Special Committee, on Florida law matters relating to the merger agreement and the proposed transaction.

On July 15, 2011, members of the Company s management and representatives of the Lone Star Parties and their advisors held an in-person diligence meeting to discuss, among other things, the Company s sales, merchandising and marketing strategy, as well as matters pertaining to store operations, logistics, supply chain, finances, information technology, risk management, real estate, human resources and legal. Representatives of Goldman Sachs were present during those discussions.

Between July 18, 2011 and July 29, 2011, members of the Company s management and representatives of the Lone Star Parties and their advisors held several telephonic follow-up diligence discussions pertaining to, among other things, real estate, supply chain, tax, merchandising, marketing, information technology, human resources, store operations and environmental matters. Representatives of Goldman Sachs participated in each discussion.

On July 21, 2011, the Board of Directors held an in-person meeting attended by senior management of the Company. At this meeting management provided updates regarding the Company s business, financial results and operations, and the Board of Directors discussed, among other things, the Company s strategy.

Later on July 21, 2011, the Special Committee held an in-person meeting attended telephonically by representatives of Paul, Weiss and Goldman Sachs, during which representatives of Paul, Weiss provided a summary of open issues relating to the then current drafts of the merger agreement and ancillary agreements. Representatives of Paul, Weiss discussed with the Special Committee, among other things, the conditional nature of the Lone Star Parties proposal, the limited remedies the Company would have against the Lone Star Parties if the Lone Star Parties breached their obligations (which the Special Committee considered to be unsatisfactory), the Lone Star Parties proposal to raise financing through a combination of a high yield bond offering and equity financing provided by investment funds affiliated with the Lone Star Parties, and the consequences of the Lone Star Parties failing to raise the necessary debt financing. Goldman Sachs provided the Special Committee with an update on the status of the Lone Star Parties due diligence investigation. The Special Committee also discussed the recent rise in the Company s share price and the timing of the Company s earnings release for fiscal year 2011. After discussion, the Special Committee instructed Paul, Weiss and Goldman Sachs to continue negotiations with the Lone Star Parties.

On July 27, 2011, members of the Company s management and representatives of the Lone Star Parties and their advisors held an in-person diligence meeting to discuss recent financial and operating information relating to the Company and additional diligence matters, at which a representative of Goldman Sachs was present.

On July 28, 2011, the Special Committee held a telephonic meeting attended by representatives of Paul, Weiss and Goldman Sachs. At the meeting, a representative of Goldman Sachs advised the Special Committee that the Lone Star Parties were nearing completion of their due diligence investigation and that the Lone Star Parties expected to be in a position to approve the transaction by August 3, 2011. The Special Committee discussed, among other things, the advisability of publicly releasing preliminary financial results for the fourth quarter and fiscal year 2011 before entering into a transaction with the Lone Star Parties. Following discussion, the Special Committee instructed Goldman Sachs to inform the Lone Star Parties that the Company would be releasing its preliminary financial results for the fourth quarter and fiscal year 2011 on either August 1, 2011 or August 2, 2011 and that it would not be in a position to recommend to the Board of Directors that the Company enter into a merger agreement with the Lone Star Parties until several days after the Company s preliminary financial results had been publicly released. A representative of Goldman Sachs informed the Lone Star Parties of the Special Committee s decisions during a telephone conversation later that day.

On July 29, 2011, Mr. Girard, Mr. Loughlin and representatives of Goldman Sachs and William Blair participated in a conference call. During the call, Mr. Loughlin and representatives of William Blair raised concerns regarding the Special Committee s intention to defer further consideration of a potential transaction until after the Company released its preliminary financial results and at the end of the call indicated the Lone Star Parties were terminating discussions with the Company. After the call, the Lone Star Parties sent the Company a letter confirming that the Lone Star Parties were terminating discussions with the Company. The exclusivity agreement between the Company and the Lone Star Parties then automatically terminated in accordance with its terms.

On August 1, 2011, the Company released its preliminary financial results for the fourth quarter and fiscal year 2011.

On August 3, 2011, representatives of William Blair contacted a representative of Goldman Sachs to indicate that the Lone Star Parties might be receptive to reengaging in negotiations if requested by the Special Committee. Representatives of Goldman Sachs reported on this discussion to Mr. Girard.

On August 10, 2011, the Special Committee held a telephonic meeting attended by Mr. Lynch and representatives of Paul, Weiss and Goldman Sachs. During the meeting, representatives of Goldman Sachs reviewed financial information relating to the Company and the proposed transaction (based on the terms last proposed by the Lone Star Parties prior to termination of negotiations). Representatives of Paul, Weiss again advised the Special Committee of its fiduciary duties and legal obligations to the Company and its shareholders in considering a sale of the Company. The Special Committee then discussed with Mr. Lynch his views on senior management s ability to execute its business plan and his views regarding the Company s projections and growth prospects, including the remodel program. Following discussion, the Special Committee determined not to authorize additional negotiations with the Lone Star Parties.

Following cessation of discussions with the Lone Star Parties and through November 10, 2011, the Company continued to operate its business in the ordinary course. Throughout this period, the United States and world financial markets experienced significant volatility and negative news, such as the unprecedented downgrade of the U.S. government s credit rating, that led to steep declines in the value of the equity securities of many companies. By November 10, 2011, the Company s share price declined from $9.81 (on July 20, 2011, the highest closing price during the calendar year) to $6.39, which represented a decrease of 34.9% during that period.

On October 31, 2011, the Company released its financial results for the first quarter of fiscal 2012.

On November 9, 2011, the Company held its 2011 annual meeting of shareholders.

On or about November 10, 2011, Mr. Loughlin contacted Mr. Lynch to express the Lone Star Parties receptivity to reengage in negotiations regarding a potential transaction with the Company if requested by the Special Committee. Mr. Lynch informed the Board of Directors of Mr. Loughlin s contact at a regularly-scheduled meeting of the Board of Directors on November 10, 2011. During the meeting, the Independent Directors met in executive session to discuss whether or not to authorize renewed negotiations with the Lone Star Parties, considering, among other things, the Company s recent financial performance, competition in the Company s markets (including product discounts being introduced by the Company s competitors in connection with the upcoming holidays), the decline in the Company s share price that had occurred since mid-July, the shareholder voting results on matters submitted to shareholders during the annual meeting of shareholders of the Company held on November 9, 2011 and informal communications received by representatives of the Company from shareholders regarding shareholders desire that the Company take action to increase shareholder value (for example, by paying dividends or adopting a share buyback program). As a result of these discussions, the Independent Directors determined that Mr. Girard should contact Mr. Loughlin to express the Special Committee s desire to reengage in discussions regarding a possible transaction.

On November 21, 2011, Mr. Girard spoke to Mr. Loughlin to advise him that the Special Committee had expressed interest in renewing discussions regarding a potential transaction between the Company and the Lone Star Parties. Mr. Loughlin advised Mr. Girard that the Lone Star Parties would not be able to pay the same price offered in July, raising concerns regarding the macroeconomic environment and costs of financing, but did not then propose terms for a potential transaction. Mr. Loughlin further advised Mr. Girard that the Lone Star Parties were considering a revised financing structure and that he would follow up with Mr. Girard in due course.

On November 28, 2011, at Mr. Loughlin s request, Mr. Girard confirmed to the Lone Star Parties the Special Committee s invitation to the Lone Star Parties to submit a new proposal to acquire the Company.

On November 30, 2011, the Lone Star Parties sent to the Company a non-binding proposal to acquire the Company for $9.00 per share (a premium of approximately 62% to the Company s then current share price) as well as revised drafts of the merger agreement and ancillary documents, including the equity commitment letter and the Lone Star Parties guarantee, and a request for additional due diligence information.

On December 1, 2011, the Special Committee held a telephonic meeting attended by Mr. Lynch and representatives of Paul, Weiss and Goldman Sachs to discuss the Special Committee s evaluation of, and response to, the Lone Star Parties most recent proposal. Representatives of Paul, Weiss advised the Special Committee of its fiduciary duties and legal obligations to the Company and its shareholders in considering a sale of the Company. Representatives of Goldman Sachs reviewed financial information relating to the Company and the most recent proposal of the Lone Star Parties. Mr. Lynch discussed the Company s recent financial performance, long-term plans and risks inherent in the Company s business plan, noting, among other things, the uncertain macroeconomic environment and volatile financial markets, intense competition in the Company s markets, and the potential for unexpected events to have an adverse effect on the Company s ability to successfully execute on its long-term plans. The Special Committee then met in executive session and discussed, among other things, the report received from Mr. Lynch and the uncertainty and execution risk of the Company s long-term plans given the volatile financial markets, the decline in the Company s share price that had occurred since mid-July, inherent difficulties in raising sufficient debt or equity capital to finance the capital expenditures required by the remodel program, the uncertain macroeconomic environment, competition in the Company s markets and the potential for unexpected events to adversely affect successful execution of the Company s long-term plans. The Special Committee also discussed the purchase price proposed by the Lone Star Parties, the nature of the transaction proposed by the Lone Star Parties (including the Lone Star Parties status as a strategic buyer), whether pursuing the proposal was in the best interests of the Company and its shareholders, and the extent to which the Lone Star Parties proposal appropriately valued the Company in light of current market conditions, management s business plan for the Company, the Company s recent financial performance and the risks and uncertainties of the Company s long-term plans. During the course of the discussion a majority of the members of the Special Committee indicated they would not support a transaction at a price of $9.00 per share, as proposed by the Lone Star Parties, but might be in favor of the transaction if the Lone Star Parties increased their proposed offer price. Following the discussion, the Special Committee decided that Mr. Girard would speak to Mr. Loughlin in order to determine whether the Lone Star Parties were prepared to increase their proposed purchase price above $9.00 per share.

On December 2, 2011, Mr. Girard called Mr. Loughlin to discuss the terms of the Lone Star Parties latest proposal. Mr. Girard advised Mr. Loughlin that the Lone Star Parties proposed price of $9.00 per share was insufficient. Mr. Loughlin explained to Mr. Girard that, unlike the Lone Star Parties previous proposal, which contemplated financing through a bond offering, the Lone Star Parties current proposal offered more certain financing as it relied on significant additional equity financing by investment funds affiliated with the Lone Star Parties and an asset-backed credit facility and, accordingly, offered greater certainty of closing for the Company. Mr. Loughlin further explained that, because of the substantial increase in the required equity financing from the Lone Star Parties and, among other things, the general economic decline that had occurred in recent months in the Company s local markets and the decline in the Company s share price, the Lone Star Parties would not be able to increase their offer above $9.00 per share in cash. As the conversation continued, Mr. Loughlin asked Mr. Girard if the Company would be prepared to adopt the first in, first out (FIFO) method of accounting, noting that Bi-Lo used the FIFO method of accounting and, if the proposed transaction were completed, it could offer certain tax advantages to Bi-Lo if the Company also used the FIFO method of accounting. Mr. Loughlin advised Mr. Girard that the Lone Star Parties might be willing to increase their offer price if the Company adopted FIFO accounting. Later that day, Mr. Girard reported on his discussion with Mr. Loughlin to the members of the Special Committee.

During a subsequent telephone call between Mr. Loughlin and Mr. Girard on December 5, 2011, Mr. Loughlin told Mr. Girard that the Lone Star Parties would be prepared to offer $9.38 per share if the Company agreed to adopt FIFO accounting before completion of the proposed transaction. Mr. Girard advised Mr. Loughlin that a price of $9.38 was unlikely to receive support of a majority of the members of the Special Committee. Mr. Loughlin then offered $9.50 per share (a premium of approximately 79% to the Company s then

current share price), emphasizing that the Lone Star Parties would not increase its price any further and would terminate discussions with the Company if the Special Committee was not supportive of further discussions at this price. Later that day, Mr. Girard reported on his discussion with Mr. Loughlin to the members of the Special Committee.

On December 6, 2011, the Special Committee held a telephonic meeting attended by representatives of Paul, Weiss and Goldman Sachs to discuss Mr. Girard s conversations with the Lone Star Parties and their proposal to acquire the Company at a price of $9.50 per share. Representatives of Paul, Weiss again advised the Special Committee of its fiduciary duties and legal obligations to the Company and its shareholders in considering a sale of the Company. A representative of Goldman Sachs reviewed with the Special Committee financial information relating to the Company and the Lone Star Parties latest proposal. The Special Committee discussed, among other things, the increased deal certainty of the Lone Star Parties proposal compared to their prior proposal in light of changes in the Lone Star Parties proposed financing structure, the risks and uncertainties highlighted by Mr. Lynch in his report to the Special Committee on December 1, 2011, the perceptions of the Company s value in the marketplace in comparison to its competitors, the decline in the Company s share price that had occurred since mid-July, the pressure the Company had received from shareholders for the Company to take steps (such as declaring dividends or implementing a stock buyback program) to support the share price and shareholder value, the lower price currently offered by the Lone Star Parties compared to the price it had offered in July, the reasons provided by the Lone Star Parties for why they could only offer such price, and the significantly increased premium to market price of the Lone Star Parties most recent offer compared to their earlier offer. The Special Committee then discussed whether it was necessary to reengage with Party A or otherwise conduct a further market check. The Special Committee considered, among other things, the lack of interest expressed by Party A and the other potential strategic buyers previously contacted by representatives of Goldman Sachs, the Special Committee s view that, given the inability to realize synergies, expectations of negative cash flows during the period covered by management s projections for the Company and difficulties in the debt financing markets at the time, financial buyers would not be able to offer a higher price for the Company than the price offered by the Lone Star Parties, the potential repercussions of a leak of information that a transaction may be under consideration, the possible withdrawal of the Lone Star Parties offer and, if the Company entered into the proposed merger agreement with the Lone Star Parties, the Company s ability to terminate the merger agreement if the Company were to receive an unsolicited proposal that was superior to the Lone Star Parties proposal. After discussion, the Special Committee determined a further market check was not necessary and authorized further discussion with the Lone Star Parties based on an offer price of $9.50 per share.

Between December 6, 2011 and December 16, 2011, the Special Committee and representatives of Paul, Weiss reengaged in negotiations with the Lone Star Parties and Gibson Dunn over provisions of the merger agreement and ancillary agreements. Throughout this period, representatives of Paul, Weiss briefed representatives of King & Spalding on negotiations with respect to the merger agreement and ancillary agreements and the transaction and received comments from representatives of King & Spalding on the merger agreement and ancillary agreements and the transaction on behalf of the Company. Representatives of Paul, Weiss also consulted with representatives of Greenberg Traurig on matters related to Florida law with respect to the merger agreement and the transaction. During the negotiations, representatives of Paul, Weiss and the Special Committee spent considerable time analyzing and assessing, and negotiating with the Lone Star Parties and Gibson Dunn, the termination provisions in the merger agreement, the remedies for breach of the merger agreement, and the allocation of risk between the Company and the Lone Star Parties in the event the transaction were to fail to close. During the same period and upon the requests of representatives of the Lone Star Parties and their advisors, the Company provided the Lone Star Parties with access to additional financial, operating and legal information related to the Company.

On December 7, 2011, Party D, a potential financial buyer, submitted to the Company an unsolicited non-binding proposal, which set forth terms and conditions for a potential acquisition of the Company, including a proposed purchase price of $6.89 per share in cash, conditional upon, among other things, the successful completion of due diligence and arrangement of financing.

On December 8, 2011, a member of the Special Committee received an unsolicited phone call from a financial advisor to Party E, a potential financial buyer, indicating that Party E was interested in exploring a potential transaction with the Company. On December 9, 2011, Party E contacted Mr. Girard and Mr. Girard invited Party E to speak to a representative of the Company and to submit an offer if they wished to do so. In a letter dated December 10, 2011, Party E submitted to the Company a non-binding indication of interest, which set forth terms and conditions of a potential acquisition of the Company by Party E, including a proposed purchase price of $7.50 to $8.00 per share in cash, subject to, among other things, successful completion of due diligence and arrangement of financing.

On December 13, 2011, Party F, a potential financial buyer, communicated to a representative of the Company on an unsolicited basis that it was interested in meeting with representatives of the Company. Mr. Lynch reported this discussion to Mr. Girard, and Mr. Lynch invited Party F to submit an offer or schedule a meeting with representatives of the Company if they wanted to do so. Party F did not submit an offer nor did it make arrangements to meet with representatives of the Company.

On December 13, 2011, Party G, a potential financial buyer, communicated to a member of the Special Committee on an unsolicited basis that it was interested in speaking with a representative of the Company to discuss a potential transaction. On December 13, 2011, Mr. Girard contacted Party G to invite them to speak to representatives of the Company and to submit an offer if they wished to do so. Party G did not submit an offer.

On December 13, 2011, members of management held two telephonic diligence meetings with representatives of the Lone Star Parties and their advisors, one of which was attended by representatives of Paul, Weiss and both of which were attended by representatives of Goldman Sachs. During these telephonic meetings the parties discussed, among other things, the Company s recent financial performance and matters pertaining to the adoption of FIFO accounting.

Later on December 13, 2011, the Special Committee held a telephonic meeting attended by representatives of Paul, Weiss and Goldman Sachs. During the meeting, Mr. Girard summarized the indications of interest received from, and communications with, Party D, Party E, Party F and Party G. The Special Committee then discussed with Goldman Sachs and Paul, Weiss the potential benefits and risks of engaging in discussions with Party D, Party E, Party F or Party G given, among other things, the advanced stage of discussions with, and relative transaction certainty offered by, the Lone Star Parties, and the likelihood that these parties, all of whom were financial buyers, would be unable to offer a price superior to the fully negotiated price offered by the Lone Star Parties, following which discussion the Special Committee determined not to engage in additional discussions with Party D, Party E, Party F or Party G. The Special Committee also discussed the Lone Star Parties requirement that the Company change from LIFO to FIFO accounting and the related advice received from, and discussions with, Company management. Paul, Weiss then reviewed the open issues in the draft merger agreement regarding, among other things, termination fees, remedies and financing matters, and the potential resolution of these issues.

Between December 13 and 16, 2011, representatives of Paul, Weiss and Gibson Dunn continued negotiations regarding the terms of the merger agreement and the ancillary documents, including the equity commitment letter, the Lone Star Parties guarantee and the debt commitment letter.

On December 16, 2011, the Company s Special Committee held a telephonic meeting attended by Mr. Lynch and representatives of Paul, Weiss, Greenberg Traurig and Goldman Sachs to consider entering into a merger agreement with the Lone Star Parties. Mr. Girard again reviewed with the Special Committee the indications of interest received from, and communications with, Party D, Party E, Party F and Party G. Representatives of Paul, Weiss reviewed with the Special Committee its fiduciary duties and legal obligations in the context of the proposed transaction and discussed the terms of the current drafts of the merger agreement and ancillary documents, including the resolution of the open issues discussed during the December 13, 2011 meeting. A representative of Goldman Sachs reviewed financial analyses relating to the Company and the proposed transaction and delivered to the Special Committee an oral opinion, subsequently confirmed by

delivery of a written opinion dated December 16, 2011, to the effect that, as of that date and based upon and subject to the limitations, qualifications and assumptions set forth in such opinion, the $9.50 per share in cash to be paid to the holders of outstanding shares of the Company s common stock pursuant to the merger agreement was fair, from a financial point of view, to such holders. See *The Merger Opinion of the Special Committee s Financial Advisor* in this proxy statement for more information about the Goldman Sachs opinion. After discussion of the terms of the draft merger agreement and ancillary documents, consideration of other relevant issues, including the non-binding indications of interest and proposals received from Party D, Party E, Party F and Party G and a variety of business, financial and market factors, including those set forth below under *The Merger Reasons for the Merger* and the delivery of the fairness opinion, the Special Committee unanimously determined that it was advisable and in the best interests of the Company and its shareholders to recommend to the Board of Directors that it adopt and approve the merger agreement with the Lone Star Parties and resolved to recommend to the Board of Directors that it recommend to the Company s shareholders that they vote in favor of the approval of the merger agreement. Immediately following the meeting of the Special Committee, the Board of Directors held a telephonic meeting and unanimously determined that it was advisable and in the best interests of the Company and its shareholders to approve the merger agreement with affiliates of the Lone Star Parties and unanimously resolved to recommend to the Company s shareholders that they vote in favor of approving the merger agreement.

Following this meeting, on December 16, 2011 the Company and affiliates of the Lone Star Parties entered into the merger agreement and other transaction documents, and the transaction was publicly announced on December 19, 2011.

Reasons for the Merger

The Special Committee unanimously determined the merger agreement to be in the best interests of the Company and its shareholders and unanimously recommended to the Board of Directors that it approve a resolution adopting the merger agreement. The Board of Directors has unanimously determined that the merger agreement is advisable to and in the best interests of the Company and its shareholders and has authorized and unanimously approved the merger and adopted the merger agreement. The Board of Directors unanimously recommends to the shareholders of the Company that they vote **FOR** the approval of the merger agreement.

In the course of reaching their respective recommendations and determinations, the Special Committee and the Board of Directors consulted with the Company s senior management, the Special Committee s financial advisors and outside legal counsel, and the Company s outside legal counsel, and considered a number of substantive factors, both positive and negative, and potential benefits and detriments of the merger to the Company and its shareholders. The Board of Directors and the Special Committee believe that the following factors, among others, support the decision by the Board of Directors to approve the merger and the merger agreement, to adopt the merger agreement, and to recommend that shareholders vote in favor of the approval of the merger agreement:

Creating shareholder value. The Board of Directors and the Special Committee believed that the merger would maximize the immediate value of the Company s shares to its shareholders and represent the best course of action reasonably available to shareholders. The merger consideration of $9.50 per share in cash payable to the shareholders of the Company represents a significant premium over the market prices at which the Company s common shares have recently traded, including a premium of approximately 65% over the closing market price of the Company s common stock as of December 15, 2011 (the last trading day before each of the Special Committee and the Board made its determination) and a premium of 33% over the volume weighted average price for the twelve months ended December 15, 2011.

Uncertainty of future common stock market price. The Board of Directors and the Special Committee considered the financial condition, results of operations, competitive position and prospects of the Company s business, as well as current economic, financial market and stock market conditions, historical trading values of the Company s common stock in the open market, the historical discount of

the trading values of the Company s common stock in comparison to its competitors, and the decline in the trading price of the Company s common stock that had occurred since mid-July. The Board of Directors and the Special Committee believed it to be unlikely that the trading price of the Company s common stock would, in the foreseeable future, have a value greater than the merger consideration of $9.50 per share in cash payable to the shareholders of the Company.

Consideration to shareholders paid in cash. The Board of Directors and the Special Committee considered that all of the merger consideration payable to the Company s shareholders will be paid in cash, giving shareholders an opportunity to immediately realize value for their investment in the Company and providing certainty of value.

Risk of strategic alternatives. The Board of Directors and the Special Committee considered strategic alternatives to the merger, including, among other alternatives, continuing to operate the Company on a stand-alone basis (taking into account the Company s long term plans, including the remodel program and contemplated financing proposals) and the sale of the Company to other potential acquirers, and the benefits and risks associated with such alternatives, each of which the Board of Directors and the Special Committee determined to be inferior in comparison to the benefits afforded by the merger.

Risks inherent in stand-alone strategy, including increased capital expenditure requirements. The Board of Directors and the Special Committee considered their belief that, in order to maximize long-term shareholder value on a stand-alone basis, and given the intense competition faced by the Company, it would be necessary for the Company to undertake significant capital expenditures in connection with the remodel program. The Board of Directors and the Special Committee believed that this strategy would entail uncertainty and execution risk, given the volatile financial markets and inherent difficulties in raising sufficient debt or equity capital to finance the capital expenditures required by the remodel program, the uncertain macroeconomic environment, the management s expectation that the Company would have minimal or negative free cash flow through fiscal year 2015 to fund its strategic business plan and the intense competition in the Company s markets.

Absence of competitive offers. The Board of Directors and the Special Committee considered that, in response to Lone Star s unsolicited proposal, the Special Committee had, together with the Company s management and Goldman Sachs, conducted a concerted effort to solicit competing proposals from suitable strategic buyers the Special Committee believed were potentially likely to be interested in, and to have the necessary financial resources to consider, a transaction with the Company. The Board of Directors and the Special Committee considered that during the course of such discussions no such potential strategic buyer made a formal or informal offer to acquire the Company at any price. The Board of Directors and the Special Committee also considered that, while the Company had received interest from four financial buyers in a potential transaction, only two such parties had submitted non-binding proposals for a transaction and each of those proposals offered substantially less consideration to the Company s shareholders than the merger consideration of $9.50 per share in cash, and considered the Special Committee s view that, given the lack of synergies and difficulties in financing markets at the time, financial buyers would not be able to offer a transaction that would provide a superior price for the Company and the completion certainty of the proposed transaction with Lone Star. In addition, the Board of Directors and the Special Committee believed that the deal protections provided in the merger agreement, including the termination fee payable to accept a superior proposal, were not preclusive of a superior proposal.

Limited conditionality and likelihood of closing. The Board of Directors and the Special Committee considered the limited conditionality of Lone Star s obligations under the merger agreement and the absence of a financing condition to the merger, as well as the likelihood that the proposed asset-backed credit facility to be used by BI-LO to finance the merger consideration could be completed and funded promptly upon satisfaction of the conditions to the merger.

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Complementary market coverage and limited likelihood of store closings. The Board of Directors and the Special Committee considered, as permitted by Florida law, that the communities served by BI-LO and the Company do not overlap and, as a result, no store closures were expected.

Terms of the merger agreement. The Board of Directors and the Special Committee considered the terms and conditions of the merger agreement, including the following provisions, which are favorable to the Company:

- the provisions of the merger agreement that allow the Company to engage in negotiations with other potential buyers in response to an unsolicited proposal to acquire at least 50% of the Company s outstanding shares of common stock or assets that is reasonably likely to constitute a superior proposal;
- the provisions of the merger agreement that allow the Board of Directors to change its recommendation in response to superior proposals and intervening events;
- the ability of the Company to specifically enforce Holdings obligations under the merger agreement in circumstances in which the proposed debt financing is or would be available; and
- the fact that if Holdings fails to complete the transaction when obligated to do so (including due to a failure of its proposed debt financing) or otherwise materially breaches its obligations such that the conditions to closing would not be met, then it may be required to pay the Company a closing failure fee in the amount of $72,825,000, or approximately 13% of the equity value of the Company implied by the merger consideration.

See *Proposal 1 The Merger Agreement* in this proxy statement for a more complete description of the terms and conditions of the merger agreement.

Financial advisor s opinion. The Board of Directors and the Special Committee considered that the Special Committee received an opinion of Goldman Sachs, dated as of December 16, 2011, which stated that as of such date and based upon and subject to the limitations, qualifications and assumptions set forth in such opinion, the $9.50 in cash per share to be paid to the holders of outstanding shares of common stock of the Company pursuant to the merger agreement was fair from a financial point of view to such holders, as more fully described below under the heading *Opinion of the Special Committee s Financial Advisor*.

The Board of Directors and the Special Committee also considered a variety of negative factors, uncertainties and risks in its deliberations concerning the merger, including:

Risk of non-completion. The Board of Directors and the Special Committee considered the risk that the merger might not be completed as a result of the failure of Holdings affiliates to obtain debt financing or in other circumstances. The Company also considered that the Company had incurred and would incur significant transaction and opportunity costs attempting to consummate the merger, the Company s business may be subject to disruption and the Company s directors, officers and other employees had expended and would expend considerable time and effort to consummate the merger.

Possible deterrence of alternative offers. The Board of Directors and the Special Committee considered the risk that various provisions of the merger agreement, including the provisions restricting the Company s ability to solicit proposals from other potential buyers and the requirement that the Company pay Holdings a break-up fee of $19,600,000 if the merger agreement is terminated in connection with the acceptance of a superior proposal, could deter or discourage other potential bidders from making an offer for the Company. See *Proposal 1 - The Merger Agreement Termination of the Merger Agreement* in this proxy statement.

Restrictions on operations of the Company s business. The Board of Directors and the Special Committee considered the requirement that the Company operate in the ordinary course of business prior to completion of the merger and be subject to specified restrictions on the conduct of its business without

Holdings prior consent (which may not be unreasonably withheld, delayed or conditioned), which might delay or prevent the Company from undertaking business opportunities that might arise before the merger is completed. See *Proposal 1 - The Merger Agreement Conduct of Business Pending the Merger* in this proxy statement.

Taxable transaction. The Board of Directors and the Special Committee considered that an all cash transaction would be taxable to the Company s shareholders for U.S. federal income tax purposes. See *The Merger Material United States Federal Income Tax Consequences of the Merger* in this proxy statement.

Cashout transaction. The Board of Directors and the Special Committee considered that the nature of the merger as a cash transaction will prevent the Company s shareholders from being able to participate in any future earnings or growth of the Company and any potential appreciation in the value of the Company s shares, including any value that could be achieved if the Company engages in future strategic or other transactions or as a result of the improvements to the Company s business.

LIFO to FIFO election; use of net operating losses. The Board of Directors and the Special Committee considered the potential risks involved in agreeing to Lone Star s request to change the Company s method of valuing inventory for U.S. federal and state income tax purposes from the last-in, first-out (LIFO) method to the first-in, first-out (FIFO) method, which is the method currently used by BI-LO. The Board of Directors considered that Lone Star had requested that the Company adopt the FIFO method of accounting no later than March 15, 2012, and therefore that the change might be made before the completion of the merger was certain to occur. The Board of Directors and the Special Committee considered that the adoption of the FIFO method of accounting would result in the Company recognizing taxable income of approximately $210 million, allocated between the taxable year of the change and the three following taxable years. This taxable income could be set off against the Company s accumulated net operating loss carryforwards, resulting in a reduction in such net operating loss carryforwards (assuming that the merger did not occur) from approximately $750 million to approximately $540 million. The Board of Directors and the Special Committee considered whether the Company expected to be able to otherwise benefit from the net operating loss carryforwards in question. See *The Merger Adoption of FIFO Method of Accounting* in this proxy statement.

Parent s limited liability for breach. The Board of Directors and the Special Committee considered that Holdings is a newly formed limited liability company with no assets and, while Lone Star has guaranteed Holdings liability for failure to comply with specified obligations under the merger agreement, Holdings liability is limited to a closing failure fee of $72,825,000 plus other specified costs and expenses of the Company. See *Proposal 1 - The Merger Agreement Termination Fee and Closing Failure Fee* in this proxy statement.

Offer of $10.50 per share in July 2011. The Board of Directors and the Special Committee considered that Lone Star offered, and subsequently withdrew, a higher offer price of $10.50 per share to acquire the Company in July 2011, albeit under different market conditions and based on a different financing structure and at a time when the Company s share price was substantially higher.

The Board of Directors and the Special Committee also considered a variety of other factors, including:

Potential employment of management with affiliates of Lone Star. The Board of Directors and the Special Committee considered the possibility that, while the Special Committee had required management and Lone Star not to engage in material discussions relating to management s potential employment with Lone Star or its affiliates until the principal terms of the merger agreement were agreed, and although no such discussions had in fact taken place before the merger agreement was executed, the Company s

management may become employees of Holdings and its subsidiaries after completion of the merger and may therefore have interests in the merger that are different from, or in addition to, those of the Company s shareholders.

Interests of the Company s directors and officers. The Board of Directors and the Special Committee considered the potential conflicts of interest of the Company s directors and executive officers in light of their ownership of shares of the Company s common stock, the effect of the merger on outstanding options and restricted stock units, Mr. Lynch s employment agreement and the Company s severance plans. See *The Merger Interests of Our Directors and Officers in the Merger* in this proxy statement.

The Board of Directors and the Special Committee concluded that the potentially negative factors associated with the proposed merger were outweighed by the potential benefits that the Company s shareholders are expected to achieve as a result of the merger, including the belief of the Board of Directors and the Special Committee that the merger maximizes the immediate value of the Company s shares to its shareholders and eliminates the risks and uncertainty affecting the future prospects of the Company, including the potential execution risks associated with the Company s strategic business plan. Accordingly, the Special Committee recommended to the Board of Directors and the Board of Directors determined that the merger agreement and the merger are advisable to, and in the best interests of, the Company and its shareholders.

The foregoing discussion of the information and factors considered by the Board of Directors and the Special Committee is not exhaustive, but the Company believes it includes the material factors considered by the Board of Directors.

In view of the wide variety of factors considered in connection with its evaluation of the merger and the complexity of these matters, the Board of Directors and the Special Committee did not consider it practicable to, and did not attempt to, quantify or otherwise assign relative or specific weight or values to any of these factors. Rather, the Board of Directors and the Special Committee viewed their positions and recommendations as being based on an overall analysis and on the totality of the information presented to and factors considered by it. In considering the factors described above, individual directors may have ascribed greater degrees of importance to different factors. After considering this information, the Special Committee recommended to the Board of Directors that it approve a resolution adopting the merger agreement and Board of Directors approved the merger agreement and the merger, adopted the merger agreement, and recommended to the shareholders of the Company that they vote in favor of the approval of the merger agreement.

Recommendation of Our Board of Directors

On December 16, 2011, after evaluating, in consultation with our management and legal and financial advisors, the various business, financial, market and other factors described above, and after due discussion and consideration, on the unanimous recommendation of the Special Committee, our Board of Directors unanimously determined that the merger is in the best interests of Winn-Dixie and our shareholders and unanimously approved, adopted and declared advisable the merger agreement and the transactions contemplated thereby, including the merger. **ACCORDINGLY, OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT THE SHAREHOLDERS OF WINN-DIXIE VOTE FOR THE APPROVAL OF THE MERGER AGREEMENT.**

Opinion of the Financial Advisor to the Special Committee

Goldman Sachs rendered its oral opinion to the Special Committee, subsequently confirmed in writing, that, as of December 16, 2011, and based upon and subject to the factors and assumptions set forth therein, the $9.50 per share in cash to be paid to the holders of outstanding shares of the Company s common stock pursuant to the merger agreement was fair, from a financial point of view, to such holders.

The full text of the written opinion of Goldman Sachs, dated December 16, 2011, which sets forth assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with the opinion, is attached as Annex B to this proxy statement. Goldman Sachs provided its opinion for the information and assistance of the Special Committee in connection with its consideration of the merger. Goldman Sachs opinion is not a recommendation as to how any holder of shares of the Company s common stock should vote with respect to the merger or any other matter.

In connection with rendering the opinion described above and performing its related financial analyses, Goldman Sachs reviewed, among other things:

- the merger agreement;
- annual reports to the shareholders of the Company and Annual Reports on Form 10-K of the Company for the five fiscal years ended June 29, 2011;
- certain interim reports to the shareholders of the Company and Quarterly Reports on Form 10-Q of the Company;
- certain other communications from the Company to its shareholders;
- certain publicly available research analyst reports for the Company; and
- certain internal financial analyses and forecasts for the Company prepared by its management in each case as approved for Goldman Sachs use by the Company, which we refer to as the Forecasts.

Goldman Sachs also held discussions with members of the senior management of the Company regarding their assessment of the past and current business operations, financial condition and future prospects of the Company. In addition, Goldman Sachs reviewed the reported price and trading activity for the shares of the Company s common stock, compared certain financial and stock market information for the Company with similar information for certain other companies the securities of which are publicly traded, reviewed the financial terms of certain recent business combinations in the food retail industry and in other industries, and performed such other studies and analyses, and considered such other factors, as it deemed appropriate.

For purposes of rendering the opinion described above, Goldman Sachs relied upon and assumed, without assuming any responsibility for independent verification, the accuracy and completeness of all of the financial, legal, regulatory, tax, accounting and other information provided to, discussed with or reviewed by Goldman Sachs. In that regard, Goldman Sachs assumed with the consent of the Special Committee that the Forecasts had been reasonably prepared on a basis reflecting the best currently available estimates and judgments of the management of the Company. Goldman Sachs did not make an independent evaluation or appraisal of the assets and liabilities (including any contingent, derivative or other off-balance-sheet assets and liabilities) of the Company or any of its subsidiaries and Goldman Sachs was not furnished with any such evaluation or appraisal.

Goldman Sachs assumed that all governmental, regulatory, or other consents and approvals necessary for the consummation of the merger will be obtained without any adverse effect on the expected benefits of the merger in any way meaningful to its analysis. Goldman Sachs also assumed that the merger will be consummated on the terms set forth in the merger agreement, without the waiver or modification of any term or condition the effect of which would be in any way meaningful to its analysis.

Goldman Sachs opinion did not address the underlying business decision of the Company to engage in the merger, or the relative merits of the merger as compared to any strategic alternatives that may be available to the Company; nor did it address any legal, regulatory, tax or accounting matters. Goldman Sachs opinion addressed only the fairness from a financial point of view, as of December 16, 2011, of the $9.50 per share in cash to be paid to the holders of the shares of Common Stock pursuant to the merger agreement.

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Goldman Sachs opinion did not express any view on, and did not address, any other term or aspect of the merger agreement or the merger or any term or aspect of any other agreement or instrument contemplated by the merger agreement or entered into or amended in connection with the merger, including, without limitation, the fairness of the merger to, or any consideration received in connection therewith by, the holders of any other class of securities, creditors, or other constituencies of the Company; nor as to the fairness of the amount or nature of any compensation to be paid or payable to any of the officers, directors or employees of the Company, or class of such persons, in connection with the merger, whether relative to the $9.50 per share in cash to be paid to the holders of the shares of Common Stock pursuant to the merger agreement or otherwise. Goldman Sachs did not express any opinion as to the impact of the merger on the solvency or viability of the Company, BI-LO Holding, LLC (Bi-Lo Holding) or any of its subsidiaries (including Holdings and its subsidiaries) or the ability of the Company, Bi-Lo Holding or any of its subsidiaries (including Holdings and its subsidiaries) to pay their respective obligations when they come due. Goldman Sachs opinion was necessarily based on economic, monetary, market and other conditions as in effect on, and the information made available to Goldman Sachs as of, the date of the opinion and Goldman Sachs assumed no responsibility for updating, revising or reaffirming its opinion based on circumstances, developments, or events occurring after the date of its opinion. Goldman Sachs opinion was approved by a fairness committee of Goldman Sachs.

The following is a summary of the material financial analysis delivered by Goldman Sachs to the Special Committee in connection with rendering the opinion described above. The following summary, however, does not purport to be a complete description of the financial analyses performed by Goldman Sachs, nor does the order of the analyses described represent relative importance or weight given to those analyses by Goldman Sachs. Some of the summaries of the financial analyses include information presented in a tabular format. The tables must be read together with the full text of each summary and are alone not a complete description of Goldman Sachs financial analyses. Except as otherwise noted, the following quantitative information, to the extent that it is based on market data, is based on market data as it existed on or before December 15, 2011 (the last trading day prior to the date of the merger agreement) and is not necessarily indicative of current market conditions.

Historical Stock Trading Analysis. Goldman Sachs analyzed the $9.50 per share in cash to be paid to the holders of the shares of Common Stock pursuant to the merger agreement in relation to (i) the closing price of the shares of Common Stock on December 15, 2011 , (ii) the high and low prices of the shares of the Company s common stock for the 52-week period ended December 15, 2011, and (iii) the volume weighted average prices (VWAP) of the shares of the Company s common stock during the one-month, three-month, six-month and twelve-month periods ended December 15, 2011. This analysis indicated that the $9.50 per share in cash to be paid to the holders of the shares of Common Stock pursuant to the merger agreement represented:

- a premium of 65.2% based on the closing price per share of the Company s common stock on December 15, 2011;
- a premium of 72.4% based on the VWAP per share of the Company s common stock during the one-month period ended December 15, 2011;
- a premium of 58.9% based on the VWAP per share of the Company s common stock during the three-month period ended December 15, 2011;
- a premium of 34.6% based on the VWAP per share of the Company s common stock during the six-month period ended December 15, 2011;
- a premium of 32.7% based on the VWAP per share of the Company s common stock during the twelve-month period ended December 15, 2011;
- a discount of 3.2% based on the highest closing price per share of the Company s common stock during the 52-week period ended December 15, 2011; and

a premium of 86.3% based on the lowest closing price per share of the Company s common stock during the 52-week period ended December 15, 2011.

Selected Companies Analysis. Goldman Sachs reviewed and compared certain financial information for the Company to corresponding financial information, ratios and public market multiples for the following publicly traded companies in the food retail industry, which we refer to as the Food Retail Peers :

- Ingles Markets, Inc.;
- The Kroger Co.;
- Ruddick Corporation;
- Safeway Inc.;
- SuperValu Inc.; and
- Weis Markets, Inc.

Although none of the selected companies is directly comparable to the Company, the Food Retail Peers were chosen by Goldman Sachs because they are publicly traded companies with operations that, for purposes of analysis, may be considered similar to certain operations of the Company.

The calculations for the Food Retail Peers were based on the closing prices per share of the Food Retail Peers respective common stock as of December 15, 2011, information from public filings, estimates from the Institutional Brokers Estimate System (IBES) and other publicly available Wall Street research and were calendarized to June year end. The multiples and ratios for the Company were based on the closing price of the Company s common stock on December 15, 2011, the $9.50 per share in cash to be paid pursuant to the merger agreement, and the Forecasts.

With respect to each of the Food Retail Peers and the Company, Goldman Sachs calculated:

- Ratios of enterprise value (EV), which is the market value of common equity on a diluted basis (including certain unvested restricted stock units and outstanding options) on December 15, 2011, plus the book value of total debt (including capital lease obligations), less cash and cash equivalents, on the last reported balance sheet date (in the case of the Company, September 21, 2011), to earnings before interest, taxes, depreciation and amortization, further adjusted for certain non-cash charges including, in the case of the Company stock based compensation (EBITDA) for the last twelve months (LTM) ended on the date of the last reported fiscal quarter (in the case of the Company, September 21, 2011) and to estimated EBITDA for the fiscal year ended June 2012;
- Ratios of EV on December 15, 2011 to EBIDTA less capital expenditures for the LTM period ended on the date of the last reported fiscal quarter (in the case of the Company, September 21, 2011) and estimated EBITDA less capital expenditures for the fiscal year ended June 2012 (other than with respect to Ingles Markets, Inc. and Weis Markets, Inc., for which estimates were not available); and
- Ratios of the closing price per share on December 15, 2011 to estimated earnings per share (EPS) for the fiscal year ended June 2012 (other than with respect to Ingles Markets, Inc. and Weis Markets, Inc., for which estimates were not available).

Goldman Sachs also calculated the following with respect to the Company:

Ratios of implied enterprise value (Implied EV), based upon the $9.50 per share in cash to be paid to holders of shares of the Company s common stock pursuant to the merger agreement, to EBITDA for the LTM period ended September 21, 2011, and to estimated EBITDA for the fiscal year ended June, 2012;

Ratios of adjusted implied total consideration (Adjusted Implied Total Consideration), based upon the $9.50 per share in cash to be paid to holders of shares of the Company s common stock pursuant to the merger agreement and adding back, for illustrative purposes, the value of cash on the balance sheet as of September 21, 2011, to EBITDA for the LTM period ended September 21, 2011 and to estimated EBITDA for the fiscal year ended June 2012;

Ratios of Implied EV to EBITDA less capital expenditures for the LTM period ended September 21, 2011 and estimated EBITDA less capital expenditures for the fiscal year ended June 2012; and

Ratio of the $9.50 per share in cash to be paid to holders of shares of the Company s common stock pursuant to the merger agreement to estimated earnings per share for the fiscal year ended June 2012.

The results of these analyses are summarized in the following tables:

	EV/EBITDA Multiple		EV/(EBITDA Capex) Multiple	
Company	**LTM**	**June 2012E**	**LTM**	**June 2012E**
Winn-Dixie (Forecasts)	1.8x	1.8x	5.4x	NM
Winn-Dixie (Forecasts Implied EV)	3.5x	3.5x	10.6x	NM
Winn-Dixie (Forecasts Adjusted Implied Total Consideration)	4.8x	4.9x	-	-
Food Retail Peers				
High	6.6x	6.1x	16.4x	12.8x
Low	4.2x	4.4x	6.0x	7.2x
Median	5.5x	5.2x	11.0x	9.8x

Note: NM means not meaningful.

Company	**P/E Multiple June 2012E**
Winn-Dixie *(Based on Dec. 15 Closing Price)*	NM
Winn-Dixie *(Based on $9.50/share Offer Price)*	NM
Food Retail Peers	
High	16.6x
Low	5.7x
Median	11.5x

Note: NM means not meaningful.

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In addition, Goldman Sachs calculated and compared average ratios of EV to EBITDA for the LTM period ended September 21, 2011 and EV to one year forward EBITDA, based on IBES estimates over each of the last three calendar years for the Company and the Food Retail Peers. The results of these analyses are summarized as follows:

Average Over Period	Winn-Dixie	Median of Food Retail Peers	Winn-Dixie Premium / (Discount) to Peers
EV to LTM EBITDA Multiple			
6 months	2.5x	5.4x	(2.9)x
1 year	2.9x	5.6x	(2.7)x
2 years	3.0x	5.6x	(2.6)x
3 years	3.3x	5.5x	(2.2)x
EV to One Year Forward EBITDA Multiple			
6 months	2.1x	5.2x	(3.1)x
1 years	2.5x	5.4x	(2.9)x
2 years	2.9x	5.4x	(2.6)x
3 years	3.3x	5.3x	(2.0)x

Illustrative Present Value of Future Share Price Analysis. Goldman Sachs performed an illustrative analysis of the implied present value of the future price per share of the Company s common stock, using the Forecasts and assuming, based on guidance from the Company s management, net debt of the Company as at the relevant fiscal year end, a total of 56.7 million outstanding shares of the Company s common stock, 2.1 million outstanding restricted stock units and 4.0 million outstanding options with a weighted average strike price of $13.81. This analysis is designed to provide an indication of the implied present value of a theoretical future value of a company s equity as a function of such company s estimated future EBITDA, its assumed EV/EBITDA multiples, and its estimated future balance sheet position based on the Forecasts. For this analysis Goldman Sachs first calculated the illustrative future values per share of the Company s common stock for the fiscal years 2012 through 2015 by applying EV to forward EBITDA multiples ranging from 1.5x to 4.0x. This range of multiples was applied to EBITDA estimates for the Company s fiscal years 2013 to 2016 derived from the Forecasts to derive an implied equity value per share of the Company s common stock, using the estimated balance sheet position for the Company as at the relevant fiscal year end based on the Forecasts. The resulting values were then discounted to present value using a discount rate of 13.0%, reflecting an estimate of the Company s cost of equity. Based on the foregoing calculations, Goldman Sachs derived an illustrative range of implied present values of $4.30 to $11.88 per share of the Company s common stock.

Illustrative Discounted Cash Flow Analysis. Goldman Sachs performed an illustrative discounted cash flow analysis to determine a range of implied per share equity values for the Company based on projected stand-alone future unlevered cash flows. In the illustrative discounted cash flow analyses described in this paragraph, unlevered free cash flow, which is the Company s projected EBITDA, minus taxes (for periods in which the Company has projected taxable income, tax expense was assumed to be $0 based on the availability of net operating loss carryforwards), minus its projected capital expenditures and minus the projected increase in net working capital, was calculated using the Forecasts. In addition, stock based compensation expense was treated as a cash expense for purposes of determining unlevered free cash flow. In addition, Goldman Sachs assumed based on guidance from the Company s management, net cash of the Company of $107.6 million as of September 21, 2011, a total of 56.7 million outstanding shares of the Company s common stock, 2.1 million outstanding restricted stock units and 4.0 million outstanding options with a weighted average strike price of $13.81. Goldman Sachs calculated indications of the net present value of the projected stand-alone future unlevered free cash flows for the Company for the remaining six months of the fiscal year ending June 2012 and the full fiscal years ending June 2013 through June 2016 using discount rates ranging from 10.0% to 12.0%, reflecting estimates of the Company s weighted average cost of capital. Goldman Sachs then calculated the

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Company s illustrative terminal values by applying terminal EV/EBITDA multiples ranging from 1.5x to 4.0x to the Company s estimated EBITDA for the fiscal year ended 2016. The results of the illustrative terminal value calculations were then discounted to present value using discount rates ranging from 10.0% to 12.0%. This analysis resulted in a range of implied present values of $6.26 to $14.81 per share of the Company s common stock.

Selected Precedent Transactions Analysis. Goldman Sachs analyzed certain publicly available information relating to selected transactions involving companies in the food retail industry since November 2000. For each of the selected transactions, Goldman Sachs calculated and compared enterprise value as a multiple of the target company s LTM EBITDA prior to the announcement of the applicable transaction. While none of the selected transactions or the selected companies that participated in the selected transactions are directly comparable to the merger or the Company, the companies that participated in the selected transactions are companies with operations that, for the purposes of analysis, may be considered similar to certain operations of the Company.

The following table presents the selected precedent transactions used by Goldman Sachs for its analysis:

Acquiror Target	Date of Announcement
Delhaize Group Delhaize America, LLC (acquisition of 55% interest not owned)	November 2000
Royal Ahold the Alliance Exchange, Inc.	September 2001
Willis Stein & Partners III, L.P. Roundy s, Inc.	April 2002
Albertson s Inc. JS USA Holdings Inc. (Shaw s Supermarkets)	March 2004
Supervalu Inc. Albertson s Inc.	January 2006
Sun Capital Partners IV, LP Marsh Supermarkets, Inc.	April 2006
The Great Atlantic & Pacific Tea Company, Inc. (A&P) Pathmark Stores, Inc.	March 2007

The following table sets forth the results of this analysis:

	EV Multiple of LTM EBITDA
Multiple for the Merger	3.5x
Multiple for the Merger - Adjusted Implied Total Consideration	4.8x
Selected Precedent Transactions	
High	10.3x
Low	6.6x
Median	8.1x

Premia Paid Analysis. Goldman Sachs reviewed and analyzed the acquisition premia for all announced or completed all cash transactions involving United States publicly-traded targets valued between $250 million and $750 million from January 2005 to December 15, 2011 (excluding transactions with undisclosed value, spinoffs, recapitalizations, tender offers, self-tender offers, repurchases, exchange offers, transactions in which a company was acquiring the remaining minority stake in a target company which it did not already own and privatization transactions), calculated relative to (i) the target s closing price one day prior to announcement; and (ii) the target s closing price four weeks prior to announcement, based on information obtained from Securities Data Company.

The following table presents the results of this analysis:

Premia	1-Day	4-Week
Premia for the Merger	65.2%	50.1%
Median Premia for Precedent Transactions	28.0%	33.0%

General

The preparation of a fairness opinion is a complex process and is not necessarily susceptible to partial analysis or summary description. Selecting portions of the analyses or of the summary set forth above, without considering the analyses as a whole, could create an incomplete view of the processes underlying Goldman Sachs opinion. In arriving at its fairness determination, Goldman Sachs considered the results of all of its analyses and did not attribute any particular weight to any factor or analysis considered by it. Rather, Goldman Sachs made its determination as to fairness on the basis of its experience and professional judgment after considering the results of all of its analyses. No company or transaction used in the above analyses as a comparison is directly comparable to the Company, Bi-Lo Holding, or the merger.

Goldman Sachs prepared these analyses for purposes of Goldman Sachs providing its opinion to the Special Committee that, as of December 16, 2011 and based upon and subject to the limitations, qualifications and assumptions set forth therein, the $9.50 per share in cash to be paid to the holders of shares of the Company s common stock pursuant to the merger agreement was fair from a financial point of view to such holders. These analyses do not purport to be appraisals nor do they necessarily reflect the prices at which businesses or securities may actually be sold. Analyses based upon forecasts of future results are not necessarily indicative of actual future results, which may be significantly more or less favorable than suggested by these analyses. Because these analyses are inherently subject to uncertainty, being based upon numerous factors or events beyond the control of the parties or their respective advisors, none of the Company, Bi-Lo Holding, Goldman Sachs or any other person assumes responsibility if future results are materially different from those forecast.

The merger consideration was determined through arm s-length negotiations between the Special Committee and Bi-Lo Holding and, consistent with the recommendation of the Special Committee was approved by the Company s board of directors. Goldman Sachs provided advice to the Special Committee during these negotiations. Goldman Sachs did not, however, recommend any specific amount of consideration to the Company, Special Committee or the Company s board of directors or that any specific amount of consideration constituted the only appropriate consideration for the merger.

As described above, Goldman Sachs opinion to the Special Committee was one of many factors taken into consideration by Special Committee in making its determination to recommend that the Company s board of directors approve the merger agreement. The foregoing summary does not purport to be a complete description of the analyses performed by Goldman Sachs in connection with its opinion and is qualified in its entirety by reference to the full text of the written opinion of Goldman Sachs attached as Annex B.

Goldman Sachs and its affiliates are engaged in investment banking and financial advisory services, commercial banking, securities trading, investment management, principal investment, financial planning, benefits counseling, risk management, hedging, financing, brokerage activities and other financial and non-financial activities and services for various persons and entities. In the ordinary course of those activities and services, Goldman Sachs and its affiliates may at any time make or hold long or short positions and investments, as well as actively trade or effect transactions, in the equity, debt and other securities (or related derivative securities) and financial instruments (including bank loans and other obligations) of the Company, Bi-Lo Holding and any of their respective affiliates and third parties, including Lone Star Fund V (U.S.), L.P., an affiliate of Holdings, and the family of investment funds commonly known as Lone Star Funds (collectively, Lone Star), and their affiliates and portfolio companies, or any currency or commodity that may be involved in the transaction contemplated by the merger agreement for their own account and for the accounts of their customers. Goldman Sachs has provided certain investment banking services to Lone Star and its affiliates and portfolio companies from time to time for which the Investment Banking Division of Goldman Sachs has received, and may receive, compensation. During the two year period ended December 16, 2011, the Investment Banking Division of Goldman Sachs has received compensation for services provided to Lone Star and its affiliates and portfolio companies of approximately $700,000. Goldman Sachs may also in the future provide investment banking services to the Company, Holdings and their respective affiliates and Lone Star and its

affiliates and portfolio companies for which the Investment Banking Division of Goldman Sachs may receive compensation. Affiliates of Goldman Sachs also may have co-invested with Lone Star and its affiliates from time to time and may have invested in limited partnership units of affiliates of Lone Star from time to time and may do so in the future.

The Special Committee selected Goldman Sachs as its financial advisor because it is an internationally recognized investment banking firm that has substantial experience in transactions similar to the merger. Pursuant to a letter agreement dated May 5, 2011, the Special Committee engaged Goldman Sachs to act as its financial advisor in connection with the merger. Pursuant to the terms of this engagement letter, the Company has agreed to pay Goldman Sachs a fee of approximately $7 million, $125,000 of which became payable upon execution of the merger agreement and the remainder of which is payable upon consummation of the merger. In addition, the Company has agreed to reimburse Goldman Sachs for certain of its expenses, including attorneys fees and disbursements, and to indemnify Goldman Sachs and related persons against certain liabilities that may arise out of its engagement, including certain liabilities under the federal securities laws.

Winn-Dixie Projected Financial Information

In connection with Lone Star s due diligence review, we provided to Lone Star certain projected financial information concerning us prepared by our management. Set forth below are summaries of the material projected financial information provided to Lone Star (the May 2011 Projections). The May 2011 Projections were prepared based on management s five-year plan as of May 2011 and assumed we would raise additional financing in the form of $100 million of convertible debt securities. In addition, Goldman Sachs was provided with certain projected financial information concerning us prepared by our management based on management s five-year plan as of July 2011 and without assuming the issuance of $100 million of convertible debt securities. Set forth below are summaries of the material projected financial information provided to Goldman Sachs (the July 2011 Projections and together with the May 2011 Projections, the Projections). Lone Star was also offered an opportunity to review the July 2011 Projections. The inclusion of the Projections in this proxy statement should not be regarded as an admission or representation of Winn-Dixie, Lone Star, Holdings or Merger Sub, or an indication that any of Winn-Dixie, Lone Star, Holdings or Merger Sub or their respective affiliates or representatives considered, or now consider, the Projections to be a reliable prediction of actual future events or results, and the Projections should not be relied upon as such. The Projections are being provided in this document only because Winn-Dixie made them available to Lone Star in connection with Lone Star s due diligence review of Winn-Dixie or to Goldman Sachs in connection with their engagement as financial advisor to the Special Committee. None of Winn-Dixie, Lone Star, Holdings or Merger Sub or any of their respective affiliates or representatives assumes any responsibility for the accuracy of the Projections or makes any representation to any shareholder regarding the Projections, and none of them intends to update or otherwise revise the Projections to reflect circumstances existing after the date when made or to reflect the occurrence of future events, even in the event that any or all of the assumptions underlying the Projections are shown to be in error.

The Projections were prepared by Winn-Dixie s management. The Projections were not prepared with a view to public disclosure or complying with U.S. generally accepted accounting principles (GAAP), the published guidelines of the SEC regarding projections or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information. Winn-Dixie s independent registered public accounting firm has not examined, compiled or performed any procedures with respect to the Projections presented in this proxy statement, and it has not expressed any opinion or any other form of assurance of such information or the likelihood that Winn-Dixie may achieve the results contained in the Projections, and accordingly assumes no responsibility for them and disclaims any association with them. The ultimate achievability of the Projections included herein is also subject to numerous risks and uncertainties including but not limited to the risks and uncertainties described in our Annual Report on Form 10-K for the

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fiscal year ended June 29, 2011 and subsequent filings made with the SEC. We have made publicly available our actual results of operations for the first quarter of fiscal 2012. You should review the Company s Quarterly Report on Form 10-Q for the quarter ended September 21, 2011 to obtain this information. Readers of this proxy statement are strongly cautioned not to place undue reliance on the Projections set forth below.

The Projections reflect numerous estimates and assumptions with respect to industry performance, general business, economic, regulatory, market and financial conditions, as well as matters specific to our business. Many of these matters are beyond our control and the continuing uncertainty surrounding general economic conditions and in the industry in which we operate creates significant uncertainty around the Projections. As a result, there can be no assurance that the projected results will be realized or that actual results will not be significantly higher or lower than projected. Because the Projections cover multiple years, such information by its nature becomes less reliable with each successive year. The Projections do not take into account any circumstances or events occurring after the date they were prepared, including the announcement of the merger. There can be no assurance that the announcement of the merger will not affect our business. Further, the Projections do not take into account the effect of any failure to occur of the merger and should not be viewed as accurate or continuing in that context.

In addition, the Projections included non-GAAP financial measures under SEC rules, including our earnings before interest expense, interest income, income taxes, depreciation and amortization and stock-based compensation expense (Adjusted EBITDA), earnings before interest expense, interest income, income taxes, depreciation and amortization, stock-based compensation expense and rent expense (Adjusted EBITDAR) and free cash flow. The Company provided this information to Lone Star and Goldman Sachs because the Company believed it could be useful in evaluating, on a prospective basis, the Company s potential operating performance and cash flow. This information should not be considered in isolation or in lieu of our operating and other financial information determined in accordance with GAAP. In addition, because non-GAAP financial measures are not determined consistently by all entities, the non-GAAP measures presented in the Projections may not be comparable to similarly titled measures of other companies. A reconciliation of Adjusted EBITDA, Adjusted EBITDAR and free cash flow to the most directly comparable GAAP measure (Net income (loss)), prepared by Winn-Dixie s management, is provided below. In the reconciliation tables below, numbers may not foot due to rounding.

Projected Financial Information (May 2011 Projections)

(dollars in millions)			**Fiscal year**		
	2012	**2013**	**2014**	**2015**	**2016**
Units (end of year)	483	484	488	495	502
% Same store sales growth	3.1%	2.3%	2.9%	3.1%	3.1%
Sales	$7,102	$7,317	$7,650	$8,078	$8,524
Gross profit	1,991	2,069	2,182	2,324	2,473
SG&A	2,012	2,073	2,167	2,281	2,385
Adjusted EBITDA	$125	$158	$196	$240	$290
Adjusted EBITDAR(1)	325	361	404	455	512
Net income (loss)	(38)	(21)	(1)	27	72
Depreciation and amortization	135	154	173	190	194
Free cash flow	$(94)	$(51)	$(43)	$(1)	$40
Cash (end of year)	134	83	40	38	79
Debt (end of year)	151	152	154	153	153

(1) Adjusted EBITDAR for each period from fiscal 2012-2016 as provided to Lone Star in the May 2011 Projections was inadvertently calculated on the basis of rent expense for the applicable prior year period, resulting in immaterial differences between Adjusted EBITDAR as provided to Lone Star and Adjusted EBITDAR calculated on the basis of rent expense for the appropriate period. Adjusted EBITDAR in the May 2011 Projections as provided to Lone Star was $323, $359, $399, $448 and $505 in fiscal 2012, 2013, 2014, 2015 and 2016, respectively. The corrected projected Adjusted EBITDAR amounts presented in this proxy statement were not identified prior to execution of the merger agreement and, consequently, were not provided to Lone Star prior to execution of the merger agreement. Adjusted EBITDAR in the July 2011 Projections was calculated on the basis of the appropriate rent expense projections.

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Reconciliation of Non-GAAP Measures (May 2011 Projections)

(dollars in millions)			Fiscal year		
	2012	**2013**	**2014**	**2015**	**2016**
Reconciliation of Adjusted EBITDA and Adjusted EBITDAR:					
Net income (loss)	(38)	(21)	(1)	27	72
Taxes (1)					
Interest expense, net	17	16	16	16	16
Depreciation and amortization	135	154	173	190	194
Stock-based compensation expense	11	8	8	7	7
Adjusted EBITDA	$125	$158	$196	$240	$290
Rent expense(2)	200	203	208	215	222
Adjusted EBITDAR	325	361	404	455	512
Reconciliation of Free Cash Flow					
Net income (loss)	(38)	(21)	(1)	27	72
Depreciation and amortization	135	154	173	190	194
Stock-based compensation expense	11	8	8	7	7
Change in working capital	14	6	10	10	10
Capital lease principal payments	(14)	(15)	(14)	(15)	(15)
Capital expenditures	(195)	(179)	(216)	(220)	(228)
Other cash expenses(3)	(7)	(5)	(3)		
Free cash flow	$(94)	$(51)	$(43)	$(1)	$40

(1) For periods in which the Company has projected taxable income, tax expense is assumed to be $0 based on the availability of net operating loss carryforwards.

(2) Consists of minimum rentals, contingent rentals and sublease rentals under operating leases.
(3) Consists of rent expense for discontinued stores.

Projected Financial Information (July 2011 Projections)

(dollars in millions)			Fiscal year		
	2012	**2013**	**2014**	**2015**	**2016**
Units (end of year)	486	487	491	498	505
% Same store sales growth	3.2%	2.3%	2.9%	3.1%	3.1%
Sales	$7,101	$7,342	$7,678	$8,106	$8,552
Gross profit	1,980	2,064	2,178	2,320	2,469
SG&A	1,987	2,050	2,144	2,259	2,364
Adjusted EBITDA	$127	$164	$201	$246	$295
Adjusted EBITDAR	328	368	410	462	518
Net income (loss)	(16)	5	25	51	95
Depreciation and amortization	122	141	160	178	183
Free cash flow	$(108)	$(37)	$(11)	$(2)	$50
Cash (end of year)	100	63	52	50	101
Debt (end of year)	61	67	70	71	73

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Reconciliation of Non-GAAP Measures (July 2011 Projections)

(dollars in millions)			**Fiscal year**		
	2012	**2013**	**2014**	**2015**	**2016**
Reconciliation of Adjusted EBITDA and Adjusted EBITDAR:					
Net income (loss)	(16)	5	25	51	95
Taxes(1)					
Interest expense, net	10	9	9	9	9
Depreciation and amortization	122	141	160	178	183
Stock-based compensation expense	11	8	8	7	7
Adjusted EBITDA	$127	$164	$201	$246	$295
Rent expense(2)	201	204	209	216	223
Adjusted EBITDAR(3)	$328	$368	$410	$462	$518
Reconciliation of Free Cash Flow					
Net income (loss)	(16)	5	25	51	95
Depreciation and amortization	122	141	160	178	183
Stock-based compensation expense	11	8	8	7	7
Change in working capital	5	6	10	10	10
Capital lease principal payments	(14)	(14)	(15)	(16)	(16)
Capital expenditures	(202)	(179)	(194)	(231)	(230)
Other cash expenses(4)	(14)	(5)	(3)		
Free cash flow(5)	$(108)	$(37)	$(11)	$(2)	$50

(1) For periods in which the Company has projected taxable income, tax expense is assumed to be $0 based on the availability of net operating loss carryforwards.

(2) Consists of minimum rentals, contingent rentals and sublease rentals under operating leases.

(3) On December 16, 2011, the Special Committee was also presented Adjusted EBITDAR calculated on the basis of rent expense defined as store rental expense only. Projected rent expense for stores only was $207, $211, $218, $227 and $237 for fiscal year 2012, 2013, 2014, 2015 and 2016, respectively, resulting in Adjusted EBITDAR of $333, $375, $419, $473 and $532 for fiscal year 2012, 2013, 2014, 2015 and 2016, respectively.

(4) Consists of rent expense for discontinued stores.

(5) On December 16, 2011, the Special Committee was also presented free cash flow calculated without adding back stock-based compensation expense or capital lease principal payments, resulting in free cash flow of $(106), $(31), $(3), $8 and $59 for fiscal year 2012, 2013, 2014, 2015 and 2016, respectively.

Certain Effects of the Merger

If the merger agreement is approved by our shareholders and the other conditions to the closing of the merger are either satisfied or waived, Merger Sub will be merged with and into us, and we will remain as the surviving corporation. When the merger is completed, we will cease to be a publicly traded company and will instead become a wholly owned subsidiary of Holdings.

When the merger is completed, each share of our common stock issued and outstanding immediately prior to the effective time of the merger (other than shares held by (i) us as treasury stock, (ii) by Holdings or Merger Sub and (iii) by any of our direct or indirect wholly owned subsidiaries, which will be cancelled immediately prior to the effective time of the merger and no consideration will be paid in respect to such cancellation), will be cancelled and converted into the right to receive $9.50 in cash, without interest and less any applicable withholding tax.

When the merger is completed, each share of common stock of Merger Sub issued and outstanding immediately prior to the effective time of the merger will be converted into one share of common stock of the surviving corporation. After the effective time of the merger, each certificate evidencing ownership of shares of Merger Sub common stock will evidence ownership of such shares of the surviving corporation.

The merger agreement provides that, immediately prior to the effective time of the merger, all options to purchase shares of our common stock that are outstanding immediately prior to the effective time and that are

vested or that, upon consummation of the merger, will automatically vest in accordance with their terms, will be cancelled by us and will be converted into the right to receive a cash payment equal to the excess, if any, of $9.50 per share in cash over the exercise price per share of the option, multiplied by the number of shares subject to the applicable option, without interest and less any applicable withholding tax. If the exercise price per share of any option is $9.50 or greater, the holder thereof will not receive any cash payment when the option is cancelled. All options to purchase shares of our common stock that are unvested at the effective time and that are not automatically vested pursuant to their terms by virtue of the merger will be cancelled, retired and cease to exist as of the effective time of the merger and the holders of such stock options will have no right to receive any consideration for such options. The merger agreement also provides that, except as otherwise agreed to in writing by Holdings and us, all restricted stock units that are outstanding immediately prior to the effective time and that, upon consummation of the merger, will automatically vest in accordance with their terms, will be converted into the right to receive $9.50 per share in cash, without interest and less any applicable withholding tax. All shares of restricted stock units subject to performance based vesting conditions that are unvested at the effective time and that are not automatically vested pursuant to their terms by virtue of the merger will be cancelled, retired and cease to exist as of the effective time of the merger and the holders of such performance based restricted stock units will have no right to receive any consideration for such units.

With respect to our ESPP, as of the effective time, any then current offering period under the ESPP shall be terminated and no new offering periods will begin under the ESPP after such date and no further shares of our common stock will be purchased under the ESPP. Winn-Dixie will refund any remaining cash (without interest) in a participant s account to such participant and terminate the ESPP.

At the effective time of the merger, our shareholders will have only the right to receive the merger consideration and will cease to have ownership interests in Winn-Dixie or rights as Winn-Dixie shareholders. Therefore, our shareholders will not participate in our future earnings or growth and will not benefit from any appreciation in our value.

Our common stock is currently registered under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act, and is quoted on The Nasdaq Global Select Market under the symbol WINN. As a result of the merger, Winn-Dixie will be a wholly owned subsidiary of Holdings, our common stock will cease to be quoted on The Nasdaq Global Select Market and there will be no public market for our common stock. In addition, the registration of our common stock under the Exchange Act will be terminated, and we will no longer be required to file periodic reports with the SEC.

Effects on Winn-Dixie if the Merger is Not Completed

If the merger agreement is not approved by our shareholders or if the merger is not completed for any other reason, our shareholders will not receive any payment for their shares in connection with the merger. Instead, we will remain an independent public company, and our common stock will continue to be quoted on The Nasdaq Global Select Market. In addition, if the merger is not completed, we expect that management will operate our business in a manner similar to that in which it is being operated today and that our shareholders will continue to be subject to the same risks and opportunities to which they are currently subject, including, without limitation, risks related to the highly competitive industry in which we operate and adverse economic conditions.

Furthermore, if the merger is not completed, and depending on the circumstances that would have caused the merger not to be completed, it is likely that the price of our common stock will decline significantly. If that were to occur, it is uncertain when, if ever, the price of our common stock would return to the price at which it trades as of the date of this proxy statement.

Accordingly, if the merger is not completed, there can be no assurance as to the effect of these risks and opportunities on the future value of your shares of our common stock. If the merger is not completed, our Board of Directors will continue to evaluate and review our business operations, properties, dividend policy and

capitalization, among other things, make such changes as are deemed appropriate and continue to seek to identify strategic alternatives to enhance shareholder value. If the merger agreement is not approved by our shareholders or if the merger is not completed for any other reason, there can be no assurance that any other transaction acceptable to us will be offered or that our business, prospects or results of operation will not be adversely impacted.

If the merger agreement is terminated, under certain circumstances we will be obligated to pay a termination fee of $19.6 million to Holdings upon or following such termination, and under certain other circumstances, Holdings will be required to pay us a closing failure fee of $72,825,000. See *The Merger Termination Fee and Closing Failure Fee.*

Financing of the Merger

Holdings has obtained equity and debt financing commitments, the aggregate proceeds of which will be sufficient to consummate the merger and the other transactions contemplated by the merger agreement. These commitments are described in more detail below. The funding under these commitments is subject to certain conditions, including conditions that do not relate directly to the conditions to closing in the merger agreement. Although obtaining the proceeds of any financing, including the financing under these commitments, is not a condition to Holdings obligation to complete the merger, the failure of Holdings and Merger Sub to obtain financing (whether under these commitments or otherwise) is likely to result in the failure of the merger to be completed. In that case, depending on the specific circumstances that led to such failure, Holdings may be obligated to pay us a fee of $72,825,000 as described under *The Merger Agreement Termination Fee and Closing Failure Fee* beginning on page 77.

Equity Financing

Holdings has delivered to us a copy of an equity financing commitment letter, dated December 16, 2011, pursuant to which the Lone Star Fund VII (U.S.), L.P. (the Sponsor) has, subject to customary terms and conditions, committed to provide an aggregate equity contribution in an amount of up to approximately $340.8 million to Holdings for the purpose of funding the equity portion of the financing for the closing of the transactions contemplated by the merger agreement. The amount actually funded under this equity commitment will be reduced on a dollar-for-dollar basis to the extent Holdings does not need the full amount of the commitment to complete the merger.

The Sponsor s obligations to fund the financing contemplated by the equity financing commitment letter for closing are generally subject to the satisfaction of the conditions to Holdings and Merger Sub s obligations to consummate the transactions contemplated by the merger agreement and the funding of the debt financing pursuant to the debt commitment letter.

Debt Financing

Pursuant to the debt commitment letter dated December 16, 2011, Citigroup Global Markets Inc. and Deutsche Bank Trust Company Americas (collectively, the Lenders) have committed to provide a $700 million senior secured asset-based revolving credit facility, up to $300 million of which would be available to finance the transactions contemplated by the merger agreement (the Revolving Closing Date Loans). In addition, the Lenders will provide an aggregate amount equal to the difference between $440 million and any Revolving Closing Date Loans to back stop outstanding letters of credit at closing.

The debt financing commitments are conditioned on the consummation of the merger in accordance with the merger agreement, as well as other customary conditions, including, but not limited to:

- the execution and delivery of definitive documentation consistent with the debt commitment letter;
- the absence of a Material Adverse Effect (as defined below);

- the payment in full of all fees, expenses and other amounts payable under the debt commitment letter;
- the accuracy of certain representations and warranties in the loan documents;
- the repayment of certain specified, existing indebtedness of Winn-Dixie and BI-LO Holding, LLC;
- the delivery of certain audited and unaudited financial statements;
- BI-LO, LLC s use of commercially reasonable efforts to provide the agents with certain appraisals and field examinations;
- BI-LO, LLC s use of commercially reasonable efforts to provide to the arrangers certain information included in a customary confidential information memorandum and customary lenders presentation; and
- the delivery of customary closing documents, including customary legal opinion, officers certificates, evidence of existing insurance, a borrowing base certificate and a solvency certificate.

The debt commitment letter is not subject to due diligence or a market out condition, which would allow the lenders not to fund their respective commitments if the financial markets are materially adversely affected. The debt commitment letter will terminate on the earliest of (i) June 13, 2012, (ii) the date definitive documentation becomes effective, (iii) the date the merger agreement is terminated and (iv) the date the merger is consummated (regardless of whether the revolving credit facility is funded on such date).

Interests of Our Directors and Executive Officers in the Merger

In addition to their interests in the merger as shareholders, certain of our directors and executive officers have interests in the merger that differ from, or are in addition to, your interests as a shareholder. Our Board of Directors was aware of, and considered the interests of, our directors and executive officers in approving and adopting the merger agreement and recommending that you vote **FOR** the approval of the merger agreement.

Common Stock, Stock Options and Restricted Stock Units to be Cashed Out in the Merger

The following table sets forth the cash proceeds that each of our directors and executive officers could receive at the closing of the merger from:

- the conversion of the shares of our common stock that they already hold into the merger consideration;
- the conversion of their vested in the money options to purchase shares of our common stock (i.e., options with a per-share exercise price less than $9.50) into the merger consideration;
- the accelerated vesting, as a result of the merger, of options to purchase shares of our common stock, and the conversion of such in the money options into the merger consideration; and
- the accelerated vesting, as a result of the merger, of restricted stock unit grants and the conversion of such restricted stock units into the merger consideration;

each based on his or her beneficial ownership as of January 4, 2012:

Name	Value of Shares of Common Stock Owned ($)	Value of Vested Stock Options ($)	Value of Unvested Stock Options that Vest upon the Merger ($)	Value of Restricted Stock Units that Vest upon the Merger ($)	Total Cash Payment With Respect to all Equity ($)
Non-Employee Directors					
Evelyn V. Follit	288,667			152,247	440,914
Charles P. Garcia	264,148			152,247	416,395
Jeffrey C. Girard	375,431			152,247	527,678
Yvonne R. Jackson	310,536			152,247	462,783
Gregory P. Josefowicz	389,681			152,247	541,928
James P. Olson	367,356			152,247	519,603
Terry Peets	385,472			152,247	537,719
Richard E. Rivera	374,243			152,247	526,490
Employee Director/Executive Officer:					
Peter L. Lynch	2,739,639	62,874	344,121	3,225,640	6,372,273
Other Executive Officers:					
Laurence B. Appel	423,311	21,837	105,741	1,007,494	1,558,384
Bennett L. Nussbaum	419,710	21,837	119,524	1,137,017	1,698,089
Christopher L. Scott, Sr.	124,726	6,618	36,224	279,091	446,659
Timothy L. Williams	15,067	3,014	25,153	273,933	317,166
James Smits	69,578	5,024	27,495	189,288	291,384
Matthew Gutermuth	78,508	5,024	27,495	202,949	313,975
Mary Kellmanson	55,927	5,024	27,495	198,056	286,502
Anita Dahlstrom-Gutel	23,494	3,014	49,649	232,123	308,280
Maura Hart	22,715	5,024	27,495	148,780	204,013
Lynn Schweinfurth	8,322	3,014	18,594	86,621	116,551
Michael Byrum	15,428	3,014	16,498	131,784	166,724
Frank O. Eckstein	413,602	7,483	14,966		436,051
Daniel Portnoy	150,328				150,328
All Directors and Executive Officers as a Group (22 Persons)	**7,315,889**	**152,800**	**840,451**	**8,330,750**	**16,639,889**

Employment Related Provisions of the Merger Agreement

The merger agreement provides that Holdings will provide our employees (including our executive officers) with certain compensation and other benefits. See *Proposal 1 The Merger Agreement Employee Benefits Matters*.

Information About Golden Parachute Compensation

We have several plans and agreements that provide for amounts to be paid or equity awards to accelerate in the event of a change in control. The merger will constitute a change in control under each of these plans. We describe each of these below and quantify the amounts that will be payable assuming the merger is completed and there is a termination of the named executive officers.

Equity Incentive Plans. In the event of a change in control, our Fiscal 2012 Equity Incentive Plan, Fiscal 2010 Equity Incentive Plan and Amended and Restated Equity Incentive Plan generally provide that all unvested stock options and restricted stock units, other than the outperformance stock options and restricted stock units described below, will become fully vested. In the event of a change in control, the outperformance stock options and outperformance restricted stock units will vest on a pro rata basis (rather than upon the achievement of

performance goals) based on the number of months that the employee is continuously employed by Winn-Dixie from date of grant of the outperformance stock option or outperformance restricted stock unit, as applicable, through the change in control date, divided by 60 months.

Severance Payments to Mr. Lynch. We have a written employment agreement with Mr. Lynch. Pursuant to the employment agreement, if his employment is terminated by us without cause (as defined below), or he resigns for good reason (as defined below), Mr. Lynch is entitled to receive the following severance payments, provided he executes a general release and waiver of claims:

- a monthly payment for the duration of the non-compete period (as defined below) equal to one-twelfth of the sum of his then current base salary and target annual incentive plan bonus;

- a pro rata annual incentive plan bonus for the fiscal year in which his employment ends based on our actual performance for such year, paid out after the end of such fiscal year; and

- continuation of medical and dental benefits during the non-compete period.

The non-compete period to which Mr. Lynch is subject is defined as the remaining portion of our fiscal year at the time his employment ends plus one year. The timing of the payment of each of these amounts is subject to payment restrictions imposed by Section 409A of the Code.

Cause is defined as a termination of Mr. Lynch based upon any of the following: (1) he has been convicted of (or pleads guilty or no contest to) a felony involving theft or moral turpitude; (2) he has engaged in conduct that constitutes gross misconduct in the performance of his duties; (3) he materially breaches the terms of the agreement and the breach is not fully cured within ten business days after we provide him with written notice; or (4) he materially breaches a written Company policy that is determined by the Board in good faith to be material to us, and the breach is not fully cured within ten business days after we provide him with written notice.

Good reason is defined as the following events that are taken by us without Mr. Lynch s consent: (1) a reduction of his base salary or bonus opportunity, other than in connection with any across-the-board reduction of base salaries or target bonus opportunities of all senior executives; (2) a failure to nominate him for election as Chairman of the Board; (3) a failure to appoint him as Chairman during the period he serves on the Board; (4) the failure of the acquirer of all or substantially all of the assets of the Company to assume the agreement if we are to be liquidated within a reasonable period of time following the acquisition; or (5) a material diminution in his duties or responsibilities; or (6) our decision not to renew the original term of the agreement or any renewal term.

If Mr. Lynch is entitled to any payments under the employment agreement or any other plan, program or arrangement under which he participates that would constitute an excess parachute payment subject to the excise tax imposed by Section 4999 of the Internal Revenue Code (the Excise Tax), and the amount of the parachute payment payable to Mr. Lynch is more than $50,000 greater than the threshold at which such amount becomes an excess parachute payment, then Winn-Dixie will pay to Mr. Lynch an additional amount (the Gross-up Payment) so that the net amount retained by him will be equal to the Excise Tax. The agreement also provides that if a reduction of $50,000 or less in the total amount of payments to Mr. Lynch would eliminate the need for the Gross-up Payment, then the amount of the payments will be reduced by the amount of the excess.

Executive Severance Plan. In January 2008, the Board of Directors adopted the Executive Severance Plan to help retain key team members and to provide these key team members with a measure of security so they can remain focused on helping to drive Company performance. Our named executive officers other than Mr. Lynch and Mr. Eckstein are participants in the plan (each, a Participant) and are entitled to the benefits under the plan. Mr. Lynch is not a participant in the Executive Severance Plan, as his severance arrangements are provided pursuant to the terms of his employment agreement. Mr. Eckstein retired effective December 1, 2011 and, in accordance with the terms of the plan, he is not entitled to additional benefits under the plan.

The plan provides that change in control severance is payable when we terminate the employment of a Participant without cause during the change in control period, or they resign for good reason during the change in control period. The following terms are defined in the plan:

- The change in control period is the period beginning one year preceding the announcement of a change in control through and including the 24 month period following a change in control.

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Cause includes any of the following: (1) they continually failed to substantially perform, or were grossly negligent in the discharge of, their duties to us; (2) they committed or engaged in an act of theft, embezzlement or fraud; (3) they are convicted of or plead guilty or *nolo contendere* to a felony or a misdemeanor with respect to which fraud or dishonesty is a material element; (4) they materially violated any material Company policy; or (5) they intentionally engaged in any other action or inaction that the plan administrator for the Executive Severance Plan determines was not taken in good faith for our best interests.

Good reason is defined as any of the following events that are taken by us without the Participant s consent: (1) a material diminution in base compensation; (2) a material diminution in authority, duties, or responsibilities; or (3) a material change in the geographic location at which services are to be performed for Winn-Dixie.

In connection with change in control severance, a Participant must execute a general release and waiver of claims that will include a two year non-disparagement, two year non-solicitation and five year non-disclosure agreement.

If change in control severance becomes due, Participants will receive six months of salary and one-half of the target annual incentive plan bonus then in place, plus a pro rata amount of the current target annual incentive plan bonus, in a lump sum cash payment after the effective date of the general release and waiver of claims executed by the Participant, subject to payment restrictions imposed by Section 409A of the Code. For each additional full week the Participant remains unemployed after six months, he or she will receive an additional week of salary and 1/52nd of the target annual incentive plan bonus, up to a total of 18 months of salary and 1.5 times the target annual incentive plan bonus. Participants will also be entitled to company-paid COBRA continuation of medical and dental benefits for up to 18 months; provided that after the initial 18 month COBRA period expires, the company will pay directly to the Participant an amount equal to the COBRA premium grossed up for income taxes for up to an additional 6 months. These additional change in control severance payments will cease when the Participant secures an equivalent position with a new employer. If a Participant secures a lower paying position, we will reduce the weekly payment due to the Participant by the weekly salary earned by the Participant. The additional change in control severance payments paid following the initial lump sum cash payment will be paid in cash in monthly installments in accordance with Winn-Dixie s normal payroll dates and are subject to Participant reporting of continued unemployment.

If a Participant is entitled to change in control severance under the plan and if the payments due from Winn-Dixie under the plan will be subject to the tax imposed by Section 4999 of the Internal Revenue Code (the Excise Tax), Winn-Dixie will pay to or for the benefit of the Participant an additional amount (the Gross-up Payment) so that the net amount retained by the Participant (after deduction of any Excise Tax on Winn-Dixie payments and any U.S. federal, state and local income or payroll tax upon the Gross-up Payment, but before deduction for any U.S. federal, state and local income or payroll tax on Winn-Dixie payments) will be equal to the Winn-Dixie payments.

The plan also provides that if a reduction of $50,000 or less in the total amount of change in control severance benefit otherwise payable to a Participant would eliminate the need for the Gross-up Payment, then the amount of the change in control severance benefit will be reduced by the amount of the excess.

Aggregate Amounts of Potential Compensation. The following table sets forth, in the format prescribed by SEC rules and regulations, the information regarding the aggregate dollar value of the various elements of compensation that could be received by the named executive officers that is based on or otherwise relates to the merger. In preparing the table, we made the following assumptions:

the merger will close on March 31, 2012;

the employment of the named executive officers that were employed by Winn-Dixie at the time of the merger closing was terminated on March 31, 2012, either by Winn-Dixie without cause or by the named executive officers for good reason;

the named executive officers (other than Mr. Lynch) remain unemployed for two years following the date of their termination of employment;

all outstanding stock options vest (other than the outperformance stock options) and the holders thereof will receive an amount in cash equal to the product of (i) the total number of shares subject to such stock option, multiplied by (ii) the excess, if any, of $9.50 over the exercise price per share of such stock option;

all outstanding restricted stock units vest (other than the outperformance restricted stock units), and the holders thereof will receive an amount in cash equal to $9.50 for each such vested unit;

a pro rata portion of the outperformance stock options vest based on the number of months that the named executive officer is continuously employed by Winn-Dixie from the date of grant of the applicable award through March 31, 2012, divided by 60 months, and the holders thereof will receive an amount in cash equal to the product of (i) the total number of shares subject to such stock option, multiplied by (ii) the excess, if any, of $9.50 over the exercise price per share of such stock option;

a pro rata portion of the outperformance restricted stock units vest based on the number of months that the named executive officer is continuously employed by Winn-Dixie from the date of grant of the applicable award through March 31, 2012, divided by 60 months, and the holders thereof will receive an amount in cash equal to $9.50 for each such vested unit; and

no shares are withheld by Winn-Dixie to cover the tax obligations of the named executive officers upon the vesting or payment of stock options or restricted stock units.

In addition to the above assumptions, the costs of providing continued medical and dental benefits and the tax reimbursements are based on estimates. Any changes in these assumptions or estimates would affect the amounts shown in the following table.

Golden Parachute Compensation

Name	Cash ($) (1)	Equity ($) (2)	Pension/ NQDC ($) (3)	Perquisites/ Benefits ($) (4)	Tax Reimburse-ments ($) (5)	Other ($)	Total ($)
Peter L. Lynch	4,374,063	3,587,930		11,447			7,973,440
Bennett L. Nussbaum	2,595,435	1,262,586		33,634			3,891,655
Laurence B. Appel	2,344,210	1,119,283		33,187			3,496,680
Timothy L. Williams	1,423,820	299,071		33,634	532,128		2,288,653
Christopher L. Scott, Sr.	1,275,936	315,298		32,570			1,623,804
Frank O. Eckstein							
Daniel Portnoy	1,134,893						1,134,893

(1) For Mr. Lynch, amount represents the cash severance payable pursuant to his employment agreement. The amount equals (i) one-twelfth of the sum of his current base salary and target annual incentive plan bonus for fiscal 2012 multiplied by the number of months in his non-compete period, and (ii) a pro rata annual incentive plan bonus for fiscal 2012 based on our actual performance for such year. With respect to (ii), we have assumed a payout under the annual incentive plan for fiscal 2012 at the target level of performance. The non-compete period is assumed to be 15 months (April 1, 2012 through June 30, 2013). This amount is payable only upon termination of Mr. Lynch.

For the other executive officers, amounts represent the cash severance payable pursuant to the Executive Severance Plan. The amounts equal the sum of two years of current base salary and two times the target annual

incentive plan bonus for fiscal 2012, plus the prorated current year target annual incentive plan bonus. These amounts are payable only upon the occurrence of the double trigger of a change in control and a termination of the named executive officer without cause or by the named executive officer for good reason during the change in control period. Because Mr. Portnoy was terminated effective January 5, 2011, which is within the one year period preceding the announcement of a change in control, under the Executive Severance Plan he is entitled to receive these amounts upon the completion of the merger. Mr. Eckstein is not entitled to receive any cash severance as a result of the merger, as he retired effective December 1, 2011 and therefore is not eligible to participate in the Executive Severance Plan.

The following table quantifies each element of the cash severance reported in the column for the named executive officers:

Name	Base Salary ($)	Annual Incentive Plan Bonus ($)
Peter L. Lynch	1,681,625	2,692,438
Bennett L. Nussbaum	1,235,600	1,359,835
Laurence B. Appel	1,116,000	1,228,210
Timothy L. Williams	780,000	643,820
Christopher L. Scott, Sr.	650,000	625,936
Frank O. Eckstein		
Daniel Portnoy		1,134,893

(2) Amounts represent the cash to be received upon completion of the merger due to the accelerated vesting of unvested stock options and restricted stock units. These amounts are payable upon the occurrence of the single trigger of a change in control. Mr. Portnoy does not hold any unvested stock options or restricted stock units that are subject to accelerated vesting upon a change in control. Mr. Eckstein would not hold any unvested stock options or restricted stock units that are subject to accelerated vesting upon a change in control as of March 31, 2012.

Name	Accelerated Vesting of Stock Option ($)	Accelerated Vesting of Restricted Stock Units($)
Peter L. Lynch	344,120	3,243,810
Bennett L. Nussbaum	119,524	1,143,062
Laurence B. Appel	105,740	1,013,543
Timothy L. Williams	25,152	273,919
Christopher L. Scott, Sr.	36,224	279,074
Frank O. Eckstein		
Daniel Portnoy		

(3) We do not have any defined benefit pension plans. Although Mr. Lynch s employment agreement provides for a deferred compensation award, no amount is payable in connection with the merger, nor are there any benefit enhancements in connection with the merger.

(4) For Mr. Lynch, the amount represents the cash payment to cover the continuation of benefits during the non-compete period of 15 months. This amount is payable only upon termination of Mr. Lynch. For the other named executive officers, the amount represents the cash payment to cover the continuation of benefits during the two-year period following the executive s termination of employment and the gross-up with respect to medical continuation for the 6 months after the initial 18 month COBRA period. This amount is payable only upon termination of the executive.

(5) Amount represents the estimated change in control gross-up payment payable to the named executive officers (other than Mr. Lynch) pursuant to the Executive Severance Plan. In determining the estimated tax gross-up, we

assumed an excise tax rate under 280G of the Internal Revenue Code of 20%, a 35% federal income tax rate and a 1.45% Medicare tax rate. In addition, no value was ascribed to the applicable non-competition provisions of the Executive Severance Plan. Based on these assumptions, only Mr. Williams would be entitled to a gross-up payment, and the amount of such payment may be decreased after determining a value for such non-competition provisions. The amount is payable only upon the occurrence of the double trigger of a change in control and a termination of the named executive officer without cause or by the named executive officer for good reason during the change in control period. Although Mr. Lynch is eligible to receive a gross-up payment pursuant to his employment agreement, no amount would be due.

Directors and Officers Indemnification and Insurance

The merger agreement provides that each of Holdings and the surviving corporation will indemnify, to the fullest extent permitted by law, each present and former director or officer of Winn-Dixie, whom we refer to as the indemnified parties, in respect of actions, omissions or events of such person through the effective time of the merger. For a period of six years after the effective time of the merger, unless otherwise required by applicable law, all rights to indemnification, advancement of expenses and exculpation of directors and officers that are set forth in our articles of incorporation and bylaws, the certificates of incorporation or bylaws or any other organizational documents of our subsidiaries, our benefit plans and any agreement between us and a director or officer which is included as an exhibit to our filings with the SEC, in each case as in effect on the date of the merger agreement, shall continue in full force and effect in accordance with their terms.

The merger agreement further provides that Holdings shall either, (1) maintain in effect our current officers and directors liability insurance policies for a period of six years after the effective time of the merger, (2) obtain an insurance policy with a claims period of at least six years from the effective time of the merger with respect to directors and officers liability insurance the terms of which, including coverage and amount, are no less favorable in any material respect than our existing policies or (3) request that Winn-Dixie obtain prior to the effective time extended coverage for the six year period under its existing insurance programs, in each case, so long as the annual premium is not in excess of 250% of the amount of the annual premiums paid by Winn-Dixie for fiscal year 2011 for such purpose; provided that Holdings will nevertheless be obligated to obtain as much coverage as can be obtained for the remainder of such period for a premium not in excess of 250% of the fiscal year 2011 premium. However, in lieu of the arrangements described above, we may obtain a tail insurance policy so long as the cost of such policy does not exceed a specified amount.

In connection with the execution of the merger agreement, we entered into an Expense Advance Agreement with each of our current directors, which agreement provides that if any director incurs any expenses in defending any civil or criminal proceeding brought in connection with such director s service on the Board of Directors, such expenses shall be advanced by us, to the fullest extent permitted by law. Prior to the advancement of any expenses, the applicable director is required to deliver an undertaking to repay such advanced expenses if he or she is ultimately found not to be entitled to indemnification by us pursuant to the applicable provisions of our amended and restated articles of incorporation and amended and restated by-laws.

Our obligations under the Expense Advance Agreement shall continue with respect to each director following the time that such person ceases to be a director of Winn-Dixie, so long as such person is subject to any proceeding covered by the Expense Advance Agreement, whether or not such person is acting or serving in any such capacity at the time any liability or expense is incurred for which indemnification can be provided under the Expense Advance Agreement.

Continued Employment of Executive Officers

Certain of our executive officers may receive cash or other non-equity compensation from the Company, Holdings or affiliates of Holdings for services to be rendered in the future in connection with their continued employment following the closing of the merger.

On January 11, 2012, Mr. Lynch entered into an Executive Retention Bonus Agreement (the Retention Bonus Agreement) with Bi-Lo Holding. Pursuant to the terms of the Retention Bonus Agreement, after the closing of the merger, Mr. Lynch will no longer be the Chairman, Chief Executive Officer and President of Winn-Dixie but will remain employed by Winn-Dixie as an adviser. Contingent upon the closing of the merger, if Mr. Lynch remains employed with Winn-Dixie from the date of the merger agreement through the end of the first full consecutive 28 day period, commonly known as a grocery period, following the closing of the merger, he will have the opportunity to earn from Winn-Dixie (i) a performance bonus of up to $750,000 if Winn-Dixie meets certain fiscal 2012 targets during such period and (ii) a discretionary bonus of up to $750,000 if it is determined in good faith by Bi-Lo Holding at the sole discretion of the Board of Directors of Bi-Lo Holding that Mr. Lynch has completed certain objectives during such period, including, among others, assisting with the transition of the new management and the integration of Winn-Dixie with Bi-Lo Holding. The Retention Bonus Agreement will have no effect on Mr. Lynch s existing employment agreement and his rights thereunder.

On January 25, 2012, Mr. Nussbaum entered into a Post-Closing Employment Agreement (the Post-Closing Employment Agreement) with Bi-Lo Holding. Pursuant to the terms of the Post-Closing Employment Agreement, after the closing of the merger, Mr. Nussbaum will cease to serve as Chief Financial Officer of the Company but will remain employed with the Company as its integration lead. Mr. Nussbaum s employment will be at will and will terminate upon either party giving 90 days advance notice to the other of termination of the employment relationship; provided that the Company may choose to pay Mr. Nussbaum his base salary through the end of such 90 day period in lieu of giving notice. In connection with his employment following the merger, Mr. Nussbaum will receive a base monthly salary of $51,483.33 from the Company. He will also be eligible to receive an annual incentive plan bonus for the fiscal year ending on or about June 30, 2012, prorated to March 31, 2012, based on actual performance for such year. In addition, for each calendar quarter beginning on April 1, 2012 during which Mr. Nussbaum is employed as the Company s integration lead, he will be eligible for a quarterly performance bonus from the Company of up to $150,000 per calendar quarter, in lieu of any other bonus or incentive pay, as determined in the sole discretion of the Board of Directors of the Company. The Post-Closing Employment Agreement preserves all of Mr. Nussbaum s rights under the Executive Severance Plan. Prior to the closing of the merger, other of our executive officers may also enter into retention or employment arrangements with Bi-Lo Holding or Holdings.

Adoption of FIFO Method of Accounting

In the merger agreement, we agreed to change and cause each of our applicable direct and indirect subsidiaries to change our and each such subsidiary s method of valuing inventory for federal and state income tax purposes from the last-in, first-out method to the first-in, first-out method for our taxable year ended June 29, 2011, prior to the earlier of (i) the filing of our federal income tax return for the taxable year ended June 29, 2011 and (ii) March 15, 2012. The adoption of the FIFO method of accounting would result in our recognizing taxable income of approximately $210 million, allocated among the taxable year of the change and the three following taxable years. This taxable income could be set off against our accumulated net operating loss carryforwards, resulting in a reduction in such net operating loss carryforwards (assuming that the merger did not occur) from approximately $750 million to approximately $540 million. We currently maintain a full valuation allowance against substantially all of our net deferred tax assets. The valuation allowance will be maintained until there is sufficient positive evidence to conclude that it is more likely than not that the net deferred tax assets will be realized.

Material United States Federal Income Tax Consequences of the Merger

The following is a discussion of the material United States federal income tax consequences of the merger to holders of our common stock who exchange their shares for cash in the merger. The discussion is based upon the Internal Revenue Code of 1986, as amended (the Code), U.S. Treasury regulations and judicial and administrative decisions in effect as of the date of this proxy statement, all of which are subject to change (possibly with retroactive effect) or to different interpretations, which could affect the U.S. federal income tax consequences discussed in this discussion in a material and adverse manner. The following discussion does not

purport to consider all aspects of U.S. federal income taxation that might be relevant to you. This discussion applies only to shareholders who, on the date on which the merger is completed, hold shares of our common stock as a capital asset within the meaning of Section 1221 of the Code. The following discussion does not address taxpayers subject to special treatment under U.S. federal income tax laws, such as insurance companies, financial institutions, dealers in securities, traders in securities who elect to mark their securities to market, tax-exempt organizations, mutual funds, real estate investment trusts, S corporations, taxpayers subject to the alternative minimum tax, U.S. expatriates, controlled foreign corporations, passive foreign investment companies, corporations that accumulate earnings to avoid United States federal income tax and persons holding their shares as part of a hedge, straddle, conversion transaction or other integrated transaction. In addition, the following discussion may not apply to shareholders who acquired their shares of our common stock upon the exercise of employee stock options or otherwise as compensation for services or through a tax-qualified retirement plan. This discussion does not address the receipt of cash in connection with the cancellation of stock options or any other matters related to equity compensation or benefit plans. The following discussion does not address potential foreign, state, local, estate and gift and other tax consequences of the merger.

For purposes of this discussion, a U.S. holder is a holder of shares of our common stock who or that is, for U.S. federal income tax purposes:

- an individual who is a citizen or resident of the United States;
- a corporation (or other entity taxable as a corporation) created or organized in or under the laws of the United States, any state of the U.S. or the District of Columbia;
- an estate the income of which is subject to U.S. federal income tax regardless of its source; or
- a trust if (1) a U.S. court is able to exercise primary supervision over the trust s administration and one or more U.S. persons are authorized to control all substantial decisions of the trust; or (2) it has a valid election in place to be treated as a United States domestic trust for U.S. federal income tax purposes.

A non-U.S. holder is a person who or that is not a U.S. holder and not a partnership (or other pass-through entity) for U.S. federal income tax purposes.

If shares of our common stock are held by a partnership (or other pass-through entity), the U.S. federal income tax treatment of a partner in the partnership (or owners of such pass-through entity) will generally depend upon the status of the partner or owner and the activities of the entity. Partnerships (or other pass-through entities) that hold shares of our common stock and partners (or owners) of such entities are urged to consult their own tax advisors regarding the tax consequences to them of the merger.

All shareholders are urged to consult their own tax advisors regarding the U.S. federal income tax consequences, as well as the foreign, state and local tax consequences, of the disposition of their shares in the merger.

U.S. Holders

For U.S. federal income tax purposes, the merger will be treated as a taxable sale of our common stock for cash by each of our shareholders. Accordingly, if you are a U.S. holder, the U.S. federal income tax consequences to you generally will be as follows:

- You will recognize a capital gain or loss upon the disposition of your shares of our common stock pursuant to the merger.
- The amount of capital gain or loss you recognize will be measured by the difference, if any, between the amount of cash you receive in the merger and your adjusted tax basis in the shares of our common stock surrendered in the merger. Gain or loss will be determined separately for each block of shares (i.e. shares acquired at the same cost in a single transaction).

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- The capital gain or loss, if any, will be long-term capital gain or loss with respect to shares of our common stock that have a holding period for tax purposes in excess of one year at the time of the merger. Long-term capital gains of individuals are eligible for reduced rates of taxation. There are limitations on the deductibility of capital losses.

Cash payments made pursuant to the merger will be reported to our shareholders and the Internal Revenue Service to the extent required by the Code and applicable Treasury regulations. These amounts ordinarily will not be subject to withholding of U.S. federal income tax. However, backup withholding at applicable rates may apply to all cash payments to which a non-corporate U.S. holder is entitled pursuant to the merger agreement if such holder (1) fails to (A) supply the paying agent with such holder s taxpayer identification number (Social Security number, in the case of individuals, or employer identification number, in the case of other shareholders), (B) certify that such number is correct and (C) otherwise comply with the backup withholding rules, (2) has received notice from the Internal Revenue Service of a failure to report all interest and dividends as required or (3) is subject to backup withholding in certain other cases. Certain holders (including corporations) are not subject to backup withholding. Accordingly, each U.S. holder will be asked to complete and sign a Substitute Form W-9, which will be included in the appropriate letter of transmittal for the shares of our common stock, to provide the information and certifications necessary to avoid backup withholding, unless an exemption applies and is established in a manner satisfactory to the paying agent.

Backup withholding is not an additional tax. Any amounts withheld from your proceeds under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability provided the required information is timely furnished to the Internal Revenue Service.

Non-U.S. Holders

Any gain realized on the receipt of cash in the merger by a non-U.S. holder generally will not be subject to United States federal income tax unless:

- the gain is effectively connected with the conduct of a trade or business by the non-U.S. holder in the United States (and, if required by an applicable income tax treaty, is attributable to a United States permanent establishment of the non-U.S. holder);

- the non-U.S. holder is an individual who is present in the United States for 183 days or more in the taxable year of the merger and certain other conditions are met; or

- Winn-Dixie is or has been a United States real property holding corporation for U.S. federal income tax purposes and the non-U.S. holder owned more than 5% of Winn-Dixie s common stock at any time during the shorter of the five years preceding the merger or such non-U.S. holder s holding period.

A non-U.S. holder described in the first bullet point above will be subject to tax on its net gain under regular graduated U.S. income tax rates in the same manner as if it were a U.S. person as defined under the Code. In addition, if a non-U.S. holder that is a foreign corporation falls under the first bullet point above, such holder may be subject to a branch profits tax equal to 30% of its effectively connected earnings and profits or at such lower rate as may be specified by an applicable income tax treaty. An individual non-U.S. holder described in the second bullet point above will be subject to a flat 30% tax (or such lower rate as may be specified by an applicable income tax treaty) on the gain derived from the merger, which may be offset by U.S. source capital losses, even though the individual is not considered a resident of the United States.

Winn-Dixie believes that it is not and has not been a United States real property holding corporation for U.S. federal income tax purposes.

Cash received by a non-U.S. holder in the merger will be subject to information reporting and backup withholding, unless the non-U.S. holder certifies its exempt non-U.S. status under penalties of perjury on an applicable Internal Revenue Service Form W-8 or otherwise establishes an exemption.

Backup withholding is not an additional tax. Any amounts withheld from your proceeds under the backup withholding rules may be allowed as a refund or a credit against your U.S. federal income tax liability provided that the required information is timely furnished to the Internal Revenue Service.

The foregoing discussion of certain material U.S. federal income tax consequences is included for general informational purposes only and is not intended to be, and should not be construed as, legal or tax advice to any holder of shares of our common stock. We urge you to consult your own tax advisor to determine the particular tax consequences to you (including the application and effect of any state, local or foreign income and other tax laws) of the receipt of cash in exchange for shares of our common stock pursuant to the merger.

Appraisal Rights

None of our shareholders or any other person will have any appraisal or dissenters rights with respect to our common stock, pursuant to our organizational documents or Florida law or any other provision of applicable law, in connection with the merger, approval of the merger agreement or any other transaction contemplated by the merger agreement.

HSR Act Approval

The HSR Act and related rules provide that transactions such as the merger may not be completed until the parties submit a Notification and Report Form to the Antitrust Division of the DOJ and the FTC and certain waiting period requirements have been satisfied. Winn-Dixie and Lone Star Guarantor each filed its Notification and Report Form on December 30, 2011, and on January 12, 2012, early termination of the applicable waiting period under the HSR Act was granted.

Under the merger agreement, Winn-Dixie and Holdings agreed to use their reasonable best efforts to defend any lawsuits or other legal proceedings, whether judicial or administrative, challenging the merger agreement, including seeking to have any temporary restraining or interim order entered by any governmental authority vacated or reversed. The obligations of Holdings under these provisions include the obligation of Holdings to, and to cause its affiliates (include its direct and indirect parent companies) to, sell, license, or dispose of certain assets, in each case in exchange for obtaining the expiration of the waiting period under the HSR Act; provided, however, that Holdings and its affiliates are not required to take any such action that, individually or in the aggregate, would reasonably be likely to cause the debt financing for the merger to be unavailable at the closing of the merger.

Limited Guarantee

Lone Star Guarantor provided us with a direct guarantee of the full and prompt payment and performance of certain payment obligations of Holdings and Merger Sub arising under the merger agreement (including payment of the $72,825,000 termination fee) as limited pursuant to the terms of the merger agreement; provided that Lone Star Guarantor s liability under the guarantee will not exceed $72,825,000.

Shareholder Litigation

Seven complaints challenging the merger have been filed in the Circuit Court of the Fourth Judicial District in and for Duval County, Florida by plaintiffs seeking to represent a class of Winn-Dixie shareholders: *United Union Roofers, Waterproofers and Allied Workers Local Union No. 8 v. Winn-Dixie Stores, Inc., et al.,* Case No. 16-2011-CA-010616-XXXX-MA (filed December 20, 2011); *Sunberg, et al. v. Winn-Dixie Stores, Inc., et al.,* Case No. 16-2011-CA-010667-XXXX-MA (filed December 21, 2011); *Murphy v. Winn-Dixie Stores, Inc., et al.,* Case No. 16-2011-CA-010670-XXXX-MA (filed December 21, 2011); *Raul v. Winn-Dixie Stores, Inc., et al.,* Case No. 16-2011-CA-010699-XXXX-MA (filed December 22, 2011); *Schultze Asset Mgmt., LLC v. Winn-Dixie Stores, Inc., et al.,* Case No. 16-2011-010722-XXXX-MA (filed December 22, 2011); *Chauncey v. Winn-Dixie Stores, Inc., et al.,* Case No. 16-2011-010808-XXXX-MA (filed December 27, 2011); and *Thomas Pilling v. Winn-Dixie Stores, Inc., et al.,* Case No. 11ca10900 (filed December 28, 2011). All seven of these cases have been consolidated and Plaintiff *Schultze Asset Mgmt., LLC* appointed as Lead Plaintiff.

On January 26, 2012, Lead Plaintiff filed an amended complaint alleging, among other things, that the consideration agreed to in the merger agreement is inadequate and unfair to Winn-Dixie shareholders, that this proxy statement contains materially misleading disclosures or omissions regarding the proposed transaction, and that the members of Winn-Dixie s Board of Directors breached their fiduciary duties in approving the merger agreement and issuing this proxy statement. The Lead Plaintiff also alleges that those alleged breaches of fiduciary duty were aided and abetted by Winn-Dixie and the entities affiliated with BI-LO, LLC named in the various complaints. The plaintiffs seek equitable relief, including an injunction prohibiting consummation of the merger, and rescission or rescissory damages if the merger is consummated. The defendants responses to the amended complaint are not yet due.

One complaint challenging the merger has been filed in the United States District Court for the Middle District of Florida: *Walter v. Winn-Dixie Stores, Inc., et al.,* Case No. 3:12-CV-68-J-20MCR (filed on January 20, 2012). Like the plaintiffs in the consolidated case pending in state court, the plaintiff in *Walter* seeks to represent a class of Winn-Dixie shareholders and alleges, among other things, that the consideration agreed to in the merger agreement is inadequate and unfair to Winn-Dixie shareholders, that this proxy statement contains materially misleading disclosures or omissions regarding the proposed transaction, and that the members of Winn-Dixie s Board of Directors breached their fiduciary duties in approving the merger agreement and issuing this proxy statement. The plaintiff in *Walter* also asserts claims against BI-LO LLC; Opal Merger Sub, Inc.; BI-LO Holding, LLC; Lone Star Fund V (U.S.), L.P.; and Lone Star Funds, alleging that these entities, along with Winn-Dixie Stores, Inc., aided and abetted the alleged breaches of fiduciary duty. The defendants responses to the *Walter* complaint are not yet due.

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PROPOSAL 1 THE MERGER AGREEMENT

The merger agreement is the legal document that governs the merger. This section of the proxy statement describes the material provisions of the merger agreement but may not contain all of the information about the merger agreement that is important to you. A copy of the merger agreement is included as Annex A to this proxy statement and is incorporated into this proxy statement by reference. You should read the merger agreement carefully and in its entirety. The merger agreement attached as Annex A to this proxy statement has been included to provide you with information regarding its terms. It is a commercial document that establishes and governs the legal relations between us, Holdings and Merger Sub with respect to the transactions described in this proxy statement. It is not intended to be a source of factual, business or operational information about us, Holdings or Merger Sub. The representations, warranties and covenants made by us, Holdings and Merger Sub are qualified and subject to important limitations agreed to by us, Holdings and Merger Sub in connection with negotiating the terms of the merger agreement, including information in a disclosure letter that the Company has provided to Holdings and Merger Sub. Furthermore, the representations and warranties may be subject to standards of materiality applicable to us, Holdings and Merger Sub that may be different from that which is applicable to you. These representations and warranties may or may not have been accurate as of any specified date and do not purport to be accurate as of the date of this proxy statement. Accordingly, you should not rely on the representations and warranties as characterizations of the actual state of facts at the time they were made or otherwise.

Form of the Merger

Upon the terms and subject to the conditions of the merger agreement and in accordance with Florida law, at the effective time of the merger, Merger Sub, a wholly owned subsidiary of Holdings created solely for the purpose of engaging in the transactions contemplated by the merger agreement, will merge with and into Winn-Dixie. The separate corporate existence of Merger Sub will cease, and Winn-Dixie will continue as the surviving corporation and will become a wholly owned subsidiary of Holdings.

Effective Time of the Merger

The merger will become effective upon the filing of the articles of merger with the Florida Department of State or at such later time as is agreed upon by Merger Sub and us and specified in the articles of merger in accordance with Florida law.

The closing of the merger is expected to occur on the second business day after the conditions to the merger set forth in the merger agreement have been satisfied or waived or at such other time agreed to by us and Holdings. Although we expect to complete the merger shortly after the special meeting of our shareholders, we cannot specify when, or assure you that, we and Holdings will satisfy or waive all conditions to the merger.

Articles of Incorporation and Bylaws

The articles of incorporation and the bylaws of the surviving corporation will be amended and restated in their entirety at the effective time of the merger in the form agreed by Winn-Dixie, Holdings and Merger Sub until thereafter amended in accordance with the provisions thereof and as provided by law.

Directors and Officers of the Surviving Corporation

The directors of Merger Sub immediately prior to the effective time of the merger will be the initial directors of the surviving corporation. The officers of Winn-Dixie immediately prior to the effective time of the merger will be the initial officers of the surviving corporation. The directors and officers will serve in accordance with the articles of incorporation and bylaws of the surviving corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified.

Merger Consideration

At the effective time of the merger, each share of our common stock issued and outstanding immediately prior to the effective time of the merger will be cancelled and automatically converted into the right to receive $9.50 in cash, without interest. The following shares of common stock will not receive the $9.50 per share merger consideration, all of which shares will be automatically cancelled without any payment of consideration with respect thereto: (i) shares held by us as treasury stock immediately prior to the effective time of the merger, (ii) shares held by Holdings or Merger Sub immediately prior to the effective time of the merger, and (iii) shares held by any direct or indirect wholly owned subsidiary of us immediately prior to the effective time of the merger.

Holdings, the surviving corporation, Winn-Dixie, Merger Sub and the paying agent will be entitled to deduct and withhold from the consideration otherwise payable to any holder of shares of our common stock, stock options or restricted stock units such amounts for taxes that it is required to deduct and withhold with respect to making such payment under all applicable tax laws.

Effect on Stock Options and Restricted Stock Units

The merger agreement provides that, at the effective time of the merger, all options to purchase shares of our common stock that are outstanding immediately prior to the effective time and that are vested or that, upon consummation of the merger, will automatically vest in accordance with their terms, will be cancelled by us and will be converted into the right to receive a cash payment equal to the excess, if any, of $9.50 per share in cash over the exercise price per share of the option, multiplied by the number of shares subject to the applicable option, without interest and less any applicable withholding tax. If the exercise price per share of any option is $9.50 or greater the holder thereof will not receive any cash payment when the option is cancelled. All options to purchase shares of our common stock that are unvested at the effective time and that are not automatically vested pursuant to their terms by virtue of the merger will be cancelled, retired and cease to exist as of the effective time of the merger. The holders of such stock options will have no right to receive any consideration for such options.

The merger agreement provides that, at the effective time of the merger, restricted stock units that are outstanding immediately prior to the effective time and that, upon consummation of the merger, will automatically vest in accordance with their terms, will be converted into the right to receive $9.50 per share in cash, without interest and less any applicable withholding tax. All restricted stock units that are unvested at the effective time and that are not automatically vested pursuant to their terms by virtue of the merger will be cancelled, retired and cease to exist as of the effective time of the merger. The holders of such performance based restricted stock units will not receive any merger consideration.

Employee Stock Purchase Plan

The merger agreement provides that, as of the effective time any then current offering period under the ESPP will be terminated and no new offering periods will begin under the ESPP after the effective time and no further shares of our common stock will be purchased under the ESPP. Winn-Dixie will refund any remaining cash (without interest) in a participant s account to such participant.

Payment Procedures

Prior to the effective time of the merger, Holdings will designate a paying agent reasonably acceptable to us to act as the paying agent in the merger. At the effective time of the merger, Holdings will deposit cash funds to the paying agent in an amount necessary for payment of the aggregate merger consideration.

At the effective time of the merger, we will close our stock transfer books. After that time, there will be no further registrations of transfers of shares of our common stock.

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Promptly after the effective time of the merger (and in no event later than the third business day after thereafter), the paying agent will mail to each holder of record of a certificate our common stock and, if required, each holder of uncertificated shares of our common stock represented by book-entry, a letter of transmittal (specifying that delivery shall be effected, and risk of loss and title to the certificates shall pass, only upon proper delivery of the certificates to the paying agent, or in the case of book-entry shares, upon adherence to the procedures set forth in the letter of transmittal) and instructions advising how to surrender the certificates or book-entry shares in exchange for the $9.50 per share merger consideration. Upon surrender to the paying agent of a stock certificate representing shares of our common stock or book-entry shares of our common stock, together with a duly executed letter of transmittal and any other documents that may be reasonably required by the paying agent, you will be entitled to receive in exchange for such certificate or book-entry shares the $9.50 per share merger consideration for each share formerly represented by such certificate or book-entry. Interest will not be paid or accrue in respect of the $9.50 per share merger consideration. The paying agent will reduce the amount of any merger consideration paid to you by any applicable withholding taxes.

Upon demand by the surviving corporation, the paying agent will deliver to it any funds unclaimed by our shareholders six months after the effective time of the merger. Any holders of our stock certificates or book-entry shares who have not surrendered such certificates or book-entry shares in compliance with the above payment procedures may thereafter look only to the surviving corporation as general creditors for payment of the applicable merger consideration.

If any stock certificate for our common stock has been lost, stolen or destroyed, upon the making of an affidavit, in form and substance reasonably acceptable to Holdings, by the owner of such certificate stating such certificate has been lost, stolen or destroyed, and if required by Holdings or the paying agent, the posting of a bond by such person in the form and amount reasonably necessary as indemnity against any claim that may be made against the surviving corporation with respect to such certificate, the paying agent will deliver to such person the applicable merger consideration, without interest and less any applicable withholding taxes, with respect to the shares formerly represented by such lost, stolen or destroyed certificate.

Stock certificates should not be surrendered by our shareholders before the effective time of the merger and should be sent only pursuant to instructions set forth in the letters of transmittal to be mailed to our shareholders promptly following the effective time of the merger. In all cases, the merger consideration will be provided only in accordance with the procedures set forth in such letters of transmittal.

If any merger consideration is to be paid to a person other than the person in whose name the surrendered certificate or book-entry share is registered, then the merger consideration may be paid to such a transferee so long as (i) the surrendered certificate is accompanied by all documents required to evidence and effect that transfer and (ii) the person requesting such payment shall have paid any transfer or other taxes required by reason of the payment to a person other than the registered holder or shall have established to the satisfaction of Holdings that such tax is not applicable.

Each certificate or book-entry will be deemed, from and after the effective time of the merger, to represent only the right to receive the applicable merger consideration. Any merger consideration paid upon the surrender of any certificate or book-entry will be deemed to have been paid in full satisfaction of all rights pertaining to that certificate or book-entry and the shares formerly represented by it.

Representations and Warranties

The merger agreement contains representations and warranties made by each of the parties regarding aspects of their respective businesses, financial condition and structure, as well as other facts pertinent to the merger. Our representations and warranties relate to, among other things:

- due organization, corporate power and authority, good standing and qualification, and other corporate matters with respect to us and our subsidiaries;

the articles of incorporation and bylaws;

capitalization;

subsidiaries;

corporate power and authorization to execute and deliver and to perform its obligations under the merger agreement and to consummate the merger and the other transactions contemplated by the merger agreement;

board approval and our board recommendation to our shareholders to approve the merger agreement and related transactions;

the required shareholder vote to approve the merger agreement and the transactions contemplated by the merger;

absence of any conflict or violation of organizational documents, applicable laws or other contracts as a result of entering into and carrying out the obligations of the merger agreement;

required regulatory filings and consents and approvals of governmental entities;

our filings and reports with the SEC since December 1, 2008, the accuracy of the information in those documents, including our financial statements and the maintenance of our disclosure controls and procedures and system of internal control over financial reporting;

absence of undisclosed liabilities;

absence of certain changes or events since June 29, 2011, including the absence of a Material Adverse Effect (as defined below);

absence of litigation;

our permits and compliance with applicable laws;

employee benefit plans;

labor and employment matters;

environmental matters;

taxes;

specified contracts;

certain insurance matters;

real and personal property;

intellectual property;

inapplicability of any anti-takeover statute or regulation;

absence of rights plan;

related party transactions;

- identification of any brokers and finders fees; and
- the opinion of our financial advisor, Goldman, Sachs & Co.

In addition, Holdings and Merger Sub each made representations and warranties to us regarding, among others:

- due organization and good standing;
- corporate power and authorization to execute and deliver and to perform their obligations under the merger agreement and to consummate the merger and the other transactions contemplated by the merger agreement;
- the absence of any conflict or violation of organizational documents, laws, or other contracts as a result of entering into and carrying out the obligations of the merger agreement;
- the accuracy of information supplied for this proxy statement;
- absence of brokers and finders fees;
- ownership of our common stock by Holdings, Merger Sub and their subsidiaries;
- financing for the merger and the sufficiency of funds to pay the merger consideration and related fees and expenses;
- the limited guarantee of Lone Star Guarantor;
- solvency;
- absence of arrangements with management;
- absence of regulatory impediments; and
- no other representations and warranties of Winn-Dixie or its subsidiaries and affiliates.

Material Adverse Effect

Many of our representations and warranties and the conditions to complete the merger are subject to a Material Adverse Effect qualification. A Material Adverse Effect means any event, change, circumstance, occurrence, effect or state of facts that (a) is materially adverse to the business, assets, condition (financial or otherwise) or results of operations of Winn-Dixie and its subsidiaries, taken as a whole, or (b) materially impairs, or prevents or materially delays, the ability of Winn-Dixie to consummate the merger or any of the other transactions contemplated by the merger agreement. However, with respect to clause (a) above, the determination of a Material Adverse Effect shall exclude the following events, changes, circumstances, occurrences, effects and states of fact:

those generally affecting Winn-Dixie s industry, or the economy or the financial or securities markets of the United States, including effects on such industry, economy or markets resulting from any regulatory and political conditions or developments in general;

any outbreak or escalation of hostilities or declared or undeclared acts of war or terrorism;

changes or proposed changes in law or generally accepted accounting principles;

- customary seasonal fluctuations in the business of Winn-Dixie and its subsidiaries;

- any change, in and of itself, in the market price or trading volume of any securities or indebtedness of Winn-Dixie, or any change of or failure to meet, in and of itself, any internal or public projections, forecasts, budgets or estimates of or relating to Winn-Dixie or any of its subsidiaries for any period (it being understood that the underlying causes of such change or failure shall, if they are not otherwise excluded from the definition of Material Adverse Effect, be taken into account in determining whether a Material Adverse Effect has occurred);

- any hurricane, tropical storm, flood, forest fire, earthquake or other similar natural disaster;

- the execution, announcement, performance and existence of the merger agreement, including any actual or potential loss or impairment after the date of the merger agreement of any contract as a result thereof;

- any action taken or not taken by Winn-Dixie at the written request of Holdings, subject to certain identified exceptions; and

- any action taken by Holdings, Merger Sub or any of their affiliates, subject to certain identified exceptions;

provided, however, with respect to matters described in the first six bullets above, such matters shall be excluded solely to the extent that the impact of such matters is not disproportionately adverse to Winn-Dixie and its subsidiaries in comparison to similarly situated businesses (in which case the disproportionate impact shall be taken into account).

Conduct of Business Pending the Merger

We have agreed that until the effective time of the merger, subject to certain identified exceptions:

- we will, and will cause our subsidiaries to, carry on our and their business in the ordinary course consistent with past practice; and

- we will, and will cause our subsidiaries to, use reasonable best efforts to (i) preserve intact our and their business (ii) preserve intact our and their present relationships with customers, suppliers, landlords and other persons with which we have material business relations, and (iii) keep available the services of our and their current officers.

We have agreed that until the effective time of the merger, subject to certain identified exceptions, that we will not, and will not permit any of our subsidiaries to, without Holding s prior written consent (not to be unreasonably withheld, delayed or conditioned):

- declare, set aside or pay any dividends on, or make any other distributions (whether in cash, stock or property) in respect of, any of our or their capital stock or other equity interests, except for dividends by a wholly owned subsidiary of Winn-Dixie to its parent;

- purchase, redeem or otherwise acquire shares of capital stock or other equity interests of Winn-Dixie or our subsidiaries or any options, warrants or rights to acquire any such shares or other equity interests;

- split, combine, reclassify or otherwise amend the terms of any of our or their capital stock or other equity interests, or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of our or their capital stock or other equity interests;

issue, deliver, sell, grant, pledge or otherwise encumber or subject to any lien any shares of our or their capital stock or other equity interests or any securities convertible into, exchangeable for or exercisable for any such shares or other equity interests, or any rights, warrants or options to acquire any such shares or other equity interests, or any stock appreciation rights, phantom stock rights, performance units, rights to receive shares of capital stock of Winn-Dixie on a deferred basis or other rights linked to the value of shares, including pursuant to contracts as in effect on the date of the merger agreement (other than (i) grants of rights or options to acquire shares legally required to be granted pursuant to the ESPP as in effect on the date of the merger agreement, (ii) the issuance of shares upon the exercise of stock options of Winn-Dixie and the vesting of restricted stock units outstanding on December 16, 2011 in accordance with their terms or (iii) the purchase, redemption or other acquisition of shares or other equity interests of Winn-Dixie from former employees, directors and consultants pursuant to any contract or equity plan of Winn-Dixie in accordance with its terms as of the date of the merger agreement providing for the repurchase of shares in connection with any termination of services to Winn-Dixie or any of our subsidiaries);

amend or otherwise change our or their articles of incorporation or bylaws or similar organizational documents;

directly or indirectly acquire or agree to acquire (i) by merging or consolidating with, purchasing a substantial equity interest in or a substantial portion of the assets of, making an investment in or loan or capital contribution to, or in any other manner, any corporation, partnership, association or other business organization or division thereof, or (ii) any assets that are otherwise material to Winn-Dixie and our subsidiaries, taken as a whole, other than inventory acquired in the ordinary course of business consistent with past practice;

directly or indirectly sell, lease, license, sell and leaseback, abandon, mortgage or otherwise encumber or subject to any lien or otherwise dispose in whole or in part of any properties, assets or rights or any interest therein that are material to us and our subsidiaries, taken as a whole, except for sales of inventory or the disposition of used or excess equipment, in each case in the ordinary course of business consistent with past practice;

adopt or enter into a plan of complete or partial liquidation, dissolution, restructuring, recapitalization or other reorganization;

other than for borrowings under our revolving credit facility in the ordinary course of business consistent with past practice, incur, create, assume or otherwise become liable for, or prepay, any indebtedness, or amend, modify or refinance any indebtedness;

make any loans, advances or capital contributions to, or investments in, any other person, other than Winn-Dixie or any direct or indirect wholly owned subsidiary of Winn-Dixie;

incur or commit to incur, in any fiscal quarter of Winn-Dixie, any capital expenditures other than (i) capital expenditures provided for in the capital expenditure budget for such quarter (provided, that, if the budgeted amount set forth for any quarter is not spent in full in such quarter, the unused amount shall roll-forward to the subsequent quarters until used) and (ii) additional capital expenditures of less than $1,000,000 in the aggregate;

pay, discharge, settle or satisfy any material claims, liabilities or obligations (whether absolute, accrued, asserted, unasserted, contingent or otherwise), other than the payment, discharge, settlement or satisfaction of any such claims, liabilities or obligations in the ordinary course of business consistent with past practice or as required by their terms;

cancel any material indebtedness owed to us or any of our subsidiaries by a third person;

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modify, amend, terminate, cancel or extend any Material Contract (as defined in the merger agreement);

enter into any contract that if in effect on the date of the merger agreement would be a Material Contract;

compromise, settle or agree to settle any action (including any action relating to the merger agreement or the transactions contemplated thereby), other than compromises, settlements or agreements (i) of actions that do not relate to the merger agreement or the transactions contemplated thereby, (ii) that are made in the ordinary course of business consistent with past practice, and (iii) that involve only the payment of money damages of less than $1,000,000 (for any action individually, and in the aggregate for all related actions), without the imposition of any equitable relief on, or the admission of wrongdoing by, us;

change our or their financial or tax accounting methods, principles or practices, except insofar as may have been required by a change in GAAP or applicable law or by the merger agreement, or revalue any of our or their material assets, except insofar as required by GAAP;

except as required by the merger agreement, settle or compromise any material liability for taxes, amend any material tax return except as required by applicable law, make any material tax election on or after the date of the merger agreement or change any method of accounting for tax purposes;

change our or their fiscal year;

grant any current or former director, officer, employee or independent contractor any increase in compensation, bonus or other benefits, or grant any type of compensation or benefits to any current or former director, officer, employee or independent contractor not previously receiving or entitled to receive such type of compensation or benefit (except as required to comply with any applicable law or any Winn-Dixie plan in effect as of the date of the merger agreement, or for pay or fee increases made in the ordinary course of business consistent with past practice (other than with respect to officers of Winn-Dixie or any individual receiving base pay in excess of $100,000 per year));

grant or pay to any current or former director, officer, employee or independent contractor any severance, change in control or termination pay, or modifications thereto or increases therein, except as required to comply with any applicable law or any Winn-Dixie plan in effect as of the date of the merger agreement;

grant or amend in any material respect any equity or equity-based award (including in respect of stock options, stock appreciation rights, performance units, restricted stock or other stock-based or stock-related awards or the removal or modification of any restrictions in any Winn-Dixie plan or awards made thereunder) except as required to comply with any applicable law or any Winn-Dixie plan in effect as of the date hereof or as may be required to comply with the merger agreement;

adopt or enter into any collective bargaining agreement or other labor union contract;

take any action to accelerate the vesting, funding or payment of any compensation or benefit under any Winn-Dixie plan, any agreement issued thereunder, or any other contract, except as required to comply with any applicable law or any Winn-Dixie plan in effect as of the date of the merger agreement, or as may be required to implement the actions contemplated by the merger agreement;

adopt any new employee benefit or compensation plan or arrangement or any agreement thereunder, or amend or modify in any material respect any existing Winn-Dixie plan or any agreement thereunder, in

each case for the benefit of any current or former director, officer, employee or independent contractor, other than as required by applicable law;

renew or enter into any non-compete, exclusivity, non-solicitation or similar agreement, in each case that would restrict or limit, in any material respect, the operations of Winn-Dixie or any of our subsidiaries;

enter into any new line of business outside of its existing business; or

authorize any of, or commit, resolve or agree to take any of, the foregoing actions.

Other Covenants Under the Merger Agreement

Access to Information; Confidentiality

Until the effective time of the merger, subject to certain express exceptions, we will (and will cause our subsidiaries to) provide to Holdings, Merger Sub and their respective representatives, reasonable access during normal business hours to our and our subsidiaries respective properties, assets, book, contracts, commitments, personnel and records.

Acquisition Proposals; Change in the Recommendation of Our Board of Directors

We have agreed that we will not, nor will we permit any of our subsidiaries or our subsidiaries respective agents or representatives to take any of the following actions, directly or indirectly:

solicit, initiate, endorse, knowingly encourage or knowingly facilitate any inquiry, proposal or offer with respect to, or the making or completion of, any acquisition proposal, or any inquiry, proposal or offer that is reasonably likely to lead to any acquisition proposal;

enter into, continue or otherwise participate in any discussions or negotiations regarding, or furnish to any person any information or data with respect to, or otherwise cooperate in any way with, any acquisition proposal; or

resolve, propose or agree to do any of the foregoing.

Any violation of the foregoing restrictions by any representative or affiliate of Winn-Dixie, whether or not such person is purporting to act on behalf of Winn-Dixie or any of our subsidiaries, or otherwise, will be deemed to be a breach of the non-solicitation provisions of the merger agreement by us.

However, this covenant will not prohibit us, at any time prior to obtaining the approval of the merger agreement by our shareholders, from (i) furnishing information regarding Winn-Dixie and our subsidiaries to a person making an acquisition proposal (subject to the execution of an acceptable confidentiality agreement) and (ii) participating in discussions and negotiations with the person making such acquisition proposal regarding such acquisition proposal if:

we have received a written acquisition proposal from a third party that our Board of Directors believes in good faith to be bona fide;

such acquisition proposal was unsolicited and did not result from a breach of the non-solicitation provisions of the merger agreement;

our Board of Directors determines in good faith, after consultation with our outside counsel and financial advisor, that such acquisition proposal constitutes, or is reasonably likely to lead to a superior proposal; and

our Board of Directors determines in good faith, after consultation with our outside counsel, that the failure to take the actions described in clauses (i) and (ii) above would be reasonably likely to constitute a breach of its fiduciary duties to the shareholders of Winn-Dixie under applicable Florida law.

In addition to the obligations set forth above, we are also required to:

- advise Holdings in writing, within 24 hours of the receipt of any indication by any person that it is considering making an acquisition proposal, any inquiry or request for information, discussion or negotiation that is or is expected to be reasonably likely to lead to or that contemplates an acquisition proposal or any proposal or offer that is or is reasonably likely to lead to an acquisition proposal, in each case together with a description of the material terms and conditions of and facts surrounding any such indication, inquiry, request, proposal or offer, the identity of the person making any such indication, inquiry, request, proposal or offer, and a copy of any written proposal, offer or draft agreement provided by such person;

- keep Holdings informed in all material respects on a timely basis of the status and details (including, within 24 hours after the occurrence of any material amendment or modification) of any such acquisition proposal, request, inquiry, proposal or offer, including by furnishing copies of any material written inquiries, correspondence and draft documentation, and written summaries of any material oral inquiries or discussions; and

- promptly (and in any event within 24 hours) notify Holdings orally and in writing if we determine to begin providing information or to engage in discussions or negotiations concerning an acquisition proposal.

Our Board of Directors has also agreed that neither it nor any of its committees will:

- withdraw (or modify or qualify in any manner adverse to Holdings or Merger Sub) the adoption, approval, recommendation or declaration of advisability by the Board of Directors or any such committee of the merger agreement, the merger or any of the other transactions contemplated thereby;

- adopt, approve, recommend, endorse or otherwise declare advisable the approval of any acquisition proposal;

- cause or permit Winn-Dixie or any of our subsidiaries to enter into any letter of intent, memorandum of understanding, agreement in principle, acquisition agreement, merger agreement, option agreement, joint venture agreement, partnership agreement or other contract constituting or related to, or which is intended to or is reasonably likely to lead to, any acquisition proposal; or

- or resolve, agree or propose to take any of the above listed actions.

Notwithstanding the foregoing, at any time prior to obtaining approval of the merger agreement by our shareholders, our Board of Directors may, if it determines in good faith (after consultation with outside counsel) that the failure to do so would be reasonably likely to result in a breach of its fiduciary duties to the shareholders of Winn-Dixie under applicable Florida law, taking into account all adjustments to the terms of the merger agreement that are offered in writing by Holdings, (i) withdraw (or modify or qualify in a manner adverse to Holdings), or publicly propose to withdraw its recommendation that our shareholders approve the merger agreement, or approve or recommend, or propose publicly to approve or recommend, or resolve to approve or recommend any acquisition proposal, referred to in this proxy statement as a change of board recommendation, in response to either a superior proposal or an intervening event, or (ii) solely in response to a superior proposal received after the date of the merger agreement that did not result from a breach of the non-solicitation provisions

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of the merger agreement, cause Winn-Dixie to terminate the merger agreement in accordance with the terms thereof and concurrently enter into a binding acquisition agreement with respect to such superior proposal; provided, however, that our Board of Directors may not take the actions set forth in (i) or (ii) above, unless:

- we notify Holdings in writing at least five calendar days before taking that action of our intention to do so, and specify the reasons therefor, including the terms and conditions of, and the identity of the person making, such superior proposal, and contemporaneously furnishes a copy (if any) of the proposed acquisition agreement related thereto and any other relevant transaction documents. In the event of any revisions to financial terms or any other material term of the superior proposal, then we will be required to deliver a new written notice and again comply with the notice and other requirements described above with respect to such revised superior proposal, on each occasion on which a revised superior proposal is submitted (provided, however, that the notice period will be three calendar days in lieu of five calendar days); and

- if Holdings makes a proposal during such five (or three, as applicable) calendar day period to adjust the terms and conditions of the merger agreement, our Board of Directors, after taking into consideration the adjusted terms and conditions of the merger agreement as proposed by Holdings, continues to determine in good faith (after consultation with outside counsel and its financial advisor) that such superior proposal continues to be a superior proposal and that the failure to effect a change of board recommendation or terminate the merger agreement, as applicable, would be reasonably likely to result in a breach of its fiduciary duties to our shareholders under applicable Florida Law;

provided, further, that our Board of Directors may not effect a change of board recommendation in response to an intervening event unless:

- Winn-Dixie provides Holdings with written information describing such event in reasonable detail as soon as reasonably practicable after becoming aware of it;

- Winn-Dixie keeps Holdings reasonably informed of developments with respect to such intervening event;

- Winn-Dixie notifies Holdings in writing at least five calendar days before our Board of Directors effects a change of board recommendation with respect to such intervening event of its intention to do so and specifying the reasons therefor; and

- if Holdings makes a proposal during such five calendar day period to adjust the terms and conditions of the merger agreement, our Board of Directors, after taking into consideration the adjusted terms and conditions of the merger agreement as proposed by Holdings, continues to determine in good faith (after consultation with outside counsel) that the failure to effect a change of board recommendation would be reasonably likely to result in a breach of its fiduciary duties to the shareholders of Winn-Dixie under applicable Florida Law.

If applicable, during the five (or three, as applicable) calendar day period prior to our Board of Directors effecting a change of board recommendation or terminating the merger agreement as referred to above, Winn-Dixie must, and must cause its financial and legal advisors to, negotiate with Holdings in good faith (to the extent Holdings seeks to negotiate) regarding any revisions to the terms of the transactions contemplated by the merger agreement proposed by Holdings.

As described in this proxy statement, acquisition proposal means any proposal or offer with respect to any direct or indirect acquisition or purchase, in one transaction or a series of transactions, and whether through any merger, reorganization, consolidation, tender offer, self-tender, exchange offer, stock acquisition, asset acquisition, binding share exchange, business combination, recapitalization, liquidation, dissolution, joint venture

or otherwise, of (i) assets or businesses of Winn-Dixie and our subsidiaries that generate 15% or more of the net revenues or net income or that represent 15% or more of the total assets (based on fair market value) of Winn-Dixie and our subsidiaries, taken as a whole, immediately prior to such transaction, or (ii) 15% or more of any class of capital stock, other equity securities or voting power of Winn-Dixie, any of its subsidiaries or any resulting parent company of Winn-Dixie, in each case other than the merger and other transactions contemplated by the merger agreement.

As described in this proxy statement, superior proposal means any bona fide binding written acquisition proposal that our Board of Directors determines in good faith (after consultation with outside counsel and its financial advisor), taking into account all legal, financial, regulatory and other aspects of the proposal and the person making the proposal, including the financing terms thereof and the expected timing of the consummation thereof, is (i) more favorable to the shareholders of Winn-Dixie from a financial point of view than the merger and other transactions contemplated by the merger agreement (including any adjustment to the terms and conditions proposed by Holdings in response to such proposal) and (ii) reasonably likely of being completed on the terms proposed; provided, that, for purposes of this definition of superior proposal, references in the term acquisition proposal to 15% shall be deemed to be references to 50%.

As described in this proxy statement, intervening event means a material event or circumstance that was not known to our Board of Directors prior to the execution of the merger agreement (or if known, the consequences of which were not known or reasonably foreseeable), which event or circumstance, or any material consequence thereof, becomes known to our Board of Directors prior to the receipt of approval for the merger agreement by Winn-Dixie s shareholders, provided, however, that in no event shall the receipt, existence or terms of an acquisition proposal or any matter relating thereto or consequence thereof constitute an intervening event.

Employee Benefits Matters

The merger agreement provides that Holdings will, for a period of 12 months immediately following the effective time of the merger, cause the surviving corporation and its subsidiaries to provide each of our employees with base salary or hourly wage rate, incentive compensation opportunities and other compensation employee benefits (excluding any equity or equity-based compensation) that are no less favorable for all employees in the aggregate than the benefits provided by us immediately prior to the merger. Holdings has agreed to honor all benefit plans (including all severance, change of control and similar plans and agreements) in effect for one year after the effective time of the merger.

The merger agreement also provides that our employees will receive full service credit for all purposes under all employee benefits plans (excluding any equity plans or for benefit accrual under any pension plans) of Holdings, the surviving corporation and their respective subsidiaries and affiliates, and each employee shall be immediately eligible to participate, without waiting time, in each plan of Holdings, the surviving corporation and their respective subsidiaries and affiliates to the extent such waiting time was satisfied under a similar or comparable plan of Winn-Dixie in which such employee participated immediately before the effective time. Holdings will cause all pre-existing condition exclusions or limitations and actively-at-work requirements to be waived and to allow eligible expenses to be taken into account to satisfy deductibles, coinsurance and out of pocket requirements under applicable Holdings plans. In addition, with respect to accrued but unused vacation time to which any employee is entitled pursuant to the vacation policy applicable to such employee immediately prior to the effective time, Holdings will, or will cause the surviving corporation to (i) allow such employee to use such accrued vacation or (ii) if the employee s employment terminates during the one year period following the effective time under circumstances entitling the employee to severance pay under Winn-Dixie s severance plan, pay the employee (in cash) an amount equal to the value of the accrued vacation time.

Notwithstanding anything to the contrary contained therein, the merger agreement is not intended to create a contract between Winn-Dixie and any of its employees and none of the employees of Winn-Dixie are entitled to

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rely on the merger agreement as the basis for any breach of contract claim against Holdings or Winn-Dixie. The merger agreement is also not intended to modify, amend or create any employee benefit plan (except as otherwise explicitly provided).

As of the effective time of the merger, we will terminate or cause to be terminated the ESPP and our stock incentive plans.

Anti-Takeover Statutes

We have agreed not to take any action to cause any anti-takeover law to become applicable to the merger agreement, the merger or any of the other transactions contemplated thereby. If any anti-takeover law or similar law is or becomes applicable to the merger agreement, the merger, or the other transactions contemplated by the merger agreement, our Board of Directors has agreed to take all action necessary, to the extent permitted under such law, to ensure that the transactions contemplated by the merger agreement are consummated as promptly as practicable on the terms and conditions set forth in the merger agreement.

Tax Accounting Election Change

We have agreed to change and cause each of our applicable direct and indirect subsidiaries to change our and each such subsidiary s method of valuing inventory for federal and state income tax purposes from the last-in, first-out method to the first-in, first-out method for our taxable year ended June 29, 2011, prior to the earlier of (i) our filing of our federal income tax return for the taxable year ended June 29, 2011 and (ii) March 15, 2012.

Other Covenants

The merger agreement contains a number of mutual covenants, which subject to certain exceptions, obligate us and Holdings (and in certain instances, Merger Sub), to use reasonable best efforts to take, or cause to be taken all actions that are necessary, proper or advisable to consummate and make effective, in the most expeditious manner practicable, the merger and the other transactions contemplated by the merger agreement, including using reasonable best efforts to accomplish the following:

- obtain all required consents, approvals or waivers from, or participation in other discussions or negotiations with, third parties, including as required under any material contract;

- obtain all necessary actions or nonactions, waivers, consents, approvals, orders and authorizations from governmental entities, make all necessary registrations, declarations and filings and take all steps as may be necessary to obtain an approval or waiver from, or to avoid any action by, any governmental entity, including making as soon as practicable after the date of the merger agreement, filings under the HSR Act;

- provide as promptly as possible any additional information and documentary materials that may be reasonably requested pursuant to the HSR Act;

- vigorously resist and contest any action, including administrative or judicial action, and seek to have vacated, lifted, reversed or overturned any decree, judgment, injunction or other order (whether temporary, preliminary or permanent) that is in effect and that could restrict, prevent or prohibit consummation of the merger and the other transactions contemplated by the merger agreement, including by vigorously pursuing all avenues of administrative and judicial appeal; and

- execute and deliver any additional instruments necessary to consummate the merger and the other transactions contemplated by the merger agreement and to fully carry out the purposes of the merger agreement.

In addition, Holdings obligations include the obligation to, and to cause its affiliates to:

- sell or divest or agree to sell or divest any assets or businesses of Holdings and its subsidiaries, BI-LO Holding, LLC and its subsidiaries and such affiliates;

- agree to sell or divest any assets or businesses of Winn-Dixie and its subsidiaries contemporaneously with or subsequent to the closing of the merger;

- permit Winn-Dixie to sell or divest any of its or its subsidiaries assets or businesses prior to the closing of the merger; or

- license, hold separate or enter into similar arrangements with respect to the assets of Holdings and its subsidiaries, BI-LO Holding, LLC and its subsidiaries, Winn-Dixie and its subsidiaries and such affiliates;

in each case in exchange for obtaining the expiration of the waiting period under the HSR Act without further actions being taken or any consent from any governmental entity necessary to consummate the merger and the other transactions contemplated by the merger agreement; provided, that Holdings and its affiliates shall not be required to take or consent to the taking of any such action that, individually or in the aggregate, would reasonably be likely to cause the debt financing described below to be unavailable at the closing of the merger.

Holdings Financing

Holdings has obtained debt financing commitments in connection with the merger from Citigroup Global Markets Inc. and Deutsche Bank Trust Company Americas, collectively referred to as the Lenders, and equity financing from the Sponsor. Each of Holdings and Merger Sub has agreed to use its reasonable best efforts to obtain the debt financing provided for in the Lenders commitment letters and fee letter on the terms and conditions described in such letters. This covenant includes using reasonable best efforts to (1) negotiate definitive agreements with respect thereto, (2) satisfy on a timely basis all terms and conditions applicable to Holdings and Merger Sub in the commitment letters and fee letter that are within their or their affiliates control, (3) comply with their obligations under the commitment letters and fee letter and (4) consummate the debt financing at or prior to closing of the merger. Holdings has the right from time to time to amend, replace, supplement or otherwise modify, or waive any of its rights under the debt financing commitment, or substitute other debt or equity financing; provided, that any such amendment, replacement, supplement, modification or waiver may not (i) expand upon the conditions precedent to the financing as set forth in the commitment letters and fee letter in any way or (ii) be reasonably expected to prevent or cause any delay of the consummation of the merger and the other transactions contemplated by the merger agreement.

If any portion of the debt financing described in the commitment letters becomes unavailable on the terms and conditions contemplated in such letters Holdings must promptly notify Winn-Dixie and is required to cause BI-LO Holding, LLC to use its reasonable best efforts to promptly obtain alternative financing on terms not materially less beneficial to BI-LO Holding, LLC and Holdings.

Holdings has agreed to keep us informed on a regular basis and in reasonable detail of the status of the debt financing, and to notify us of certain material developments, such as a material breach or default by any party to any of the commitment letters or if Holdings believes in good faith that it will not be able to obtain all or any material portion of the debt financing.

We have agreed to use our reasonable best efforts to, at Holdings sole cost and expense, promptly provide Holdings and Merger Sub with all cooperation as may be reasonably requested in connection with the financing, including: (1) participating in a reasonable number of meetings; (2) cooperating reasonably with marketing efforts; (3) assisting reasonably with the preparation of rating agency presentations, offering documents, bank

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information memoranda, lender presentations and similar documents; (4) furnishing promptly certain financial information of Winn-Dixie; (5) providing information with respect to collateral and access to such collateral; (6) obtaining surveys, title insurance and other like documentation customary for similar financing; (7) executing and delivering definitive financing documentation; (8) cooperating reasonably in facilitating the termination of current credit facilities; (9) cooperating reasonably in facilitating the cancellation and replacement or rollover into the debt financing of all outstanding letters of credit and the termination of all related letter of credit agreements; and (10) taking all corporate actions reasonably necessary to permit the consummation of the debt financing. However, we are not obligated to cooperate with Holdings and Merger Sub to the extent that such cooperation would interfere unreasonably with our ongoing operations or those of our subsidiaries.

Conditions to the Merger

Each party s obligation to consummate the merger is subject to the satisfaction or waiver of the following conditions as of the closing:

- the merger agreement will have been approved by the requisite vote of our shareholders;

- any waiting period (and any extension thereof) applicable to the merger and the transactions contemplated by the merger agreement under applicable antitrust laws, including the HSR Act, will have been terminated or will have expired and any required approvals under antitrust laws will have been obtained; and

- no governmental authority will have enacted, entered, promulgated, enforced or deemed applicable any temporary restraining order, preliminary or permanent injunction or other judgment, order or decree which is then in effect and no law shall have been enacted, entered, promulgated, enforced or deemed applicable, that in each case, prohibits or makes illegal the consummation of the merger.

In addition, the obligations of Holdings and Merger Sub to complete the merger are subject to the satisfaction or waiver (to the extent permitted by law) in writing of the following conditions:

- our representations and warranties in the merger agreement regarding our authorized capital stock, outstanding capital stock and holders of Winn-Dixie stock awards must be true and correct as of the merger agreement and as of the closing of the merger as if made on and as of such date, except to the extent that any such representations and warranties speak solely and expressly as of an earlier date, in which case such representations and warranties must be true and correct as of such earlier date, and except for any failures to be true and correct that, individually or in the aggregate, are *de minimis*;

- our representation and warranty in the merger agreement that no change, event or development has occurred that, individually or in the aggregate, has had or would reasonably be expected to have a Material Adverse Effect must be true and correct as of the date of the merger agreement;

- each of our representations and warranties relating to certain capitalization matters, board approval, anti-takeover statutes, required shareholder vote, a rights plan and brokers and finders fees (i) that is qualified as to materiality or Material Adverse Effect shall be true and correct and (ii) that is not qualified as to materiality or Material Adverse Effect shall be true and correct in all material respects, in each case as of the date of the merger agreement and as of the closing date of the merger as if made on and as of such date, except to the extent that any such representations and warranties speak solely and expressly as of an earlier date, in which case such representations and warranties must be true and correct as of such earlier date;

- each of our remaining representations and warranties set forth in the merger agreement must be true and correct as of the date of the merger agreement and as of the date of the closing of the merger as if

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made on and as of such date, except to the extent that any such representations and warranties speak solely and expressly as of an earlier date, in which case such representations and warranties must be true and correct as of such earlier date; provided, that this condition will be deemed to have been satisfied even if our representations and warranties are not true and correct, unless the failure of such representations and warranties to be true and correct, individually or in the aggregate, would or would reasonably be expected to have, a Material Adverse Effect;

we must have performed in all material respects all material obligations required by the merger agreement to be performed by us at or prior to the effective time of the merger;

there must not have occurred since the date of the merger agreement any event, change, circumstance, occurrence, effect or state of facts that, individually has had or would reasonably be expected to have a Material Adverse Effect; and

we must have delivered to Holdings a certificate dated the closing date or the merger and signed by an executive officer of Winn-Dixie certifying that the foregoing conditions to Holdings and Merger Sub s obligations to complete the merger have been satisfied.

In addition, our obligations to complete the merger are subject to the satisfaction or waiver (to the extent permitted by law) of the following conditions:

the representations and warranties of Holdings and Merger Sub in the merger agreement must be true and correct as of the date of the merger agreement and as of the closing date as if made on such date (except for representations and warranties made as of a specified date, the accuracy of which will be determined as of that specified date), except for inaccuracies of such representations and warranties the circumstances giving rise to which, individually or in the aggregate, have not had and would not reasonably be expected to result in any event, change, circumstance, occurrence, effect or state of facts that materially impairs or materially delays, or prevents, the ability of Holdings or Merger Sub to consummate the merger or any of the other transactions contemplated by the merger agreement;

Holdings and Merger Sub must have performed in all material respects all material obligations required by the merger agreement to be performed by them at or prior to the effective time of the merger; and

Holdings will have delivered to us a certificate, dated the closing date of the merger, signed by an executive officer of Holdings certifying that the foregoing conditions to our obligations to complete the merger have been satisfied.

Termination of the Merger Agreement

The merger agreement may be terminated and the merger may be abandoned at any time prior to the effective time of the merger, whether before or after our shareholders have adopted the merger agreement, as follows:

by mutual written consent of us and Holdings;

by either Holdings or us, if

- o the effective time of the merger does not occur on or before June 13, 2012; provided that the right to terminate the merger agreement pursuant to this provision is not available to any party whose breach of any obligation under the merger agreement has been a cause of or resulted in the failure of the effective time of the merger to occur on or before June 13, 2012;

- o any governmental action has become final and non-appealable and has the effect of making consummation of the merger illegal or otherwise prevents or prohibits consummation of the

merger; provided that the party seeking to terminate shall have used its reasonable best efforts to contest, appeal and remove such governmental action; or

- o after the meeting of our shareholders if our shareholders do not approve the merger;

by Holdings, if,

- o any of our representations and warranties are or have become untrue or inaccurate or there has been a breach on our part of any of our covenants or agreements, which such failure to be true or accurate or breach (i) would give rise to the failure of applicable closing conditions; and (ii) cannot or has not been cured prior to the earlier of June 12, 2012 or 30 days following receipt of written notice of such failure or breach; provided that Holdings will not have the right to terminate if Holdings or Merger Sub is then in material breach of any of its covenants or agreements in the merger agreement;

- o our Board of Directors (i) effects a change of board recommendation; (ii) approves or recommends, or causes or permits Winn-Dixie to enter into an acquisition agreement other than the merger agreement; (iii) fails to publicly reaffirm its recommendation of the merger within 10 business days after the date of any acquisition proposal or any material modification thereto is first commenced, published or sent or given to our shareholders upon a request to do so by Holdings; or (iv) formally resolves or publicly authorizes or proposes to take any of the foregoing actions; or

- o we have breached or failed to perform in any material respect any of our obligations described under *Acquisition Proposals; Change in the Recommendation of Our Board of Directors* or our obligations to call and hold the special meeting of our shareholders, in each case if such breach or failure cannot be or has not been cured on or prior to the earlier of June 12, 2012 and the 10th day after the giving of notice to us of such breach or failure; provided, that Holdings will not have the right to terminate if Holdings or Merger Sub is then in material breach of any of its covenants or agreements in the merger agreement; or

by us, if,

- o any of the representations and warranties of either Holdings or Merger Sub are or have become untrue or inaccurate, or there has been a breach on the part of either Holdings or Merger Sub of any of its covenants or agreements, and such failure to be true or accurate or breach (i) would give rise to the failure of applicable closing conditions; and (ii) cannot or has not been cured prior to the earlier of June 12, 2012 or 30 days following receipt of written notice of such failure or breach; provided that we will not have the right to terminate if we are then in material breach of any of our covenants or agreements in the merger agreement;

- o at any time prior to our shareholders approving the merger agreement in order to accept a superior proposal; provided, that we have (i) simultaneously with such termination entered into an acquisition agreement pursuant to such superior proposal, (ii) otherwise complied with our obligations described under *Acquisition Proposals; Change in the Recommendation of Our Board of Directors* and (iii) paid the required termination fee; or

- o if the merger is not consummated prior to the second business day after satisfaction of all of the conditions to the obligations of Holdings and Merger Sub to effect the merger (other than conditions that by their nature are to be satisfied at the closing of the merger), and we were ready, willing and able to consummate the merger at such time.

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Termination Fee and Closing Failure Fee

Generally, all fees and expenses incurred in connection with the merger agreement, the merger and the other transactions contemplated by the merger agreement will be paid by the party incurring such fees and expenses, whether or not the merger is completed. We have agreed, however, to pay Holdings a termination fee of $19.6 million if:

Holdings or Winn-Dixie terminates the merger agreement as a result of the merger not being closed on or before June 13, 2011, and prior to the termination of the merger agreement (i) a person or group made an acquisition proposal or an acquisition proposal is publicly announced, and (ii) no later than 12 months following the date of the termination of the merger agreement, Winn-Dixie enters into an agreement with respect to an acquisition proposal, or an acquisition proposal is consummated;

either party terminates the merger agreement after the meeting of our shareholders if the shareholders do not approve the merger, and prior to the termination of the merger agreement (i) a person or group made an acquisition proposal or an acquisition proposal is publicly announced, and (ii) no later than 12 months following the date of the termination of the merger agreement, Winn-Dixie enters into an agreement with respect to an acquisition proposal, or an acquisition proposal is consummated;

Holdings terminates the merger agreement because our Board of Directors:

o effects a change of board recommendation;

o approves or recommends, or causes or permits Winn-Dixie to enter into an acquisition agreement other than the merger agreement;

o fails to publicly reaffirm its recommendation of the merger within 10 business days after the date of any acquisition proposal or any material modification thereto is first commences, published or sent or given to our shareholders upon a request to do so by Holdings; or

o Winn-Dixie formally resolves or publicly authorizes or proposes to take any of the foregoing actions; or

o we terminate the merger agreement in order to accept a superior proposal from a third-party in accordance with the terms of the merger agreement.

Holdings has agreed to pay us a closing failure fee of $72,825,000 if:

we terminate the merger agreement as a result of any of the representations and warranties of either Holdings or Merger Sub having become untrue or inaccurate, or there has been a breach on the part of either Holdings or Merger Sub of any of its covenants or agreements, and such failure to be true or accurate or breach (i) would give rise to the failure of applicable closing conditions; and (ii) cannot or has not been cured prior to the earlier of June 13, 2012 or 30 days following receipt of written notice of such failure or breach;

we terminate the merger agreement as a result of the merger not having been consummated prior to June 13, 2012, and all of the conditions to the consummation of the merger were satisfied as of such date other than the obligations of Holdings and Merger Sub,

and we were ready, willing and able to consummate the merger; or

either party terminates the merger agreement as a result of Holdings failing to take actions related to the divestiture of assets to obtain approval for the merger under the HSR Act as required under the merger agreement.

Amendment and Waiver

The merger agreement may be amended by us, Holdings and Merger Sub at any time prior to the effective time of the merger. However, after approval of the merger agreement by our shareholders, no amendment can be made except as allowed under applicable law. Any amendment to the merger agreement must be made by a written instrument signed by us, Holdings and Merger Sub.

Parties in Interest

The merger agreement expressly disclaims any third party beneficiary rights subject to (i) the rights of our directors, officers and other indemnified persons to enforce their rights to indemnification, exculpation, advancement and insurance as provided in the merger agreement, (ii) the rights of Holdings financing sources to enforce certain rights under the merger agreement, and (iii) the rights of our equity holders and option holders to receive the merger consideration after the effective time of the merger.

Governing Law

The merger agreement is governed by New York law, except to the extent that Florida law mandatorily applies.

Specific Performance

Holdings, Merger Sub and we have agreed that irreparable harm would occur if any provision of the merger agreement is not performed in accordance with its specific terms or is otherwise breached. The parties will be entitled to seek equitable relief, including injunctive relief and specific performance, to prevent breaches of the provisions of the merger agreement and to enforce specifically the merger agreement and its terms and provisions.

Notwithstanding the foregoing, pursuant to the terms of the merger agreement, we will be entitled to specific performance to cause Holdings and Merger Sub to draw down the equity financing or to consummate the merger only if:

- all conditions to the obligations of Holdings and Merger Sub to consummate the merger (other than those conditions that by their nature are to be satisfied at closing) have been satisfied;

- Holdings and Merger Sub have failed to consummate the merger by the second business day following satisfaction of such conditions;

- the debt financing has been funded or is expected to be funded at the closing if the equity financing is funded at the closing (provided, that Holdings and Merger Sub will not be required to drawn down the equity financing or to consummate the merger if the debt financing is not in fact funded at closing); and

- we have irrevocably confirmed that if specific performance is granted and the equity and debt financing are funded, then the closing will occur.

In addition, the Company shall be entitled to specific performance to cause Holdings and Merger Sub to draw down the debt financing (or any replacement debt financing) only if the closing (including consummation of the merger) will occur substantially simultaneously with such draw down.

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MARKET PRICE OF OUR COMMON STOCK

Our common stock is traded on Nasdaq under the symbol WINN. We did not pay dividends during fiscal 2011 or fiscal 2010 and have not paid a dividend during fiscal 2012.

The closing price of our common stock on Nasdaq on December 16, 2011, the last trading day prior to the public announcement of the merger agreement, was $5.43 per share. On February 2, 2012, the most recent practicable date before this proxy statement was mailed to our shareholders, the closing price of our common stock on Nasdaq was $9.46 per share. You are encouraged to obtain current market quotations for our common stock in connection with voting your shares.

The following table shows the quarterly high and low sales prices of Winn-Dixie s common stock for each quarter in fiscal 2012, fiscal 2011 and fiscal 2010:

	2010	
	High	**Low**
First Quarter	$16.00	$12.36
Second Quarter	$15.08	$9.80
Third Quarter	$13.17	$8.90
Fourth Quarter	$13.90	$9.60

	2011	
	High	**Low**
First Quarter	$10.44	$6.25
Second Quarter	$7.46	$5.95
Third Quarter	$7.20	$6.05
Fourth Quarter	$9.56	$6.53

	2012	
	High	**Low**
First Quarter	$10.08	$6.04
Second Quarter	$9.43	$5.07
Third Quarter (through February 2, 2012)	$9.49	$9.37

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SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table, except as otherwise noted, sets forth information about the beneficial ownership of our common stock as of January 4, 2012 by:

- the shareholders we know to beneficially own more than 5% of our outstanding common stock;
- each of our current directors and executive officers; and
- all of our current directors and executive officers as a group.

Unless otherwise indicated by footnote, the persons named in the table have sole voting and investment power with respect to the shares beneficially owned. Unless otherwise noted, the address of each person listed in the table is: c/o 5050 Edgewood Court, Jacksonville, Florida 32254.

	Number of Shares of Common Stock	Options Exercisable within 60 Days[(1)]	Unvested Restricted Stock Units[(2)]	Total Shares Beneficially Owned[(3)]	Percent of Outstanding Shares[(4)]
Directors and Executive Officers:					
Evelyn V. Follit	30,386	0	0	30,386	*
Charles P. Garcia	27,805	0	0	27,805	*
Jeffrey C. Girard	39,519	0	0	39,519	*
Yvonne R. Jackson	32,688	0	0	32,688	*
Gregory P. Josefowicz	41,019	0	0	41,019	*
Peter L. Lynch	288,383	878,851	0	1,167,234	2.06
James P. Olson	38,669	0	0	38,669	*
Terry Peets	40,576	0	0	40,576	*
Richard E. Rivera	39,394	0	0	39,394	*
Laurence B. Appel	44,559	238,826	0	283,385	*
Frank O. Eckstein	43,537	172,885	0	216,422	*
Bennett L. Nussbaum	44,180	202,907	0	247,087	*
Christopher L. Scott, Sr.	13,129	70,650	0	83,779	*
Timothy L. Williams	1,586	22,789	0	24,375	*
Directors and executive officers as a group (22 persons)	770,093	1,701,636	0	2,471,729	4.36
5% Shareholders:					
Zhengxu He [(5)]	3,040,140				5.37
Dimensional Fund Advisors LP[(6)]	3,498,886				6.17
Contrarius Investment Management [(7)]	4,547,871				8.03
BlackRock Institutional Trust Co., NA[(8)]	3,186,427				5.62

* Indicates beneficial ownership of less than 1%.

(1) Represents shares of common stock that may be acquired through stock options exercisable through March 4, 2012.

(2) Each RSU represents a contingent right to receive one share of our common stock. The column represents the number of unvested restricted stock units that are vesting within 60 days, or through March 4, 2012.

(3) Under SEC rules, a person is deemed to be a beneficial owner of a security if that person has or shares voting power, which includes the power to vote or to direct the voting of such security, or investment power, which includes the power to dispose of or to direct the disposition of such security. A person also is deemed to be a beneficial owner of any securities which that person has the right to acquire within 60 days. Under these rules, more than one person may be

deemed to be a beneficial owner of the same securities and a person may be deemed to be a beneficial owner of securities as to which he or she has no economic or pecuniary interest.

(4) Percent of class reported for directors and executive officers is based on 56,663,030 shares of common stock issued and outstanding as of January 4, 2012. Percent of class for 5% shareholders is based on ownership reported in a Schedule 13F or Schedule 13G as filed with the SEC by each 5% shareholder.

(5) According to a Schedule 13G filed with the SEC on March 23, 2011 by Zhengxu He, Institute of Math, AMSS, CAS, Haidian District, Beijing, 100080 P.R.C. Mr. He possesses shared investment and/or voting power of the shares of Company common stock that is owned by the He & Fang Revocable Living Trust and may be deemed to be the beneficial owner of Company stock held by this trust.

(6) According to a Schedule 13G filed with the SEC on February 11, 2011 by Dimensional Fund Advisors LP (Dimensional), Palisades West, Building One, 6300 Bee Cave Road, Austin, Texas, 78746. Dimensional, an investment advisor registered under Section 203 of the Investment Advisors Act of 1940, furnishes investment advice to four investment companies registered under the Investment Company Act of 1940, and serves as investment manager to certain other commingled group trusts and separate accounts. These investment companies, trusts and accounts are the Funds . In its role as investment advisor or manager, Dimensional possesses investment and/or voting power over the shares of Company common stock that are owned by the Funds, and may be deemed to be the beneficial owner of Company common stock held by the Funds. However, all securities reported are owned by the Funds. Dimensional disclaims beneficial ownership of such securities. In addition, the filing of the Schedule 13G shall not be construed as an admission by Dimensional or any of its affiliates that they are the beneficial owner of any securities covered by the Schedule 13G for any other purposes than Section 13(d) of the Exchange Act . The Funds have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, the securities held in their respective accounts. To the knowledge of Dimensional, the interest of any one such Fund does not exceed 5% of the class of securities. Dimensional disclaims beneficial ownership of all such securities.

(7) According to a Schedule 13F filed with the SEC on November 4, 2011 by Contrarius Investment Management Limited, Sir Walter Raleigh House, 48-50 Esplanade, St. Helier, Jersey JE1 4HH, Channel Islands.

(8) According to a Schedule 13G filed with the SEC on February 9, 2011 by BlackRock, Inc., 55 East 52nd Street, New York, NY.

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PROPOSAL 2 COMPENSATION OF NAMED EXECUTIVE OFFICERS

As required by Item 402(t) of Regulation S-K and Section 14A(b) of the Exchange Act, we are providing our shareholders with the opportunity to cast an advisory (non-binding) vote on the compensation that may become payable to our named executive officers in connection with the completion of the merger.

We believe that the compensation that may become payable to our named executive officers in connection with the completion of the merger is reasonable and demonstrates that our executive compensation program was designed appropriately and structured to ensure the retention of talented executives and a strong alignment of their interests with the long-term interests of our shareholders. This vote is not intended to address any specific item of compensation, but rather the overall compensation that may become payable to our named executive officers in connection with the completion of the merger. In addition, this vote is separate and independent from the vote of our shareholders on the merger agreement and the adjournment proposal. The Board of Directors asks that our shareholders vote **FOR** the following resolution:

RESOLVED, that the compensation that may become payable to the named executive officers named in this proxy statement in connection with the completion of the merger is approved.

This vote is advisory and, therefore, it will not be binding on Winn-Dixie, nor will it overrule any prior decision or require the Board of Directors (or any committee thereof) to take any action. The proposal will be approved if the votes cast FOR the proposal exceed the votes cast AGAINST the proposal.

More information regarding the compensation that may become payable to our named executive officers in connection with the completion of the merger is set forth in the section captioned *The Merger Interests of Our Directors and Executive Officers in the Merger* beginning on page 48.

Our Board of Directors unanimously recommends that you vote FOR the approval of the compensation that may become payable to our named executive officers in connection with the merger.

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PROPOSAL 3 ADJOURNMENT OF THE SPECIAL MEETING

If at the special meeting the number of shares of our common stock present or represented and voting in favor of the approval of the merger agreement is insufficient to approve the merger agreement under Florida law, we may propose to adjourn the special meeting for the purpose of soliciting additional proxies to approve the merger agreement. In that event, we will ask you to vote only upon the adjournment proposal and not the merger proposal.

In this proposal, we are asking you to authorize the holder of any proxy solicited by our Board of Directors to vote in favor of adjourning the special meeting and any later adjournments. If the shareholders approve the adjournment proposal, we could adjourn the special meeting, and any adjourned session of the special meeting, to use the additional time to solicit additional proxies in favor of the proposal to approve the merger agreement, including the solicitation of proxies from our shareholders that have previously voted against the merger proposal. Among other things, approval of the adjournment proposal could mean that, even if we had received proxies representing a sufficient number of votes against the proposal to approve the merger agreement, we could adjourn the special meeting without a vote on the proposal to approve the merger agreement and seek to convince the holders of those shares to change their votes to votes in favor of the approval of the merger agreement.

The approval of the proposal to adjourn the special meeting (if necessary or appropriate) to solicit additional proxies requires (i) if a quorum exists, that the number of shares voted in favor of adjournment are greater than those voted against, or (ii) in the absence of a quorum, the affirmative vote of the holders of a majority of the shares of our common stock represented at the special meeting. Accordingly, if a quorum is present, abstentions and broker non-votes will have no effect on the outcome of this proposal. However, if a quorum is not present and you abstain from voting, it has the same effect as a vote AGAINST the proposal. If no instructions are indicated on your proxy card, your shares will be voted FOR any adjournment of the special meeting (if necessary or appropriate) to solicit additional proxies.

Our Board of Directors believes that if the number of shares of our common stock present or represented at the special meeting and voting in favor of the proposal to approve the merger agreement is insufficient to approve the merger agreement, it is in the best interests of our shareholders to enable our Board of Directors to continue to seek to obtain a sufficient number of additional votes to approve the merger agreement.

Our Board of Directors unanimously recommends that you vote FOR the proposal to adjourn the special meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the merger agreement.

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OTHER MATTERS

Our Board of Directors currently knows of no other business that will be presented for consideration at the special meeting. Nevertheless, should any business other than that set forth in the notice of special meeting of shareholders be properly presented by or at the direction of the Board of Directors, the enclosed proxy confers discretionary authority to vote with respect to such matters, including matters that the Board of Directors does not know, a reasonable time before proxy solicitation, are to be presented at the special meeting. If any of these matters are properly presented by or at the direction of the Board of Directors at the special meeting, then the proxy agents named in the enclosed proxy card will vote in accordance with the recommendation of the Board of Directors.

FUTURE SHAREHOLDER PROPOSALS

If the merger is completed, there will be no public shareholders of Winn-Dixie and no public participation in any future meetings of our shareholders. However, if the merger is not completed, our shareholders will continue to be entitled to attend and participate in our shareholder meetings. We intend to hold an annual shareholders meeting in 2012 only if the merger is not completed, or if we are required to do so by law.

Proposals received from shareholders in accordance with Rule 14a-8 under the Exchange Act are given careful consideration by Winn-Dixie. Shareholder proposals are eligible for consideration for inclusion in the proxy statement for the 2012 annual meeting of shareholders if they are received by us on or before May 30, 2012. Shareholder proposals must be directed to us c/o Corporate Secretary, Winn-Dixie Stores, Inc., 5050 Edgewood Court, Jacksonville, Florida 32254. In order for a shareholder proposal submitted outside of Rule 14a-8 to be considered timely within the meaning of Rule 14a-4(c) under the Exchange Act, such proposal must be received by us not later than the last date for submission under our bylaws. In order for a proposal to be timely under our bylaws, proposals of shareholders made outside of Rule 14a-8 under the Exchange Act must have been submitted, in accordance with the requirements of our bylaws, no later than August 9, 2012 and no earlier than July 10, 2012; provided, however if the 2012 annual meeting of shareholders is advanced more than 30 days prior to or delayed more than 30 days after November 9, 2012, a proposal by a shareholder to be timely must be received not later than the close of business on the 10th day following the day on which notice of the date of the annual meeting was mailed or disclosure of the date of the annual meeting was made, whichever occurs first.

SHAREHOLDERS SHARING AN ADDRESS

We may deliver only one copy of this proxy statement to certain shareholders sharing an address unless we have received contrary instructions from one or more of the shareholders. Upon written or oral request, we will promptly deliver a separate copy of the proxy statement to a shareholder at a shared address to which a single copy of the proxy statement is delivered. A shareholder can notify us that the shareholder wishes to receive a separate copy of the proxy statement by contacting us at: Shareholder Relations, 5050 Edgewood Court, Jacksonville, Florida 32254-3699, telephone number (904) 783-5000, email address *shareholderrelations@winn-dixie.com*. Conversely, if multiple shareholders sharing an address receive multiple proxy statement and wish to receive only one, such shareholders can notify us at the address, phone number or email address set forth above.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any reports, statements or other information that we file with the Securities and Exchange Commission at the SEC s public reference room at the following location: Station Place, 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may also obtain copies of those documents at prescribed rates by writing to the Public Reference Section of the SEC at that address. Please call the SEC at (800) SEC-0330 for

further information on the public reference room. These SEC filings are also available to the public from commercial document retrieval services and at www.sec.gov.

You may obtain any of the documents we file with the SEC, without charge, by requesting them in writing from us at the following address: Winn-Dixie Stores, Inc., Investor Relations, 5050 Edgewood Court, Jacksonville, Florida, 32254-3699.

If you have any questions about this proxy statement, the special meeting or the merger or need assistance with the voting procedures, you should contact Georgeson, our proxy solicitor, toll-free at (866) 432-2791.

You should only rely on information provided in this proxy statement. No persons have been authorized to give any information or to make any representations other than those contained in this proxy statement and, if given or made, such information or representations must not be relied upon as having been authorized by us or any other person. This proxy statement is dated February 3, 2012. You should not assume that the information contained in this proxy statement is accurate as of any date other than that date, and the mailing of this proxy statement to stockholders shall not create any implication to the contrary.

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Annex A

AGREEMENT AND PLAN OF MERGER

among

OPAL HOLDINGS, LLC,

OPAL MERGER SUB, INC.

and

WINN-DIXIE STORES, INC.

Dated as of December 16, 2011

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AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER (this Agreement), dated as of December 16, 2011, between OPAL HOLDINGS, LLC, a Delaware limited liability company (Parent), OPAL MERGER SUB, INC., a Florida corporation and a wholly-owned Subsidiary of Parent (Merger Sub), and WINN-DIXIE STORES, INC., a Florida corporation (the Company).

RECITALS

WHEREAS, the parties intend that Merger Sub be merged with and into the Company, with the Company surviving, on the terms and subject to the conditions set forth herein (the Merger);

WHEREAS, the Board of Directors of the Company (the Company Board), acting on the unanimous recommendation of the special committee of the Company Board (the Special Committee), has unanimously (a) determined that it is in the best interests of the Company and its shareholders, and declared it advisable, to enter into this Agreement, (b) adopted this Agreement in accordance with the Florida Business Corporation Act (the FBCA), and (c) recommended that the shareholders of the Company approve this Agreement;

WHEREAS, the Board of Directors of Merger Sub has unanimously (a) determined that it is in the best interests of Merger Sub and its sole shareholder, Parent, and declared it advisable, to enter into this Agreement, (b) adopted this Agreement in accordance with the FBCA, and (c) recommended that its sole shareholder, Parent, approve this Agreement;

WHEREAS, the sole member of Parent has unanimously approved this Agreement; and

WHEREAS, concurrently with the execution of this Agreement, and as a condition and inducement to the Company s willingness to enter into this Agreement, Lone Star Fund V (U.S.), L.P. (the Guarantor) has provided a limited guarantee (the Limited Guarantee) to the Company with respect to certain of Parent s obligations under this Agreement;

NOW, THEREFORE, in consideration of the premises, and of the representations, warranties, covenants and agreements contained herein, and intending to be legally bound hereby, Parent, Merger Sub and the Company hereby agree as follows:

AGREEMENT

ARTICLE I

THE MERGER

SECTION 1.1 The Merger. Upon the terms and subject to the conditions set forth in this Agreement and in accordance with the FBCA, at the Effective Time, Merger Sub shall be merged with and into the Company. Following the Merger, the separate corporate existence of Merger Sub shall cease, and the Company shall continue as the surviving corporation in the Merger (the Surviving Corporation) and as a wholly-owned subsidiary of Parent.

SECTION 1.2 Closing. The closing of the Merger (the Closing) shall take place at 10:00 a.m., New York City time, on the second Business Day following the satisfaction or, to the extent permitted by applicable Law, waiver of the conditions set forth in Article VI (other than those conditions that by their terms are to be satisfied at the Closing, but subject to the satisfaction or, to the extent permitted by applicable Law, waiver of those conditions) at the New York offices of Gibson, Dunn & Crutcher LLP, unless another date, time or place is agreed to in writing by Parent and the Company. The date on which the Closing occurs is referred to in this Agreement as the Closing Date.

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SECTION 1.3 Effective Time. Upon the terms and subject to the provisions of this Agreement, as soon as practicable on the Closing Date, the parties shall file articles of merger (the "Articles of Merger") with the Department of State of Florida, executed in accordance with the relevant provisions of the FBCA, and, as soon as practicable on the Closing Date, shall make any and all other filings or recordings required under the FBCA to be made on the Closing Date. The Merger shall become effective at such time as the Articles of Merger are duly filed with the Department of State of Florida or at such other date or time on or after the date of filing of the Articles of Merger as Parent and the Company shall agree in writing and shall specify in the Articles of Merger (the time the Merger becomes effective being the "Effective Time").

SECTION 1.4 Effects of the Merger. The Merger shall have the effects set forth in this Agreement, the Articles of Merger and in the relevant provisions of the FBCA.

SECTION 1.5 Articles of Incorporation; Bylaws.

(a) At the Effective Time, the articles of incorporation of the Company shall be amended so that they read in their entirety as set forth in Exhibit A, and, as so amended, shall be the articles of incorporation of the Surviving Corporation until thereafter amended.

(b) At the Effective Time, and without any further action on the part of the Company and Merger Sub, the bylaws of the Company shall be amended so that they read in their entirety as set forth in Exhibit B, and, as so amended, shall be the bylaws of the Surviving Corporation until thereafter amended.

SECTION 1.6 Directors. The directors of Merger Sub immediately prior to the Effective Time shall be the directors of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified.

SECTION 1.7 Officers. The officers of the Company immediately prior to the Effective Time shall be the officers of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified.

ARTICLE II

EFFECT ON THE CAPITAL STOCK OF THE

CONSTITUENT CORPORATIONS; EXCHANGE OF CERTIFICATES

SECTION 2.1 Conversion of Capital Stock. At the Effective Time, by virtue of the Merger and without any action on the part of the Company, Parent, Merger Sub or the holders of any shares of capital stock of the Company, Parent or Merger Sub:

(a) Each share of common stock, par value $0.001 per share, of the Company (such shares, collectively, the "Shares") issued and outstanding immediately prior to the Effective Time (other than Shares to be cancelled in accordance with Section 2.1(b)) shall thereupon be converted automatically into and shall thereafter represent the right to receive $9.50 in cash, without interest, and subject to deduction for any required withholding Tax (the "Merger Consideration"), and shall no longer be outstanding and shall automatically be cancelled and shall cease to exist, and shall thereafter only represent the right to receive the Merger Consideration in accordance with Section 2.3, without interest.

(b) Each Share held in the treasury of the Company or owned, directly or indirectly, by Parent, Merger Sub or any wholly owned Subsidiary of the Company immediately prior to the Effective Time shall automatically be cancelled and shall cease to exist, and no consideration shall be delivered in exchange therefor.

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(c) Each share of common stock of Merger Sub issued and outstanding immediately prior to the Effective Time shall be converted into and shall become one validly issued, fully paid and non-assessable share of common stock of the Surviving Corporation.

(d) If at any time during the period between the date of this Agreement and the Effective Time, the outstanding shares of capital stock of the Company shall be changed into a different number of shares or a different class or shall have different terms, as a result of any reclassification, recapitalization, stock split (including a reverse stock split), subdivision, combination, exchange, stock dividend, stock distribution, or any other similar event, then the Merger Consideration shall be equitably adjusted to reflect such event so as to provide Parent and the holders of Shares the same economic effect as contemplated by this Agreement prior to such event; provided, that nothing in this paragraph (d) shall be construed to permit the Company to take any action with respect to its securities that is prohibited by the terms of this Agreement.

SECTION 2.2 Treatment of Options and Other Equity-Based Awards.

(a) Except as provided below, at the Effective Time, each option (each, a Company Stock Option) to purchase Shares granted under the 2012 Equity Incentive Plan, the 2010 Equity Incentive Plan or the 2007 Equity Incentive Plan (the Company Stock Plans) that is outstanding immediately prior to the Effective Time and that is vested or that, upon consummation of the Merger, will automatically vest in accordance with its terms, shall be cancelled and converted into the right to receive an amount in cash (without interest, and subject to deduction for any required withholding Tax) equal to the product of (i) the excess (if any) of the Merger Consideration over the exercise price per Share under such Company Stock Option and (ii) the number of Shares subject to such Company Stock Option; provided, that if the exercise price per Share of any such Company Stock Option is equal to or greater than the Merger Consideration, such Company Stock Option shall be cancelled without any cash payment being made in respect thereof. Notwithstanding the foregoing, any Company Stock Options attributable to outperformance awards (as defined in the Company Stock Plans or award agreements thereunder) that are unvested at the Effective Time and that are not automatically vested pursuant to their terms by virtue of the Merger shall be forfeited as of the Effective Time, without any consideration paid to the option holder.

(b) Except as provided below, at the Effective Time, each restricted stock unit (RSU) granted under the Company Stock Plans that is outstanding immediately prior to the Effective Time and that is vested or that, upon consummation of the Merger, will automatically vest in accordance with its terms, shall become fully vested with respect to 100% of the Shares set forth in the terms of the agreement granting such RSU and shall be cancelled and converted into the right to receive an amount in cash (without interest, and subject to deduction for any required withholding Tax) equal to the Merger Consideration for each such fully earned and vested RSU. Notwithstanding the above, any RSUs attributable to outperformance awards that are unvested at the Effective Time and that are not automatically vested pursuant to their terms by virtue of the Merger shall be forfeited as of the Effective Time, without any consideration paid to the holder thereof.

(c) Promptly after the execution of this Agreement, the Company shall mail to each holder of Company Stock Options and RSUs a letter describing the treatment of and payment for such Company Stock Options or RSUs pursuant to this Section 2.2 and providing instructions for use in obtaining payment for such Company Stock Options or RSUs. Parent shall, and shall cause the Surviving Corporation to, at all times from and after the Effective Time maintain sufficient liquid funds to satisfy their obligations to holders of Company Stock Options and RSUs pursuant to this Section 2.2.

(d) As of the Effective Time, any then current offering period under the Company s Employee Stock Purchase Plan (ESPP) shall be terminated and any unused cash returned (without interest) to the ESPP participants, and no further Shares shall be purchased thereunder.

(e) The Company shall take all reasonable actions necessary to ensure that, as of the Effective Time, the Company Stock Plans and any agreements thereunder, together with the ESPP and any other equity-based compensation or benefit plan (collectively, the Company Equity Plans) shall be terminated, and all Company

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Stock Options, RSUs, and any other equity-based awards shall be cancelled, at the Effective Time. After the Effective Time, no holder of a Company Stock Option, RSU, or other equity-based award or any participant in any Company Equity Plan shall have any rights to acquire the capital stock of the Company, the Surviving Corporation or any of their Subsidiaries, or any other rights with respect thereto, except the right to receive the payment contemplated by this Section 2.2 in cancellation and settlement thereof.

(f) As promptly as practicable following the Effective Time and in any event not later than the third Business Day thereafter, Parent or the Surviving Corporation shall pay (at Parent s option, through the Company s payroll system or through the Paying Agent) the amounts due and payable under this Article II to each holder of Company Stock Options and RSUs.

(g) The Chief Executive Officer of the Company has not vested in the deferred compensation units granted to him under the Winn-Dixie Stores, Inc. 2006 Deferred Compensation Plan, as amended, and such units shall be cancelled and forfeited at the Effective Time without any current or future consideration therefor.

SECTION 2.3 Exchange and Payment.

(a) Prior to the Effective Time, Parent shall (i) select a bank or trust company reasonably acceptable to the Company to act as the paying agent in the Merger (the Paying Agent) and (ii) enter into a paying agent agreement with the Paying Agent, the terms and conditions of which are satisfactory to the Company in its reasonable discretion. At the Effective Time, Parent shall deposit (or cause to be deposited) with the Paying Agent, in trust for the benefit of holders of Shares, cash in an amount sufficient to pay the aggregate Merger Consideration in accordance with this Article II (such cash, the Payment Fund). Except as otherwise provided in this Agreement, the Payment Fund shall not be used for any purpose other than to fund payments due pursuant to this Article II.

(b) Promptly after the Effective Time and in any event not later than the third Business Day thereafter, the Surviving Corporation shall cause the Paying Agent to mail to each holder of record of a certificate (the Certificates) and, if required, each holder of uncertified Shares represented by book entry (the Book-Entry Shares) that immediately prior to the Effective Time represented outstanding Shares that were converted into the right to receive the Merger Consideration (i) a form of letter of transmittal (which shall specify that delivery shall be effected, and risk of loss and title to the Certificates shall pass, only upon proper delivery of the Certificates to the Paying Agent, or in the case of Book-Entry Shares, upon adherence to the procedures set forth in the letter of transmittal, and which letter shall be in customary form and contain such other provisions as Parent or the Paying Agent may reasonably specify) and (ii) instructions for use in effecting the surrender of such Certificates or Book-Entry Shares in exchange for the Merger Consideration. Upon surrender of a Certificate or Book-Entry Share to the Paying Agent, together with such letter of transmittal, duly completed and validly executed in accordance with the instructions thereto, and such other documents as the Paying Agent may reasonably require, the holder of such Certificate or Book-Entry Share shall be entitled to receive in exchange therefor the Merger Consideration for each Share formerly represented by such Certificate or Book-Entry Share (subject to deduction for any required withholding Tax), and the Certificate or Book-Entry Share so surrendered shall forthwith be cancelled. No interest will be paid or accrued for the benefit of holders of Certificates or Book-Entry Shares on the Merger Consideration.

(c) If payment of the Merger Consideration is to be made to a Person other than the Person in whose name the surrendered Certificate or Book-Entry Share is registered, it shall be a condition of payment that such Certificate so surrendered shall be properly endorsed or shall be otherwise in proper form for transfer or such Book-Entry Share shall be properly transferred and that the Person requesting such payment shall have paid any transfer and other Taxes required by reason of the payment of the Merger Consideration to a Person other than the registered holder of such Certificate or Book-Entry Share or shall have established to the satisfaction of Parent that such tax is not applicable.

(d) Until surrendered as contemplated by this Section 2.3, each Certificate or Book-Entry Share shall be deemed after the Effective Time to represent only the right to receive the Merger Consideration payable in respect thereof pursuant to this Agreement.

(e) All cash paid upon the surrender for exchange of Certificates or Book-Entry Shares in accordance with the terms of this Article II shall be deemed to have been paid in full satisfaction of all rights pertaining to the Shares formerly represented by such Certificates or Book-Entry Shares. At the Effective Time, the stock transfer books of the Company shall be closed and there shall be no further registration of transfers of the Shares that were outstanding immediately prior to the Effective Time. If, after the Effective Time, Certificates are presented to the Surviving Corporation or the Paying Agent for transfer or transfer is sought for Book-Entry Shares, such Certificates or Book-Entry Shares shall be cancelled and exchanged as provided in this Article II.

(f) The Paying Agent shall invest any cash included in the Payment Fund as directed by Parent, on a daily basis; provided, that no such investment or losses thereon shall affect the Merger Consideration payable to any Person under this Agreement and Parent shall promptly provide, or shall cause the Surviving Corporation to promptly provide, additional funds to the Paying Agent for the benefit of such Persons to the extent necessary to satisfy the obligations of Parent and the Surviving Corporation under this Section 2.3(f). Any interest or other income resulting from such investments shall be paid to Parent, upon demand.

(g) Any portion of the Payment Fund that remains undistributed to the holders of Certificates or Book-Entry Shares six months after the Effective Time shall be delivered to the Surviving Corporation, upon demand, and any remaining holders of Certificates or Book-Entry Shares shall thereafter look only to the Surviving Corporation as general creditors thereof for payment of the Merger Consideration (subject to abandoned property, escheat or other similar laws).

(h) None of Parent, the Surviving Corporation, the Paying Agent or any other Person shall be liable to any Person in respect of any portion of the Payment Fund properly delivered to a public official pursuant to any applicable abandoned property, escheat or similar Law. If any Certificates or Book-Entry Shares shall not have been exchanged prior to the date on which the related Merger Consideration would otherwise escheat to or become the property of any Governmental Entity, any such Merger Consideration in respect thereof shall, to the extent permitted by applicable Law, become the property of the Surviving Corporation, free and clear of all claims or interest of any Person previously entitled thereto.

(i) If any Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit, in form and substance reasonably acceptable to Parent, of that fact by the Person claiming such Certificate to be lost, stolen or destroyed and, if required by Parent or the Paying Agent, the posting by such Person of a bond in such amount as Parent or the Paying Agent may determine is reasonably necessary as indemnity against any claim that may be made against it or the Surviving Corporation with respect to such Certificate, the Paying Agent will deliver in exchange for such lost, stolen or destroyed Certificate the Merger Consideration payable in respect thereof pursuant to this Agreement.

SECTION 2.4 Withholding Rights. Parent, the Surviving Corporation and the Paying Agent shall be entitled to deduct and withhold from the consideration payable to any holder of Shares, Company Stock Options, RSUs or otherwise pursuant to this Agreement such amounts as Parent, the Surviving Corporation or the Paying Agent are required to deduct and withhold under the Internal Revenue Code of 1986 (the Code), or any provision of state, local or foreign Tax Law. To the extent that amounts are so withheld and paid over to the appropriate taxing authority, such amounts shall be treated for all purposes of this Agreement as having been paid to the Person in respect of which such deduction and withholding was made.

SECTION 2.5 Appraisal Rights. Notwithstanding anything in this Agreement to the contrary, if and to the extent appraisal rights are available in the Merger to holders of Shares pursuant to Section 607.1302 of the FBCA, then:

(a) any Shares issued and outstanding immediately prior to the Effective Time for which the holder thereof (i) has not voted in favor of the Merger or consented to it in writing and (ii) is entitled to demand and has demanded the appraisal of such Shares in accordance with, and has complied in all respects with, Section 607.1302 of the FBCA (collectively, the Dissenting Shares), shall not be converted into the right to receive the Merger Consideration in accordance with Section 2.1 and, instead, shall be treated in accordance with Section 607.1323 of the FBCA;

(b) the holders of Dissenting Shares shall be entitled only to such rights as may be granted to them under Section 607.1302 of the FBCA;

(c) notwithstanding the provisions of Section 2.5(a) and (b), if any holder of Dissenting Shares effectively withdraws or loses such appraisal rights (through failure to perfect such appraisal rights or otherwise), then that holder s Shares (i) shall be deemed no longer to be Dissenting Shares and (ii) shall be treated as if they had been converted automatically at the Effective Time into the right to receive the Merger Consideration in accordance with Sections 2.1 and 2.3;

(d) the Company shall give Parent (i) prompt notice of any written demands for appraisal of any Shares, any withdrawals of such demands and any other instrument served on the Company relating to rights to appraisal and (ii) the right to participate in and direct all negotiations and proceedings with respect to such demands for appraisal; and

(e) the Company shall not, without the prior written consent of Parent, make any payment with respect to, settle or offer to settle, or approve any withdrawal of any such appraisal demands.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

Except as set forth (a) in the corresponding section or subsection of the disclosure letter delivered by the Company to Parent contemporaneously with the execution of this Agreement (the Company Disclosure Letter) (it being agreed that the disclosure of any information in a particular section or subsection of the Company Disclosure Letter shall be deemed disclosure of such information with respect to any other section or subsection of this Article III to which the relevance of such information is readily apparent on its face) or (b) in the Company SEC Documents filed on or after December 1, 2010 and publicly available as of the date of this Agreement (excluding any disclosures set forth in any risk factor section, and in any section relating to forward looking statements), provided, that this clause (b) shall not apply to Sections 3.1, 3.2, 3.4, 3.5, 3.19, 3.20, 3.22 and 3.23, the Company represents and warrants to Parent and Merger Sub as follows:

SECTION 3.1 Organization, Standing and Power.

(a) Each of the Company and its Subsidiaries (i) is an entity duly organized, validly existing and in good standing under the Laws of the jurisdiction of its organization, (ii) has all requisite corporate or similar power and authority, in all material respects, to own, lease and operate its properties and to carry on its business as now being conducted, and (iii) is duly qualified or licensed to do business and is in good standing in each jurisdiction in which the nature of its business or the ownership, leasing or operation of its properties makes such qualification or licensing necessary, except in the case of clause (iii), where the failure to be so qualified or licensed or in good standing, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect.

(b) The Company has made available to Parent by posting in the Company s electronic data room true and complete copies of the Company s articles of incorporation (the Company Charter) and bylaws (the Company Bylaws) and the articles of incorporation and bylaws (or comparable organizational documents) of each of its Subsidiaries, and each as so delivered is in full force and effect. The Company is not in material violation of any provision of the Company Charter or Company Bylaws.

SECTION 3.2 Capital Stock.

(a) Company Stock.

(i) The authorized capital stock of the Company consists of 400,000,000 Shares and no shares of preferred stock. As of the close of business on December 14, 2011 (the Measurement Date), (A) 56,663,030 Shares (excluding treasury shares) were issued and outstanding, (B) 0 Shares were held by the Company in treasury and 112,607 Shares were owned by the Company s wholly-owned Subsidiaries, and (C) 11,394,674 Shares were reserved for issuance pursuant to the Company Stock Plans (of which 4,302,373 Shares were subject to outstanding Company Stock Options and 2,236,848 Shares were subject to outstanding RSUs).

(ii) All outstanding shares of capital stock of the Company are, and all shares reserved for issuance will be when issued, duly authorized, validly issued, fully paid and nonassessable, and not subject to or issued in violation of any purchase option, call option, right of first refusal, preemptive right, subscription right or any similar right under any provision of the FBCA, the Company Charter, the Company Bylaws or any Contract to which the Company is a party or is otherwise bound. Other than as set forth in paragraph (i) above, no shares of capital stock of the Company are owned by any Subsidiary of the Company. All outstanding shares of capital stock and other voting securities or equity interests of each Subsidiary of the Company have been duly authorized and validly issued, are fully paid, nonassessable and not subject to or issued in violation of any purchase option, call option, right of first refusal, preemptive right, subscription right or any similar right. All shares of capital stock and other voting securities or equity interests of each such Subsidiary are owned, directly or indirectly, by the Company, free and clear of all pledges, claims, liens, charges, options, rights of first refusal, encumbrances and security interests of any kind or nature whatsoever (including any limitation on voting, sale, transfer or other disposition or exercise of any other attribute of ownership) (collectively, Liens).

(iii) Neither the Company nor any of its Subsidiaries has outstanding any bonds, debentures, notes or other obligations having the right to vote (or convertible into, or exchangeable or exercisable for, securities having the right to vote) with the shareholders of the Company or such Subsidiary on any matter. Except as set forth above in this paragraph (a) and except for changes since the close of business on the Measurement Date resulting from the exercise of Company Stock Options described in Section 3.2(b), there are no outstanding (A) shares of capital stock or other voting securities or equity interests of the Company, (B) securities of the Company or any of its Subsidiaries convertible into or exchangeable or exercisable for shares of capital stock of the Company or other voting securities or equity interests of the Company or any of its Subsidiaries, (C) stock appreciation rights, phantom stock rights, performance units, interests in or rights to the ownership or earnings of the Company or any of its Subsidiaries or other equity equivalent or equity-based awards or rights, (D) subscriptions, options, warrants, calls, commitments, Contracts or other rights to acquire from the Company or any of its Subsidiaries, or obligations of the Company or any of its Subsidiaries to issue, any shares of capital stock of the Company or any of its Subsidiaries, voting securities, equity interests or securities convertible into or exchangeable or exercisable for capital stock or other voting securities or equity interests of the Company or any of its Subsidiaries or rights or interests described in the preceding clause (C), or (E) obligations of the Company or any of its Subsidiaries to repurchase, redeem or otherwise acquire any such securities or to issue, grant, deliver or sell, or cause to be issued, granted, delivered or sold, any such securities.

(iv) There are no shareholder agreements, voting trusts or other agreements or understandings to which the Company or any of its Subsidiaries is a party or to which the Company has knowledge with respect to

the holding, voting, registration, redemption, repurchase or disposition of, or that restricts the transfer of, any capital stock or other voting securities or equity interests of the Company or any of its Subsidiaries.

(b) Company Stock Awards.

(i) Section 3.2(b) of the Company Disclosure Letter sets forth a true and complete list of all holders, as of the close of business on the Measurement Date, of outstanding Company Stock Options, RSUs, rights to purchase Shares under the ESPP, and other similar rights to purchase or receive Shares granted under the Company Equity Plans or otherwise (collectively, Company Stock Awards), indicating as applicable, with respect to each Company Stock Award then outstanding, the type of award granted, the number of Shares subject to such Company Stock Award, the name of the plan under which such Company Stock Award was granted, the date of grant, exercise or purchase price, vesting schedule, payment schedule (if different from the vesting schedule) and expiration thereof.

(ii) Each Company Stock Option intended to qualify as an incentive stock option under Section 422 of the Code so qualifies and the exercise price of each other Company Stock Option is no less than the fair market value of a Share as determined on the date of grant of such Company Stock Option. The Company has made available to Parent true and complete copies of all Company Stock Plans and the forms of all stock option agreements evidencing outstanding Company Stock Options and restricted stock agreements evidencing outstanding RSUs. The Company Board s compensation committee, as the administrator of the Company Equity Plans, has determined (within its discretion as the administrator of the Company Equity Plans) that the Company Stock Options (whether in-the-money or out-of-the-money) and RSUs can be involuntarily cancelled without the award holder s consent upon consummation of the Merger in accordance with Section 2.2.

SECTION 3.3 Subsidiaries. Section 3.3 of the Company Disclosure Letter sets forth a true and complete list of each Subsidiary of the Company, including its jurisdiction of incorporation or formation. Except for the capital stock of, or other equity or voting interests in, its Subsidiaries, the Company does not own, directly or indirectly, any equity, membership interest, partnership interest, joint venture interest, or other equity or voting interest in, or any interest convertible into, exercisable or exchangeable for any of the foregoing, nor is it or any of its Subsidiaries under any obligation to form or participate in, provide funds to, or make any loan, capital contribution, guarantee, credit enhancement or other investment in any Person.

SECTION 3.4 Authority.

(a) The Company has all necessary corporate power and authority to execute, deliver and perform its obligations under this Agreement and to consummate the Merger and the other transactions contemplated hereby. The execution, delivery and performance of this Agreement by the Company and the consummation by the Company of the Merger and the other transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of the Company and no other corporate proceedings on the part of the Company are necessary to approve this Agreement or to consummate the Merger and the other transactions contemplated hereby, subject, in the case of the consummation of the Merger, to the approval of this Agreement by the holders of a majority of the outstanding Shares (the Company Shareholder Approval). This Agreement has been duly executed and delivered by the Company and, assuming the due authorization, execution and delivery by Parent and Merger Sub, constitutes a valid and binding obligation of the Company, enforceable against the Company in accordance with its terms (except to the extent that enforceability may be limited by applicable bankruptcy, insolvency, moratorium, reorganization or similar Laws affecting the enforcement of creditors rights generally or by general principles of equity).

(b) The Company Board, at a meeting duly called and held at which all directors of the Company were present, acting on the unanimous recommendation of the Special Committee, duly and unanimously adopted resolutions (i) determining that the terms of this Agreement, the Merger and the other transactions contemplated hereby are in the best interests of the Company and its shareholders, (ii) adopting, in accordance with the FBCA, and declaring advisable this Agreement and the transactions contemplated hereby, including the Merger,

(iii) directing that this Agreement be submitted to the shareholders of the Company for approval, and (iv) recommending that the Company s shareholders vote in favor of the approval of this Agreement and the transactions contemplated hereby, including the Merger, which resolutions have not been subsequently rescinded, modified or withdrawn in any way, except as may be permitted by Section 5.3.

(c) The Company Shareholder Approval is the only vote of the holders of any class or series of the Company s capital stock or other securities required in connection with the Merger. No vote of the holders of any class or series of the Company s capital stock or other securities is required in connection with the consummation of any of transactions contemplated hereby other than the Merger.

SECTION 3.5 No Conflict; Consents and Approvals.

(a) The execution, delivery and performance of this Agreement by the Company does not, and the consummation of the Merger and the other transactions contemplated hereby and compliance by the Company with the provisions hereof will not, conflict with, or result in any violation or breach of, or default (with or without notice or lapse of time, or both) under, or give rise to a right of, or result in, termination, cancellation, modification or acceleration of any obligation under, or to the loss of a material benefit under, or result in the creation of any Lien in or upon any of the properties, assets or rights of the Company or any of its Subsidiaries under, or give rise to any increased, additional, accelerated or guaranteed rights or entitlements under, or require any consent, waiver or approval of any Person pursuant to, any provision of (i) the Company Charter or Company Bylaws, or the articles of incorporation or bylaws (or similar organizational documents) of any Subsidiary of the Company, (ii) any bond, debenture, note, mortgage, indenture, guarantee, license, lease, purchase or sale order or other contract, commitment, agreement, obligation, undertaking or other binding arrangement (each, a Contract) to which the Company or any of its Subsidiaries is a party or by which the Company or any of its Subsidiaries or any of their respective properties or assets may be bound, or (iii) subject to the governmental filings and other matters referred to in Section 3.5(b), any federal, state, local or foreign law (including common law), statute, ordinance, rule, code, regulation, order, judgment, injunction, decree or other legally enforceable requirement (Law) or any rule or regulation of The Nasdaq Stock Market (Nasdaq) applicable to the Company or any of its Subsidiaries or by which the Company or any of its Subsidiaries or any of their respective properties or assets may be bound, except as, in the case of clauses (ii) and (iii), as individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect.

(b) No consent, approval, order or authorization of, or registration, declaration, filing with or notice to, any federal, state, local or foreign government or subdivision thereof or any other governmental, administrative, judicial, arbitral, legislative, executive, regulatory or self-regulatory authority, instrumentality, agency, commission or body (each, a Governmental Entity) is required by or with respect to the Company or any of its Subsidiaries in connection with the execution, delivery and performance of this Agreement by the Company or the consummation of the Merger and the other transactions contemplated hereby or compliance with the provisions hereof, except for (i) the actions required by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (together with the rules and regulations promulgated thereunder, the HSR Act), (ii) such filings and reports as may be required pursuant to the applicable requirements of the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act), (iii) the filing of the Articles of Merger with the Department of State of Florida as required by the FBCA, (iv) any filings and approvals required under the rules and regulations of Nasdaq, and (v) such other consents, approvals, orders, authorizations, registrations, declarations, filings or notices the failure of which to be obtained or made, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect.

SECTION 3.6 SEC Reports; Financial Statements.

(a) The Company has filed with or furnished to the SEC on a timely basis all forms, reports, schedules, statements and other documents required to be filed with or furnished to the SEC by the Company since December 1, 2008 (all such documents, together with all exhibits and schedules to the foregoing materials and all

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information incorporated therein by reference, the Company SEC Documents). As of their respective filing dates (or, if amended or superseded by a filing prior to the date of this Agreement, then on the date of such filing), the Company SEC Documents complied in all material respects with the applicable requirements of the Securities Act, the Exchange Act and all other applicable federal securities Laws (including the rules and regulations promulgated thereunder), and none of the Company SEC Documents contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

(b) The financial statements (including the related notes and schedules thereto) forming part of the Company SEC Documents (i) have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) (except, in the case of unaudited statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto), (ii) comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, and (iii) fairly present in all material respects the consolidated financial position of the Company and its Subsidiaries as of the dates thereof and their respective consolidated results of operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal year-end audit adjustments), all in accordance with GAAP and the applicable rules and regulations promulgated by the SEC. Since the end of the Company s most recently completed fiscal year, the Company has not made any material change in the accounting practices or policies applied in the preparation of its financial statements, except as required by GAAP, SEC rule or policy or applicable Law.

(c) Since December 1, 2008, the Company has maintained disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 under the Exchange Act) and a system of internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act), in each case sufficient to satisfy the requirements of the Exchange Act and such rules. Since December 1, 2008, the Company has disclosed to the Company s auditors and audit committee (i) all significant deficiencies and material weaknesses in the design or operation of the Company s internal control over financial reporting and (ii) all fraud, whether or not material, that involves management or other employees who have a significant role in the Company s internal control over financial reporting. A true and complete copy of all such disclosures has been previously made available to Parent.

(d) As of the date of this Agreement, there are no outstanding or unresolved comments in the comment letters received from the SEC staff with respect to the Company SEC Documents. To the knowledge of the Company, none of the Company SEC Documents is subject to ongoing review or outstanding SEC comment or investigation.

(e) Since December 1, 2008, the Company has been in compliance in all material respects with the applicable listing and corporate governance rules and regulations of Nasdaq.

(f) No Subsidiary of the Company is required to file any form, report, schedule, statement or other document with the SEC.

SECTION 3.7 No Undisclosed Liabilities. Neither the Company nor any of its Subsidiaries has any liabilities or obligations of any nature, whether accrued, absolute, contingent or otherwise, known or unknown, or due or to become due, of a type required to be recorded or reflected on a balance sheet under GAAP, that have had or would reasonably be expected to have a Material Adverse Effect, except (a) to the extent accrued or reserved against in the most recent consolidated balance sheet of the Company and its Subsidiaries (or disclosed in the footnotes thereto) included in the Company SEC Documents filed prior to the date hereof, (b) for liabilities and obligations incurred in the ordinary course of business consistent with past practice since the date of such balance sheet, and (c) for liabilities and obligations expressly contemplated by this Agreement.

SECTION 3.8 Absence of Certain Changes or Events. From June 29, 2011 through the date hereof: (a) the Company and its Subsidiaries have conducted their businesses in the ordinary course consistent with past

practice in all material respects; (b) there has not been any change, event or development that, individually or in the aggregate, has had or would reasonably be expected to have a Material Adverse Effect; and (c) none of the Company or any of its Subsidiaries has taken any action that, if taken after the date of this Agreement, would constitute a breach of any of the covenants set forth in Section 5.1 (other than paragraph (h) and (j) thereof). Since June 29, 2011, the Company and its Subsidiaries have not made any capital expenditures that were in excess of previously budgeted amounts as contemplated by the Company s fiscal 2012 annual operating plan.

SECTION 3.9 Litigation. As of the date hereof, there is no action, suit, claim, arbitration, investigation or other proceeding (each, an Action) pending or, to the knowledge of the Company, threatened against or affecting the Company or any of its Subsidiaries, any of their respective properties or assets, or any present or former officer, director or employee of the Company or any of its Subsidiaries in such individual s capacity as such, other than any Action commenced by a Person that is not a Governmental Entity that (a) does not involve an amount in controversy that is material to the Company and its Subsidiaries, taken as a whole, and (b) does not seek material injunctive or other non-monetary relief against the Company or any of its Subsidiaries. There is no Action pending or, to the knowledge of the Company, threatened against or affecting the Company or any of its Subsidiaries, any of their respective properties or assets, or any present or former officer, director or employee of the Company or any of its Subsidiaries in such individual s capacity as such, other than any Action that, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect. As of the date hereof, neither the Company nor any of its Subsidiaries nor any of their respective properties or assets is subject to any material outstanding judgment, order, injunction, rule or decree of any Governmental Entity. As of the date hereof, there is no Action pending or, to the knowledge of the Company, threatened seeking to prevent, hinder, modify, delay or challenge the Merger or any of the other transactions contemplated by this Agreement.

SECTION 3.10 Compliance with Laws. Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, the Company and each of its Subsidiaries are and, at all times since December 1, 2008 have been, in compliance with all Laws applicable to their businesses, operations, properties or assets. Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, none of the Company or any of its Subsidiaries has received, since December 1, 2008, a notice or other written communication alleging or relating to a possible violation of any Law applicable to their businesses, operations, properties or assets. Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, the Company and each of its Subsidiaries have in effect all permits, licenses, variances, exemptions, authorizations, operating certificates, franchises, orders and approvals of all Governmental Entities (collectively, Permits) necessary for them to own, lease or operate their properties and assets and to carry on their businesses and operations as now conducted, and there has occurred no violation of, default (with or without notice or lapse of time, or both) under or event giving to others any right of revocation, non-renewal, adverse modification or cancellation of, with or without notice or lapse of time or both, any such Permit, nor would any such revocation, non-renewal, adverse modification or cancellation result from the consummation of the transactions contemplated hereby.

SECTION 3.11 Benefit Plans.

(a) The Company has provided to Parent a true and complete list of each material (i) employee benefit plan (within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (ERISA)), (ii) multiemployer plan (within the meaning of Section 3(37) of ERISA), (iii) stock purchase, stock option, phantom stock or other equity-based plan, and (iv) severance, facility closing, employment, collective bargaining, change-in-control, fringe benefit, bonus, incentive, deferred compensation, supplemental retirement, death benefit, cafeteria, vacation, and other material employee benefit and compensation plans, agreements, programs, policies or other arrangements, whether or not subject to ERISA (including any funding mechanism therefor), whether formal or informal, (x) under which any current or former employee, director, or consultant of the Company or its Subsidiaries has any rights to material compensation or benefits from the

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Company or any of its Subsidiaries or (y) for which the Company or any Subsidiary has any material liability or with respect to which it is otherwise bound. All such plans, agreements, programs, policies and arrangements shall be collectively referred to as the Company Plans. With respect to each Company Plan, the Company has furnished or made available to Parent a current, accurate and complete copy thereof and, to the extent applicable: (i) any related trust agreement, insurance policy or other funding instrument, (ii) the most recent determination letter of the Internal Revenue Service (the IRS), if applicable, (iii) any summary plan description and other material written communications (or a description of any material oral communications) by the Company or its Subsidiaries to their employees concerning the extent of the benefits provided under a Company Plan, (iv) for the most recent year (A) the Form 5500 and attached schedules, (B) audited financial statements (or if none, the latest cost summaries, including any Form 990 or 990T filings), and (C) actuarial valuation reports, (v) nondiscrimination testing results, (vi) forms of Company Equity Plan award agreements, (vii) correspondence in connection with any material government audit or investigation, excise tax, funding waiver, closing agreement or correction program, (viii) information relating to any material pending or threatened litigation or other legal proceeding involving a Company Plan, and (ix) any self-help analysis, reports of outside consultants or auditors, or similar materials examining actual or potential liabilities with respect to any Company Plan. Section 3.11(a) of the Company Disclosure Letter sets forth the maximum aggregate Gross-Up Payments that may be triggered by the consummation of the transactions contemplated hereby, assuming an involuntary termination of all eligible employees without cause as of March 31, 2012.

(b) With respect to the Company Plans:

(i) except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, (A) each Company Plan has been established and administered in accordance with its terms and in compliance with the applicable provisions of ERISA, the Code and all other applicable Law, (B) no non-exempt prohibited transaction, as described in Section 406 of ERISA or Section 4975 of the Code, has occurred with respect to any Company Plan, and (C) all contributions required to be made under the terms of any Company Plan have been timely made;

(ii) each Company Plan intended to be qualified under Section 401(a) of the Code is so qualified and has received a favorable determination, advisory or opinion letter, as applicable, from the IRS that it is so qualified and nothing has occurred since the date of such letter that would reasonably be expected to cause the loss of such qualified status of such Company Plan;

(iii) no Company Plan is subject to Title IV or Part 3 of Title I of ERISA or Section 412 of the Code;

(iv) except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, there is no Action (including any investigation, audit or other administrative proceeding) by the Department of Labor, the Pension Benefit Guaranty Corporation (the PBGC), the IRS, the SEC or any other Governmental Entity or by any plan participant or beneficiary pending, or to the knowledge of the Company, threatened, relating to the Company Plans (other than routine, uncontested claims for benefits), nor, to the knowledge of the Company, are there facts or circumstances that exist that could reasonably give rise to any such Actions;

(v) any Company Plan providing death benefits is fully insured (other than the Company s 401(k) plan);

(vi) no Company Plan is a multiple employer plan (as defined in Code Section 413) or a multiemployer plan (within the meaning of ERISA section 3(37)) to which the Company, its Subsidiaries or any member of their Controlled Group (defined as any organization which is a member of a controlled group of organizations within the meaning of Code Sections 414(b), (c), (m) or (o)) has any liability or has contributed (or had at any time contributed or had an obligation to contribute);

(vii) with respect to each Company Plan or similar plan currently or formerly maintained or contributed to (or required to be contributed to) by the Company, a Subsidiary, or any current or former member of their Controlled Group, to the knowledge of the Company, no event has occurred and no condition exists that on

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or after the Effective Time could subject the Company, Parent or Surviving Corporation, directly or indirectly, to any material liability (including material liability under any indemnification agreement) under Section 412, 413, 4971, 4975 or 4980B of the Code or Section 302, 502, 515, 601, 606 or Title IV of ERISA;

(viii) no Company Plan provides for any post-employment welfare benefits; and with respect to any Company Plan that provides retiree welfare benefits, (A) such plans can be amended or terminated at any time, and (B) the FAS 106 liabilities of the Company or its Subsidiaries and the assumptions used therefor accurately reflect the costs associated with the rights and benefit of all plan participants;

(ix) except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, (A) none of the Company and its Subsidiaries or members of their Controlled Group has incurred any direct or indirect liability under ERISA or the Code in connection with the termination of, withdrawal from or failure to fund, any Company Plan or other retirement plan, and (B) no fact or event exists that would reasonably be expected to give rise to any such liability;

(x) none of the Company Plans provides for payment of a benefit, the increase of a benefit amount, the payment of a contingent benefit, the deemed satisfaction of goals or conditions, the release or modification of any indebtedness, or the acceleration of the funding, payment or vesting of a benefit determined or occasioned, in whole or in part, by reason of the execution of this Agreement or the consummation of the transactions contemplated hereby (CIC Payment);

(xi) no Company Plan provides for any gross-up payment for any excise tax imposed by or relating to Code Section 280G or 4999 (Gross-Up Payment);

(xii) any Gross-Up Payment provided under the Company s Executive Severance Plan is based solely on the severance pay and benefits payable under such Executive Severance Plan, and does not provide for any Gross-Up Payment relating to any accelerated vesting or payout under any Company Equity Plan or attributable to any other CIC Payment; and any Company Equity Plan acceleration or other CIC Payment is not counted in determining whether or not any Executive Severance Plan participant is entitled to any Gross-Up Payment with respect to any compensation or benefits provided under the Executive Severance Plan; and

(xiii) no Company Plan has any unfunded benefits that are not fully reflected in the Company s audited financial statements (including without limitation, any accruals or reserves or other provisions for any liabilities that may be triggered upon a change in control).

(c) Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, each Company Plan that is a nonqualified deferred compensation plan within the meaning of Section 409A(d)(1) of the Code (a Nonqualified Deferred Compensation Plan) subject to Section 409A of the Code has been operated in compliance with Section 409A of the Code.

SECTION 3.12 Labor Matters.

(a) Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, the Company and its Subsidiaries are and have been since December 1, 2008, in compliance with all applicable Laws relating to labor and employment, including those relating to wages, hours, collective bargaining, unemployment compensation, workers compensation, equal employment opportunity, age and disability discrimination, immigration control, employee classification, information privacy and security, payment and withholding of taxes and continuation coverage with respect to group health plans. Since December 1, 2010, there has not been, and as of the date of this Agreement there is not pending or, to the knowledge of the Company, threatened, any material labor dispute, work stoppage, labor strike or lockout against the Company or any of its Subsidiaries by employees.

(b) As of the date hereof no employee of the Company or any of its Subsidiaries is covered by an effective or pending collective bargaining agreement or similar labor agreement. As of the date hereof, to the knowledge of the Company, there has not been any activity on behalf of any labor organization or employee group to organize any such employees. As of the date hereof, there are no (i) material unfair labor practice charges or complaints against the Company or any of its Subsidiaries pending before the National Labor Relations Board or any other labor relations tribunal or authority and to the knowledge of the Company no such representations, claims or petitions are threatened, (ii) representation claims or petitions pending before the National Labor Relations Board or any other labor relations tribunal or authority or (iii) grievances or pending arbitration proceedings against the Company or any of its Subsidiaries that arose out of or under any collective bargaining agreement.

SECTION 3.13 Environmental Matters.

(a) Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect: (i) since December 1, 2006, the Company and each of its Subsidiaries have conducted their respective businesses in compliance with all, and have not violated any, applicable Environmental Laws; (ii) there has been no release of any Hazardous Substance by the Company or any of its Subsidiaries in any manner that has given or would reasonably be expected to give rise to any remedial obligation, corrective action requirement or liability under applicable Environmental Laws; (iii) since December 1, 2006, neither the Company nor any of its Subsidiaries has received any claims, notices, demand letters or requests for information (except for such claims, notices, demand letters or requests for information the subject matter of which has been resolved prior to the date of this Agreement) from any federal, state, local, foreign or provincial Governmental Entity or any other Person asserting that the Company or any of its Subsidiaries is in violation of, or liable under, any Environmental Law; (iv) no Hazardous Substance has been disposed of, arranged to be disposed of, released or transported in violation of any applicable Environmental Law, or in a manner that has given rise to, or that would reasonably be expected to give rise to, any liability under any Environmental Law, from any current or former properties or facilities while owned or operated by the Company or any of its Subsidiaries and, to the knowledge of the Company, Hazardous Substances are not otherwise present at or about any such current or former properties or facilities in amount or condition that has resulted in or would reasonably be expected to result in liability to the Company or any of its Subsidiaries under any Environmental Law; (v) neither the Company, its Subsidiaries nor any of their respective properties or facilities are subject to or, to the knowledge of the Company, are threatened to become subject to, any liabilities relating to any suit, settlement, court order, administrative order, regulatory requirement, judgment or claim asserted or arising under any Environmental Law or any agreement relating to environmental liabilities; and (vi) neither the Company nor any of its Subsidiaries is currently subject or party to any agreement, order, judgment or decree by or with any Governmental Entity or third party pursuant to which the Company or any of its Subsidiaries has assumed, incurred or suffered any liability or obligation under any Environmental Law. Copies of all material environmental site assessment reports (including any material Phase I or Phase II reports), material investigation, remediation or compliance studies, or material audits, assessments or similar documents which are in the possession, custody or control of either the Company or its Subsidiaries and relate to the environmental conditions at any property currently or formerly owned or leased by either the Company or its Subsidiaries have been provided to Parent.

(b) As used herein, Environmental Law means any Law relating to (i) protection of human health and environment (including air, surface water, groundwater, drinking water supply, surface land, subsurface land or any other natural resource), and (ii) the use, storage, recycling, treatment, generation, transportation, processing, handling, labeling, production, release or disposal of Hazardous Substances.

(c) As used herein, Hazardous Substance means any substance listed, defined, designated, classified or regulated as a waste, pollutant or contaminant or as hazardous, toxic, radioactive or otherwise regulated under any applicable and relevant Environmental Law, including petroleum.

(d) This Section 3.13 constitutes the exclusive representations and warranties of the Company with respect to the subject matters set forth in this Section 3.13.

SECTION 3.14 Taxes.

(a) Each of the Company and its Subsidiaries and any consolidated, combined, unitary, affiliated or aggregate group of which the Company or any of its Subsidiaries is or has since December 31, 2004 been a member (an Affiliated group), has timely filed all income Tax Returns and all other material Tax Returns required to be filed by it and each such return was complete and correct in all material respects. Each of the Company and each of its Subsidiaries and any Affiliated group has timely paid or caused to be timely paid all Taxes shown on such Tax Returns to be due with respect to the taxable periods covered by such Tax Returns (including material Taxes for which no Tax Returns are required to be filed) and all other material Taxes as are due. The Company and its Subsidiaries have accrued (in accordance with GAAP) all material Taxes required to be accrued by them.

(b) No Tax Return of the Company or any of its Subsidiaries or, to the knowledge of the Company, any Affiliated group is under audit or examination by any taxing authority with respect to any material Taxes, and no written notice of such an audit or examination has been received by the Company or any of its Subsidiaries with respect to any material Taxes.

(c) There is no currently effective agreement or other document extending, or having the effect of extending, the period of assessment or collection of any material Taxes. Neither the Company nor any of its Subsidiaries is party to or bound by any written Tax sharing agreement, Tax indemnity obligation or similar arrangement with respect to Taxes (including any advance pricing agreement, closing agreement or other similar agreement related to Taxes), excluding any agreement or arrangement (i) entered into in the ordinary course of business and the principal subject of which is not Taxes or liability for Taxes, (ii) among the Company or any of its Subsidiaries that has been listed on Section 3.14(c) of the Company Disclosure Letter or (iii) where the inclusion of a Tax indemnification or allocation provision is customary or incidental to an agreement the primary nature of which is not Tax sharing or indemnification.

(d) No material Liens for Taxes exist with respect to any assets or properties of the Company or any of its Subsidiaries, except for statutory Liens for Taxes not yet due and Liens for Taxes that are being contested in good faith and for which adequate reserves are maintained in the financial statements of the Company included in the Company SEC Documents.

(e) Except as required in connection with the Company s adoption of the first-in, first-out method of accounting pursuant to Section 5.14, neither the Company nor any of its Subsidiaries has agreed to, requested, or is required to include any material adjustment under Section 481 of the Code (or any corresponding provision of state, local, or foreign law) by reason of a change in accounting method or otherwise, which adjustments would apply after the Effective Time.

(f) The Company and its Subsidiaries have complied in all material respects with all applicable Laws relating to the payment and withholding of Taxes (including withholding of Taxes pursuant to Sections 1441, 1442, 3121 and 3402 of the Code and similar provisions under any other domestic or foreign Tax Laws) and have, within the time and the manner prescribed by Law, withheld from and paid over to the proper Governmental Entities all material amounts required to be so withheld and paid over under applicable Laws.

(g) The Company was not, at any time during the period specified in Section 897(c)(1)(A)(ii) of the Code, a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code.

(h) Neither the Company nor any of its Subsidiaries has ever participated in any listed transaction within the meaning of Treasury Regulation Section 1.6011-4(b)(2).

(i) No payment made or to be made to any current or former employee or director of the Company or any of its Subsidiaries by reason of the transactions contemplated hereby will constitute an excess parachute payment within the meaning of Section 280G of the Code. Neither the execution of this Agreement, shareholder approval of this Agreement nor the consummation of the transactions contemplated hereby will result in payments under any Company Plan which would not reasonably be expected to be deductible under Section 162(m) of the Code.

(j) As used in this Agreement, (i) Taxes shall include (A) all forms of taxation, whenever created or imposed, and whether domestic or foreign, and whether imposed by a national, federal, state, provincial, local or other Governmental Entity, including all interest, penalties and additions imposed with respect to such amounts, (B) liability for the payment of any amounts of the type described in clause (A) as a result of being a member of an Affiliated, consolidated, combined or unitary group and (C) liability for the payment of any amounts as a result of being party to any tax sharing agreement or as a result of any express or implied obligation to indemnify any other Person with respect to the payment of any amount described in clause (A) or (B) and (ii) Tax Returns shall mean all domestic or foreign (whether national, federal, state, provincial, local or otherwise) returns, declarations, statements, reports, schedules, forms and information returns relating to Taxes and any amended Tax Return.

(k) This Section 3.14 constitutes the exclusive representations and warranties of the Company with respect to the subject matters set forth in the representations set forth in this Section 3.14.

SECTION 3.15 Contracts.

(a) Section 3.15 of the Company Disclosure Letter lists, as of the date hereof, each of the following types of Contracts to which the Company or any of its Subsidiaries is a party or by which any of their respective properties or assets is bound and under which any party thereto has continuing rights or obligations (in each case, other than any Company Plan):

(i) any Contract that would be required to be filed by the Company as a material contract pursuant to Item 601(b)(10) of Regulation S-K under the Securities Act or disclosed by the Company on a Current Report on Form 8-K;

(ii) any Contract that limits the ability of the Company or any of its Subsidiaries (or, following the consummation of the Merger and the other transactions contemplated by this Agreement, would limit the ability of Parent or any of its Subsidiaries, including the Surviving Corporation) to compete in any line of business or with any Person or in any geographic area, or that restricts the right of the Company and its Subsidiaries (or, following the consummation of the Merger and the other transactions contemplated by this Agreement, would limit the ability of Parent or any of its Subsidiaries, including the Surviving Corporation) to sell to or purchase from any Person or to hire any Person;

(iii) any Contract with respect to the formation, creation, operation, management or control of a joint venture (whether formed as a partnership, limited liability company or other entity) or other similar arrangement;

(iv) any Contract relating to Indebtedness and having an outstanding principal amount in excess of $2,000,000;

(v) any Contract providing for the supply of inventory or other goods to the Company or any of its Subsidiaries, or that provides for the distribution of any such inventory or goods, and that is material to the business of the Company and its Subsidiaries, taken as a whole;

(vi) any Contract that is a license agreement that is material to the business of the Company and its Subsidiaries, taken as a whole, pursuant to which the Company or any of its Subsidiaries is a party and licenses in Intellectual Property or licenses out Intellectual Property, other than license agreements for software that is generally commercially available; or

(vii) any Contract with any Governmental Entity.

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Each contract of the type described above is referred to herein as a Material Contract.

(b) (i) Each Material Contract is valid and binding on the Company and its Subsidiaries party thereto and, to the knowledge of the Company, each other party thereto, and is in full force and effect and enforceable in all material respects in accordance with its terms (except to the extent that enforceability may be limited by the applicable bankruptcy, insolvency, moratorium, reorganization or similar Laws affecting the enforcement of creditors rights generally or by general principles of equity); (ii) the Company and each of its Subsidiaries and, to the knowledge of the Company, each other party thereto has performed all obligations required to be performed by it under each Material Contract; and (iii) there is no default under any Material Contract by the Company or any of its Subsidiaries or any other party thereto, and no event or condition has occurred that constitutes or, after notice or lapse of time or both, would constitute, a default on the part of the Company or any of its Subsidiaries or, to the knowledge of the Company, any other party thereto under any such Material Contract, nor has the Company or any of its Subsidiaries received any notice of any such default, event or condition, except, in the case of clauses (ii) and (iii), as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect. The Company has made available to Parent true and complete copies of all Material Contracts, including all amendments thereto.

SECTION 3.16 Insurance. All casualty, directors and officers liability, general liability, product liability and all other types of insurance maintained with respect to the Company and its Subsidiaries provide adequate coverage for the normal risks incident to the businesses of the Company and its Subsidiaries and their respective properties and assets, and are in all material respects customary for the industries in which the Company and its Subsidiaries operate.

SECTION 3.17 Properties.

(a) Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, the Company or one of its Subsidiaries has good and valid title to, or in the case of leased tangible assets, a valid leasehold interest in, all of its tangible assets, free and clear of all Liens, other than (i) Liens for current taxes and assessments not yet past due or the amount or validity of which is being contested in good faith by appropriate proceedings, (ii) mechanics , workmen s, repairmen s, warehousemen s and carriers Liens arising in the ordinary course of business of the Company or such Subsidiary consistent with past practice, and (iii) any such matters of record, Liens and other imperfections of title that do not, individually or in the aggregate, materially impair the continued ownership, use and operation of the assets to which they relate in the business of the Company and its Subsidiaries as currently conducted (Permitted Liens).

(b) Section 3.17(b) of the Company Disclosure Letter sets forth a true and complete list of all real property owned by the Company or any of its Subsidiaries (the Owned Real Property) and all property leased for the benefit of the Company or any of its Subsidiaries (the Leased Real Property), identifying each such property that is used by the Company as a distribution center. Except as has not had and would not reasonably be expect to have, individually or in the aggregate, a Material Adverse Effect, each of the Company and its Subsidiaries has (i) good and marketable title in fee simple to all Owned Real Property and (ii) good and marketable leasehold title to all Leased Real Property, in each case, free and clear of all Liens except Permitted Liens. Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, no parcel of Owned Real Property or Leased Real Property is subject to any governmental decree or order to be sold or is being condemned, expropriated or otherwise taken by any public authority with or without payment of compensation therefor, nor, to the knowledge of the Company, has any such condemnation, expropriation or taking been proposed. Each of the Company and its Subsidiaries enjoys peaceful and undisturbed possession under all such leases, except for any such failure to do so that, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect. All leases of Leased Real Property and all amendments and modifications thereto are in full force and effect, and there exists no default under any such lease by the Company, any of its Subsidiaries or any other party thereto, nor has any event occurred which, with notice or lapse of time or both, would constitute a default thereunder by the

Company, any of its Subsidiaries or any other party thereto, except as, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect.

(c) Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, there are no contractual or legal restrictions that preclude or restrict the ability to use any Owned Real Property or Leased Real Property by the Company or any of its Subsidiaries for the current or contemplated use of such real property. Except as has not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, all plants, warehouses, distribution centers, structures and other buildings on the Owned Real Property or Leased Real Property are adequately maintained and are in good operating condition and repair for the requirements of the business of the Company and its Subsidiaries as currently conducted.

(d) This Section 3.17 does not relate to intellectual property, which is the subject of Section 3.18.

SECTION 3.18 Intellectual Property. Section 3.18 of the Company Disclosure Letter sets forth a true and complete list of all material registered trademarks and service marks and other material intellectual property that is the subject of any registration or filing with any Governmental Entity, and all pending applications with respect to any of the foregoing, that are owned by the Company or any of its Subsidiaries and used by the Company or any of its Subsidiaries in the conduct of their businesses as currently conducted (Company Registered IP). Each item of Company Registered IP is owned exclusively by the Company or one of its Subsidiaries, free and clear of all Liens except for Permitted Liens, subsisting, unexpired and, to the knowledge of the Company, valid and enforceable, in each case, except as would not, individually or in the aggregate, have a Material Adverse Effect. Subject to the knowledge-qualified, non-infringement representation in clause (b) below with respect to third-party patents, either the Company or a Subsidiary of the Company owns, or is licensed or otherwise possesses adequate rights to use (in the manner and to the extent it has used the same), all trademarks, service marks, trade names, domain names, copyrights, patents, trade secrets and other intellectual property of any kind (whether registered or unregistered) used in their businesses as currently conducted and that are material to the businesses of the Company and its Subsidiaries taken as a whole as currently conducted (collectively, the Company Intellectual Property). Except as, individually or in the aggregate, has not had and would not reasonably be expected to have a Material Adverse Effect, (a) there are no pending or, to the knowledge of the Company, threatened claims by any Person alleging infringement, misappropriation or dilution by the Company or any of its Subsidiaries of the intellectual property rights of any Person or challenging the validity, enforceability or ownership of any Company Intellectual Property owned by or exclusively licensed to the Company or any of its Subsidiaries or the right to use to any other Company Intellectual Property; (b) the conduct of the businesses of the Company and its Subsidiaries has not infringed, misappropriated or diluted, and does not infringe, misappropriate or dilute, any intellectual property rights (other than patents) and, to the knowledge of the Company, any patents of any Person; (c) there are no pending claims made by Company or any of its Subsidiaries alleging infringement, misappropriation or other violation by others of the Company Intellectual Property owned by or exclusively licensed to the Company or any of its Subsidiaries; (d) to the knowledge of the Company, no Person is infringing, misappropriating or diluting any Company Intellectual Property owned by or exclusively licensed to the Company or any of its Subsidiaries; (e) the consummation of the Merger and the other transactions contemplated by this Agreement will not result in the loss of, or give rise to any right of any Person to terminate or modify any of the Company s or any Subsidiaries rights or obligations under, any agreement under which the Company or any of its Subsidiaries grants to any Person, or any Person grants to the Company or any of its Subsidiaries, a license or right under or with respect to any Company Intellectual Property; and (f) no Company Intellectual Property owned by the Company or any of its Subsidiaries is subject to any outstanding order, judgment or decree restricting or limiting the use, exploitation or licensing thereof by the Company or any of its Subsidiaries. This Section 3.18 does not relate to any tangible personal property or real property, which is the subject of Section 3.17.

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SECTION 3.19 Company Charter; State Takeover Statutes. The resolutions of the Company Board referred to in Section 3.4 are sufficient to render Section 2 of the Company Charter and Sections 607.0901 and 607.0902 of the FBCA inapplicable to Parent and Merger Sub and to this Agreement, the Merger and the other transactions contemplated hereby. No other provision of the Company Charter or Company Bylaws, nor any moratorium, fair price, business combination, affiliated transactions, control share acquisition or similar provision of any state anti-takeo Law (collectively, including any provisions of the Company Charter or Company Bylaws, Takeover Laws) is, or at the Effective Time will be, applicable to this Agreement, the Merger or any of the other transactions contemplated hereby.

SECTION 3.20 No Rights Plan. There is no shareholder rights plan, poison pill anti-takeover plan or other similar device in effect to which the Company is a party or is otherwise bound.

SECTION 3.21 Related Party Transactions. No present or former director or officer of the Company or any of its Subsidiaries, nor any of such Person s Affiliates or immediate family members (each of the foregoing, a Related Party), is a party to any Contract with or binding upon the Company or any of its Subsidiaries or any of their respective properties or assets or has any interest in any property owned by the Company or any of its Subsidiaries or has engaged in any transaction with any of the foregoing within the last 12 months, other than in such Person s capacity as a director or officer of the Company. No Related Party of the Company or any of its Subsidiaries owns, directly or indirectly, any material interest in, or serves as an officer or director or in another similar capacity of, any Person with which Company or any of its Subsidiaries has any contractual or other business relationship that is material to the Company and its Subsidiaries.

SECTION 3.22 Brokers. No broker, investment banker, financial advisor or other Person, other than Goldman, Sachs & Co., the fees and expenses of which will be paid by the Company, is entitled to any broker s, finder s, financial advisor s or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of the Company or any of its Affiliates. The Company has furnished to Parent a true and complete copy of any Contract between the Company and Goldman, Sachs & Co. pursuant to which Goldman, Sachs & Co. could be entitled to any payment from the Company or any of its Subsidiaries relating to the transactions contemplated hereby.

SECTION 3.23 Opinion of Financial Advisor. The Special Committee has received the opinion of Goldman, Sachs & Co., dated the date of this Agreement, to the effect that, as of the date hereof and subject to the limitations, qualifications and assumptions set forth in such opinion, the Merger Consideration to be paid to the holders of Shares pursuant to this Agreement is fair from a financial point of view to such holders. A signed true and complete copy of such opinion has been or will promptly be provided to Parent for information purposes only.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF

PARENT AND MERGER SUB

Parent and Merger Sub represent and warrant to the Company as follows:

SECTION 4.1 Organization, Standing and Power. Each of Parent and Merger Sub (a) is a limited liability company or corporation duly organized, validly existing and in good standing under the Laws of the jurisdiction of its organization and (b) has all requisite corporate or similar power and authority to own, lease and operate its properties and to carry on its business as now being conducted, except in the case of clause (b) as, individually or in the aggregate, has not had and would not reasonably be expected to have a Parent Material Adverse Effect.

SECTION 4.2 Authority. Each of Parent and Merger Sub has all necessary corporate or similar power and authority to execute, deliver and perform its obligations under this Agreement and to consummate the Merger and the other transactions contemplated hereby. The execution, delivery and performance of this Agreement by

Parent and Merger Sub and the consummation by Parent and Merger Sub of the Merger and the other transactions contemplated hereby have been duly authorized by all necessary corporate or similar action on the part of Parent and Merger Sub and no other corporate or similar proceedings on the part of Parent or Merger Sub are necessary to approve this Agreement or to consummate the Merger or the other transactions contemplated hereby, subject, in the case of the consummation of the Merger, to the approval of this Agreement by the Parent as the sole shareholder of Merger Sub. Parent, as the sole shareholder of Merger Sub, will, immediately following the execution and delivery of this Agreement by each of the parties hereto, approve the Merger. This Agreement has been duly executed and delivered by Parent and Merger Sub and, assuming the due authorization, execution and delivery by the Company, constitutes a valid and binding obligation of each of Parent and Merger Sub, enforceable against each of Parent and Merger Sub in accordance with its terms (except to the extent that enforceability may be limited by applicable bankruptcy, insolvency, moratorium, reorganization or similar Laws affecting the enforcement of creditors rights generally or by general principles of equity).

SECTION 4.3 No Conflict; Consents and Approvals.

(a) The execution, delivery and performance of this Agreement by each of Parent and Merger Sub does not, and the consummation of the Merger and the other transactions contemplated hereby and compliance by each of Parent and Merger Sub with the provisions hereof will not, conflict with, or result in any violation or breach of, or default (with or without notice or lapse of time, or both) under, or give rise to a right of, or result in, termination, cancellation, modification or acceleration of any obligation or to the loss of a material benefit under, or result in the creation of any Lien in or upon any of the properties, assets or rights of Parent or Merger Sub under, or give rise to any increased, additional, accelerated or guaranteed rights or entitlements under, or require any consent, waiver or approval of any Person pursuant to, any provision of (i) the limited liability company agreement, articles of incorporation or bylaws of Parent or Merger Sub, (ii) any Contract to which Parent or Merger Sub is a party by which Parent, Merger Sub or any of their respective properties or assets may be bound or (iii) subject to the governmental filings and other matters referred to in Section 4.3(b), any Law applicable to Parent or Merger Sub or by which Parent, Merger Sub or any of their respective properties or assets may be bound, except as, in the case of clauses (ii) and (iii), as individually or in the aggregate, has not had and would not reasonably be expected to have a Parent Material Adverse Effect.

(b) No consent, approval, order or authorization of, or registration, declaration, filing with or notice to, any Governmental Entity is required by or with respect to Parent or Merger Sub in connection with the execution, delivery and performance of this Agreement by Parent and Merger Sub or the consummation by Parent and Merger Sub of the Merger and the other transactions contemplated hereby or compliance with the provisions hereof, except for (i) the actions required by the HSR Act, (ii) such filings and reports as may be required pursuant to the applicable requirements of the Securities Act and the Exchange Act, (iii) the filing of the Articles of Merger with the Department of State of Florida as required by the FBCA, (iv) any filings and approvals required under the rules and regulations of the Nasdaq, and (v) such other consents, approvals, orders, authorizations, registrations, declarations, filings or notices the failure of which to be obtained or made, individually or in the aggregate, have not had and would not reasonably be expected to have a Parent Material Adverse Effect.

SECTION 4.4 Proxy Statement. None of the information supplied or to be supplied in writing by or on behalf of Parent or Merger Sub specifically for inclusion or incorporation by reference in the Proxy Statement will, at the time it is first mailed to the Company s shareholders, at the time of any amendments or supplements thereto, and at the time of the Company Shareholders Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they are made, not misleading.

SECTION 4.5 Brokers. No broker, investment banker, financial advisor or other Person, other than William Blair & Company, Citigroup, Inc. and The Food Partners, LLC, the fees and expenses of which will be paid by

Parent, is entitled to any broker s, finder s, financial advisor s or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Parent or Merger Sub.

SECTION 4.6 Merger Sub; Ownership of Common Stock.

(a) Merger Sub was formed solely for the purpose of engaging in the Merger and the other transactions contemplated hereby and has engaged in no business other than in connection with the transactions contemplated by this Agreement. All of the issued and outstanding capital stock of Merger Sub is owned directly or indirectly by Parent.

(b) None of Parent, Merger Sub, Sponsor or any of their Affiliates (including direct and indirect parent companies and their Affiliates) (i) owns, directly or indirectly, beneficially or of record, any shares of Common Stock (other than shares, if any, that are owned by Affiliates who are natural persons through mutual funds and other analogous investment vehicles over which they do not possess control) or (ii) holds any rights to acquire or vote any shares of Common Stock, except pursuant to this Agreement.

SECTION 4.7 Financing.

(a) Parent has delivered to the Company true and complete copies of (a) a fully executed commitment letter (the Debt Financing Commitments), pursuant to which the lender parties thereto (each a Lender) have agreed, subject to the terms and conditions thereof, to provide or cause to be provided the debt amounts set forth therein (the Debt Financing) and (b) a fully executed equity commitment letter (the Equity Financing Commitment and, together with the Debt Financing Commitments, the Financing Commitments), pursuant to which Lone Star Fund VII (U.S.), L.P. (the Sponsor) has committed, subject to the terms and conditions thereof, to provide equity financing in an aggregate amount set forth therein (the Equity Financing and, together with the Debt Financing, the Financing).

(b) As of the date of this Agreement, none of the Financing Commitments has been amended or modified, no such amendment or modification is contemplated, and the respective commitments contained in the Financing Commitments have not been withdrawn, rescinded or otherwise modified. As of the date of this Agreement, the Financing Commitments are in full force and effect and constitute the legal, valid and binding obligation of each of BI-LO Holding, Parent and Merger Sub (in the case of the Debt Financing Commitment) or Parent or Merger Sub (in the case of the Equity Financing Commitment) and, to the knowledge of Parent, the other parties thereto (except to the extent that enforceability may be limited by the applicable bankruptcy, insolvency, moratorium, reorganization or similar Laws affecting the enforcement of creditors rights generally or by general principles of equity). As of the date hereof, none of BI-LO Holding, Parent or Merger Sub has knowledge of any fact or occurrence existing on the date hereof that, with or without notice, lapse of time or both, would reasonably be expected to (i) result in any of the conditions in the Financing Commitments not being satisfied or (ii) otherwise result in the Financing not being available on a timely basis in order to consummate the transactions contemplated by this Agreement. As of the date hereof, neither the Sponsor nor any Lender has notified BI-LO Holding, Parent or Merger Sub of its intention to terminate either of the Financing Commitments or not to provide the Financing.

(c) Except for the Financing Commitments and fee letter (a complete copy of which has been provided to the Company, with only fee amounts and certain economic terms of the market flex provisions redacted (the Fee Letter)), as of the date hereof there are no side letters or other agreements to which BI-LO Holding, Parent or Merger Sub is a party related to the Financing. There are no conditions precedent related to the funding of the full amount of the Financing other than as set forth in the Financing Commitments and the Fee Letter (the Disclosed Conditions). Parent has advised the Company of the maximum total amount of fees (including original issue discount) and expenses payable by Parent and Merger Sub under the Debt Financing. No Lender has any right to impose, and none of the Sponsor, any Lender, BI-LO Holding, Parent or Merger Sub has any obligation to accept, any condition precedent to such funding other than the Disclosed Conditions nor, except as

set forth in the Financing Commitments and the Fee Letter, any reduction to the aggregate amount available under the Financing Commitments on the Closing Date (nor any term or condition which would have the effect of reducing the aggregate amount available under the Financing Commitments on the Closing Date). As of the date of this Agreement, assuming compliance by the Company with the provisions of Section 5.11 hereof, none of BI-LO Holding, Parent or Merger Sub has any reason to believe that it will be unable to satisfy on a timely basis any conditions to the funding of the full amount of the Financing, or that the Financing will not be available to BI-LO Holding, Parent or Merger Sub on the Closing Date.

(d) Assuming the satisfaction of the conditions to Parent s and Merger Sub s obligation to consummate the Merger, the aggregate proceeds contemplated by the Financing Commitments, if funded in accordance with the Financing Commitments, together with other cash of BI-LO Holding, Parent, Merger Sub, the Company and the Company s Subsidiaries on the Closing Date, will be sufficient for Parent and Merger Sub to consummate the Merger upon the terms contemplated by this Agreement, to refinance the Second Amended and Restated Credit Agreement, dated March 18, 2011, by and among the Company, the lenders party thereto, and Wells Fargo Bank, National Association, as administrative agent, to refinance the existing ABL Credit Agreement, dated February 3, 2011, by and among BI-LO Holding, the lenders, other parties party thereto and Deutsche Bank Trust Company Americas, as administrative agent and collateral agent (collectively, the Refinancing), and to pay all related fees and expenses.

(e) BI-LO Holding, Parent or Merger Sub has paid in full any and all commitment or other fees required by the Financing Commitments that are due on or before the date hereof, and will pay, after the date hereof, all such commitments and fees as they become due. It is not a condition to Closing under this Agreement, nor to the consummation of the Merger, for Parent or Merger Sub to obtain the Financing or any alternative financing.

(f) None of BI-LO Holding, Parent, Merger Sub, the Sponsor or their respective Affiliates have (i) retained any financial advisor on a basis exclusive to Parent, Merger Sub or the Sponsor (or any or all of them on a joint basis) or (ii) entered into an exclusivity, lock-up or other similar agreement, arrangement or understanding with any bank or investment bank or other potential provider of debt or equity financing that would prevent such provider from providing or seeking to provide such financing to any third party in connection with a transaction relating to the Company or its Subsidiaries, in the case of clauses (i) and (ii), in connection with the Merger or the other transactions contemplated by this Agreement.

SECTION 4.8 Limited Guarantee. Concurrently with the execution of this Agreement, the Guarantor has delivered to the Company the Limited Guarantee, dated as of the date hereof. As of the date hereof, the Limited Guarantee is in full force and effect and constitutes the legal, valid and binding obligation of the Guarantor (except to the extent that enforceability may be limited by the applicable bankruptcy, insolvency, moratorium, reorganization or similar Laws affecting the enforcement of creditors rights generally or by general principles of equity).

SECTION 4.9 Solvency. Assuming (a) satisfaction of the conditions to Parent s and Merger Sub s obligation to consummate the Merger and (b) accuracy of the representations and warranties of the Company set forth in Article III as of the Effective Time, immediately after giving effect to the transactions contemplated by this Agreement (including the Merger, the Financing, the payment of the aggregate Merger Consideration, any repayment of existing indebtedness contemplated by this Agreement or the Financing Commitments, and the payment of all related fees and expenses), the Surviving Corporation will be Solvent. With respect to the Surviving Corporation, Solvent means that, as of any date of determination, (i) the amount of the fair saleable value of the assets of the Surviving Corporation and its Subsidiaries, taken as a whole, exceeds, as of such date, the sum of all debts of the Surviving Corporation and its Subsidiaries, taken as a whole, including contingent liabilities, as such quoted term is generally determined in accordance with applicable federal Law governing determinations of the insolvency of debtors; (ii) the Surviving Corporation will not have, as of such date, an unreasonably small amount of capital for the operation of the business in which it is engaged or proposed to be engaged following the Closing Date; and (iii) the Surviving Corporation will be able to pay its debts, including contingent liabilities, as they mature.

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SECTION 4.10 Absence of Arrangements with Management. Other than this Agreement, there are no contracts, undertakings, commitments, agreements, obligations or understandings between Parent or Merger Sub or any of their respective Affiliates, on the one hand, and any member of the Company s management or the Company Board or their respective Affiliates, on the other hand, relating to the transactions contemplated by this Agreement or the operations of the Company after the Effective Time, and, as of the date hereof, no material discussions have taken place between such Persons regarding any such contracts, undertakings, commitments, agreements, obligations or understandings.

SECTION 4.11 No Regulatory Impediment. Each of Parent and Merger Sub is not aware of any fact relating to its or any of its Affiliates (including its direct and indirect parent companies and their Affiliates) respective businesses, operations, financial condition or legal status, including any officer s, director s or current employee s status, that might reasonably be expected to impair the ability of the parties to this Agreement to obtain, on a timely basis, any authorization, consent, order, declaration or approval of, or ability to contract with, any Governmental Entity or third party necessary for the consummation of the transactions contemplated by this Agreement.

SECTION 4.12 No Other Representations or Warranties. Parent and Merger Sub acknowledge and agree that except for the representations and warranties contained in Article III, any certificate delivered pursuant to Article VI or any letter of transmittal related to the Shares, none of the Company, any of its Subsidiaries, or any stockholder or Representative of the Company or any of its Subsidiaries makes or has made any representation or warranty, either express or implied, concerning the Company or its Subsidiaries or any of their respective assets or properties or the transactions contemplated by this Agreement. To the fullest extent permitted by applicable Law, except with respect to the representations and warranties contained in Article III, any certificate delivered pursuant to Article VI or any letter of transmittal related to the Shares, none of the Company or its Affiliates, Subsidiaries, stockholders or Representatives shall have any liability to Parent or Merger Sub or their respective Affiliates, Subsidiaries, stockholders or Representatives on any basis (including in contract or tort, under federal or state securities laws or otherwise) based upon any information or statements (or any omissions therefrom) provided or made available by the Company or its Affiliates, Subsidiaries, stockholders or Representatives to Parent or Merger Sub or their respective Affiliates, Subsidiaries, stockholders or Representatives in connection with the Merger and the other transactions contemplated hereby. Each of Parent and Merger Sub acknowledges and agrees that, as of the date hereof and to its knowledge, it has been furnished with, or given adequate access to, all information and materials relating to the Company and its Subsidiaries that it has requested and Representatives of the Company have answered all inquiries that Parent or Merger Sub has made of them concerning the Company and its Subsidiaries.

ARTICLE V

COVENANTS

SECTION 5.1 Conduct of Business of the Company. During the period from the date of this Agreement to the Effective Time, except as consented to in writing in advance by Parent or as otherwise specifically contemplated by this Agreement, the Company shall, and shall cause each of its Subsidiaries to, carry on its business in the ordinary course consistent with past practice and use reasonable best efforts to preserve intact its business and its present relationships with customers, suppliers, landlords and other persons with which it has material business relations, and to keep available the services of its current officers. In addition to and without limiting the generality of the foregoing, during the period from the date of this Agreement to the Effective Time, except as set forth in Section 5.1 of the Company Disclosure Letter or as specifically contemplated by this Agreement, the Company shall not, and shall not permit any of its Subsidiaries to, without Parent s prior written consent (such consent not to be unreasonably withheld, delayed or conditioned):

(a) (i) declare, set aside or pay any dividends on, or make any other distributions (whether in cash, stock or property) in respect of, any of its capital stock or other equity interests, except for dividends by a wholly owned

Subsidiary of the Company to its parent, (ii) purchase, redeem or otherwise acquire shares of capital stock or other equity interests of the Company or its Subsidiaries or any options, warrants or rights to acquire any such shares or other equity interests (except as permitted by Section 5.1(b)), or (iii) split, combine, reclassify or otherwise amend the terms of any of its capital stock or other equity interests, or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of its capital stock or other equity interests (except as permitted by Section 5.1(b));

(b) issue, deliver, sell, grant, pledge or otherwise encumber or subject to any Lien any shares of its capital stock or other equity interests or any securities convertible into, exchangeable for or exercisable for any such shares or other equity interests, or any rights, warrants or options to acquire any such shares or other equity interests, or any stock appreciation rights, phantom stock rights, performance units, rights to receive shares of capital stock of the Company on a deferred basis or other rights linked to the value of Shares, including pursuant to Contracts as in effect on the date hereof (other than (i) grants of rights or options to acquire Shares legally required to be granted pursuant to the ESPP as in effect on the date of this Agreement, to the extent set forth in Section 5.1(b) of the Disclosure Letter, (ii) the issuance of Shares upon the exercise of Company Stock Options and the vesting of RSUs outstanding on the Measurement Date in accordance with their terms or (iii) the purchase, redemption or other acquisition of Shares or other equity interests of the Company from former employees, directors and consultants pursuant to any Contract or Company Equity Plan in accordance with its terms as of the date hereof providing for the repurchase of shares in connection with any termination of services to the Company or any of its Subsidiaries);

(c) amend or otherwise change its articles of incorporation or bylaws or similar organizational documents;

(d) directly or indirectly acquire or agree to acquire (i) by merging or consolidating with, purchasing a substantial equity interest in or a substantial portion of the assets of, making an investment in or loan or capital contribution to, or in any other manner, any corporation, partnership, association or other business organization or division thereof, or (ii) any assets that are otherwise material to the Company and its Subsidiaries, taken as a whole, other than inventory acquired in the ordinary course of business consistent with past practice;

(e) directly or indirectly sell, lease, license, sell and leaseback, abandon, mortgage or otherwise encumber or subject to any Lien or otherwise dispose in whole or in part of any properties, assets or rights or any interest therein that are material to the Company and its Subsidiaries, taken as a whole, except for sales of inventory or the disposition of used or excess equipment, in each case in the ordinary course of business consistent with past practice;

(f) adopt or enter into a plan of complete or partial liquidation, dissolution, restructuring, recapitalization or other reorganization;

(g) (i) other than for borrowings under the Company s revolving credit facility in the ordinary course of business consistent with past practice, incur, create, assume or otherwise become liable for, or prepay, any Indebtedness, or amend, modify or refinance any Indebtedness, or (ii) make any loans, advances or capital contributions to, or investments in, any other Person, other than the Company or any direct or indirect wholly owned Subsidiary of the Company;

(h) incur or commit to incur, in any fiscal quarter of the Company, any capital expenditures other than (i) capital expenditures provided for in the capital expenditure budget for such quarter set forth in Section 5.1 of the Company Disclosure Letter (provided, that, if the budgeted amount set forth for any quarter is not spent in full in such quarter (including a fiscal quarter preceding the date of this Agreement), the unused amount shall roll-forward to the following quarter and subsequent quarters until used) and (ii) additional capital expenditures of less than $1,000,000 in the aggregate;

(i) (i) pay, discharge, settle or satisfy any material claims, liabilities or obligations (whether absolute, accrued, asserted, unasserted, contingent or otherwise), other than the payment, discharge, settlement or

satisfaction of any such claims, liabilities or obligations in the ordinary course of business consistent with past practice or as required by their terms (this paragraph (i)(i) does not relate to Actions, which are the subject of paragraph (k) below) or (ii) cancel any material Indebtedness owed to the Company or any of its Subsidiaries by a third Person;

(j) (i) modify, amend, terminate, cancel or extend any Material Contract or (ii) enter into any Contract that if in effect on the date hereof would be a Material Contract;

(k) compromise, settle or agree to settle any Action (including any Action relating to this Agreement or the transactions contemplated hereby), other than compromises, settlements or agreements (i) of Actions that do not relate to this Agreement or the transactions contemplated hereby, (ii) that are made in the ordinary course of business consistent with past practice, and (iii) that involve only the payment of money damages of less than $1,000,000 (for any Action individually, and in the aggregate for all related Actions), without the imposition of any equitable relief on, or the admission of wrongdoing by, the Company;

(l) change its financial or tax accounting methods, principles or practices, except insofar as may have been required by a change in GAAP or applicable Law or by Section 5.14, or revalue any of its material assets, except insofar as required by GAAP;

(m) except as required by Section 5.14, settle or compromise any material liability for Taxes, amend any material Tax Return except as required by applicable Law, make any material Tax election on or after the date of this Agreement or change any method of accounting for Tax purposes;

(n) change its fiscal year;

(o) (i) grant any current or former director, officer, employee or independent contractor any increase in compensation, bonus or other benefits, or grant any type of compensation or benefits to any current or former director, officer, employee or independent contractor not previously receiving or entitled to receive such type of compensation or benefit (except as required to comply with any applicable Law or any Company Plan in effect as of the date hereof, or for pay or fee increases made in the ordinary course of business consistent with past practice (other than with respect to officers of the Company or any individual receiving base pay in excess of $100,000 per year)), (ii) grant or pay to any current or former director, officer, employee or independent contractor any severance, change in control or termination pay, or modifications thereto or increases therein, except as required to comply with any applicable Law or any Company Plan in effect as of the date hereof, (iii) grant or amend in any material respect any equity or equity-based award (including in respect of stock options, stock appreciation rights, performance units, restricted stock or other stock-based or stock-related awards or the removal or modification of any restrictions in any Company Plan or awards made thereunder) except as required to comply with any applicable Law or any Company Plan in effect as of the date hereof or as may be required to comply with this Agreement, (iv) adopt or enter into any collective bargaining agreement or other labor union contract, (v) take any action to accelerate the vesting, funding or payment of any compensation or benefit under any Company Plan, any agreement issued thereunder, or any other Contract, except as required to comply with any applicable Law or any Company Plan in effect as of the date hereof, or as may be required to implement the actions contemplated by this Agreement, including Section 2.2, or (vi) adopt any new employee benefit or compensation plan or arrangement or any agreement thereunder, or amend or modify in any material respect any existing Company Plan or any agreement thereunder, in each case for the benefit of any current or former director, officer, employee or independent contractor, other than as required by applicable Law; provided, that nothing in clause (i), (ii) or (vi) shall restrict the Company from taking such actions in the ordinary course of business consistent with past practice in connection with new hires of employees who are not directors or officers and who receive base pay of less than $100,000 per year;

(p) renew or enter into any non-compete, exclusivity, non-solicitation or similar agreement, in each case that would restrict or limit, in any material respect, the operations of the Company or any of its Subsidiaries;

(q) enter into any new line of business outside of its existing business; or

(r) authorize any of, or commit, resolve or agree to take any of, the foregoing actions.

SECTION 5.2 Conduct of Business of Parent and Merger Sub. During the period from the date of this Agreement to the Effective Time, except as specifically contemplated by this Agreement, Parent and Merger Sub shall not, and shall cause their Affiliates not to, without the Company s prior written consent, take any action (including any acquisition of any Person in a similar line of business as the Company) or omit to take any action if such action or omission would reasonably be expected to result in any of the conditions to the Merger set forth in Article VI not being satisfied on or before the Outside Date.

SECTION 5.3 No Solicitation; Recommendation of the Merger.

(a) The Company shall not, and shall not permit or authorize any of its Subsidiaries or any director, officer, employee, investment banker, financial advisor, attorney, accountant, other advisor, agent or other representative (collectively, Representatives) of the Company or any of its Subsidiaries, directly or indirectly, to (i) solicit, initiate, endorse, knowingly encourage or knowingly facilitate any inquiry, proposal or offer with respect to, or the making or completion of, any Acquisition Proposal, or any inquiry, proposal or offer that is reasonably likely to lead to any Acquisition Proposal, (ii) enter into, continue or otherwise participate in any discussions or negotiations regarding, or furnish to any Person any information or data with respect to, or otherwise cooperate in any way with, any Acquisition Proposal, or (iii) resolve, propose or agree to do any of the foregoing. The Company shall, and shall cause each of its Subsidiaries and the Representatives of the Company and its Subsidiaries to, (A) immediately cease and cause to be terminated all existing discussions and negotiations with any Person conducted heretofore with respect to any Acquisition Proposal or potential Acquisition Proposal, (B) request the prompt return or destruction of all confidential information previously furnished with respect any Acquisition Proposal or potential Acquisition Proposal, and (C) not terminate, waive, amend, release or modify any provision of any confidentiality or standstill agreement to which it or any of its Affiliates or Representatives is a party with respect to any Acquisition Proposal or potential Acquisition Proposal, and shall enforce the provisions of any such agreement. Notwithstanding the foregoing, if at any time following the date of this Agreement and prior to obtaining the Company Shareholder Approval, (1) the Company receives a written Acquisition Proposal that the Company Board believes in good faith to be bona fide (it being agreed that, so long as the Company, its Subsidiaries and its and their Representatives have otherwise complied with this Section 5.3 in all material respects, the Company Board may correspond in writing (with a copy to Parent) with any Person making such a written Acquisition Proposal solely to request the clarification of the terms and conditions thereof so as to determine whether such Acquisition Proposal constitutes or is reasonably likely to lead to a Superior Proposal), (2) such Acquisition Proposal was unsolicited and did not otherwise result from a breach of this Section 5.3, (3) the Company Board determines in good faith (after consultation with outside counsel and its financial advisor) that such Acquisition Proposal constitutes or is reasonably likely to lead to a Superior Proposal, and (4) the Company Board determines in good faith (after consultation with outside counsel) that the failure to take the actions referred to in clause (I) or (II) below would be reasonably likely to constitute a breach of its fiduciary duties to the shareholders of the Company under applicable Florida Law, then the Company may (I) furnish information with respect to the Company and its Subsidiaries to the Person making such Acquisition Proposal pursuant to a customary confidentiality agreement containing terms substantially similar to, and no less favorable to the Company than, those set forth in the Confidentiality Agreement (including the standstill provisions thereof); provided, that any non-public information provided to such Person shall have been previously provided to Parent or shall be provided to Parent prior to or substantially concurrently with the time it is provided to such Person; and (II) participate in discussions and negotiations with the Person making such Acquisition Proposal regarding such Acquisition Proposal.

(b) Neither the Company Board nor any committee thereof shall:

(i) (A) withdraw (or modify or qualify in any manner adverse to Parent or Merger Sub) the adoption, approval, recommendation or declaration of advisability by the Company Board or any such committee of this Agreement, the Merger or any of the other transactions contemplated hereby, (B) adopt, approve, recommend, endorse or otherwise declare advisable the approval of any Acquisition Proposal, or (C) resolve, agree or propose to take any such actions (each such action set forth in this paragraph (i), an Adverse Recommendation Change), or

(ii) (A) cause or permit the Company or any of its Subsidiaries to enter into any letter of intent, memorandum of understanding, agreement in principle, acquisition agreement, merger agreement, option agreement, joint venture agreement, partnership agreement or other Contract (each, an Alternative Acquisition Agreement) constituting or related to, or which is intended to or is reasonably likely to lead to, any Acquisition Proposal, or (B) resolve, agree or propose to take any such actions.

Notwithstanding the foregoing, at any time prior to obtaining the Company Shareholder Approval, the Company Board may, if the Company Board determines in good faith (after consultation with outside counsel) that the failure to do so would be reasonably likely to result in a breach of its fiduciary duties to the shareholders of the Company under applicable Florida Law, taking into account all adjustments to the terms of this Agreement that are offered in writing by Parent pursuant to this Section 5.3, (i) make an Adverse Recommendation Change in response to either a Superior Proposal or an Intervening Event, or (ii) solely in response to a Superior Proposal received after the date hereof that did not result from a breach of this Section 5.3, cause the Company to terminate this Agreement in accordance with Section 7.1(d)(ii) and concurrently enter into a binding Alternative Acquisition Agreement with respect to such Superior Proposal; provided, however, that the Company may not make an Adverse Recommendation Change in response to a Superior Proposal or terminate this Agreement in response to a Superior Proposal unless:

(i) the Company notifies Parent in writing at least five calendar days before taking that action of its intention to do so, and specifies the reasons therefor, including the terms and conditions of, and the identity of the Person making, such Superior Proposal, and contemporaneously furnishes a copy (if any) of the proposed Alternative Acquisition Agreement and any other relevant transaction documents (it being understood and agreed that any amendment to the financial terms or any other material term of such Superior Proposal shall require a new written notice by the Company and a new three calendar day period); and

(ii) if Parent makes a proposal during such five (or three, as applicable) calendar day period to adjust the terms and conditions of this Agreement, the Company Board, after taking into consideration the adjusted terms and conditions of this Agreement as proposed by Parent, continues to determine in good faith (after consultation with outside counsel and its financial advisor) that such Superior Proposal continues to be a Superior Proposal and that the failure to make an Adverse Recommendation Change or terminate this Agreement, as applicable, would be reasonably likely to result in a breach of its fiduciary duties to the shareholders of the Company under applicable Florida Law;

provided, further, that the Company Board may not make an Adverse Recommendation Change in response to an Intervening Event unless:

(i) the Company provides Parent with written information describing such Intervening Event in reasonable detail as soon as reasonably practicable after becoming aware of it;

(ii) the Company keeps Parent reasonably informed of developments with respect to such Intervening Event;

(iii) the Company notifies Parent in writing at least five calendar days before making an Adverse Recommendation Change with respect to such Intervening Event of its intention to do so and specifying the reasons therefor; and

(iv) if Parent makes a proposal during such five calendar day period to adjust the terms and conditions of this Agreement, the Company Board, after taking into consideration the adjusted terms and conditions of this Agreement as proposed by Parent, continues to determine in good faith (after consultation with outside counsel) that the failure to make such Adverse Recommendation Change would be reasonably likely to result in a breach of its fiduciary duties to the shareholders of the Company under applicable Florida Law.

During the five (or three, as applicable) calendar day period prior to its effecting an Adverse Recommendation Change or terminating this Agreement as referred to above, the Company shall, and shall cause its financial and legal advisors to, negotiate with Parent in good faith (to the extent Parent seeks to negotiate) regarding any revisions to the terms of the transactions contemplated by this Agreement proposed by Parent.

(c) In addition to the obligations of the Company set forth in Section 5.3(a) and (b), the Company shall promptly (and in any event within 24 hours of receipt) advise Parent in writing in the event the Company or any of its Subsidiaries or Representatives receives (i) any indication by any Person that it is considering making an Acquisition Proposal, (ii) any inquiry or request for information, discussion or negotiation that is or is expected to be reasonably likely to lead to or that contemplates an Acquisition Proposal, or (iii) any proposal or offer that is or is reasonably likely to lead to an Acquisition Proposal, in each case together with a description of the material terms and conditions of and facts surrounding any such indication, inquiry, request, proposal or offer, the identity of the Person making any such indication, inquiry, request, proposal or offer, and a copy of any written proposal, offer or draft agreement provided by such Person. The Company shall keep Parent informed in all material respects on a timely basis of the status and details (including, within 24 hours after the occurrence of any material amendment or modification) of any such Acquisition Proposal, request, inquiry, proposal or offer, including by furnishing copies of any material written inquiries, correspondence and draft documentation, and written summaries of any material oral inquiries or discussions. Without limiting any of the foregoing, the Company shall promptly (and in any event within 24 hours) notify Parent orally and in writing if it determines to begin providing information or to engage in discussions or negotiations concerning an Acquisition Proposal.

(d) The Company agrees that any violation of the restrictions set forth in this Section 5.3 by any Representative of the Company or any of its Subsidiaries, whether or not such Person is purporting to act on behalf of the Company or any of its Subsidiaries or otherwise, shall be deemed to be a breach of this Agreement by the Company.

(e) Nothing contained in Section 5.3(a) shall prohibit the Company from taking and disclosing a position contemplated by Rule 14e 2(a), Rule 14d 9 or Item 1012(a) of Regulation M-A promulgated under the Exchange Act; provided, however, that any such disclosure (other than a stop, look and listen communication or similar communication of the type contemplated by Section 14d 9(f) under the Exchange Act) shall be deemed to be an Adverse Recommendation Change (including for purposes of Section 7.1(c)(iii)) unless the Company Board expressly reaffirms its recommendation to the Company s shareholders in favor of the approval of this Agreement and the Merger in such disclosure.

(f) For purposes of this Agreement:

(i) Acquisition Proposal means any proposal or offer with respect to any direct or indirect acquisition or purchase, in one transaction or a series of transactions, and whether through any merger, reorganization, consolidation, tender offer, self-tender, exchange offer, stock acquisition, asset acquisition, binding share exchange, business combination, recapitalization, liquidation, dissolution, joint venture or otherwise, of (A) assets or businesses of the Company and its Subsidiaries that generate 15% or more of the net revenues or net income or that represent 15% or more of the total assets (based on fair market value) of the Company and its Subsidiaries, taken as a whole, immediately prior to such transaction, or (B) 15% or more of any class of capital stock, other equity securities or voting power of the Company, any of its Subsidiaries or any resulting parent company of the Company, in each case other than the Merger and other transactions contemplated by this Agreement.

(ii) Superior Proposal means any bona fide binding written Acquisition Proposal that the Company Board determines in good faith (after consultation with outside counsel and its financial advisor), taking into account all legal, financial, regulatory and other aspects of the proposal and the Person making the proposal, including the financing terms thereof and the expected timing of the consummation thereof, is (A) more favorable to the shareholders of the Company from a financial point of view than the Merger and other transactions contemplated by this Agreement (including any adjustment to the terms and conditions proposed by Parent in response to such proposal) and (B) reasonably likely of being completed on the terms proposed; provided, that, for purposes of this definition of Superior Proposal, references in the term Acquisition Proposal to 15% shall be deemed to be references to 50%.

(iii) Intervening Event means a material event or circumstance that was not known to the Company Board prior to the execution of this Agreement (or if known, the consequences of which were not known or reasonably foreseeable), which event or circumstance, or any material consequence thereof, becomes known to the Company Board prior to the receipt of the Company Shareholder Approval, provided, however, that in no event shall the receipt, existence or terms of an Acquisition Proposal or any matter relating thereto or consequence thereof constitute an Intervening Event.

SECTION 5.4 Preparation of Proxy Statement; Shareholders Meeting.

(a) Provided there shall not have been an Adverse Recommendation Change specifically permitted by Section 5.3, as promptly as practicable after the date of this Agreement (and in any event within 20 Business Days after the date hereof), the Company shall file the Proxy Statement with the SEC in preliminary form as required by the Exchange Act, and shall use all reasonable efforts to have the Proxy Statement cleared by the SEC. The Company shall prepare the initial draft of the Proxy Statement. Each of Parent and Merger Sub shall furnish to the Company the information relating to it required by the Exchange Act and the rules and regulations promulgated thereunder to be set forth in the Proxy Statement. The Company shall provide Parent and Merger Sub with any comments that may be received from the SEC or its staff with respect thereto, shall respond promptly to any such comments made by the SEC or its staff with respect to the Proxy Statement, and shall cause the Proxy Statement in definitive form to be mailed to the Company s shareholders at the earliest practicable date. The Proxy Statement shall not, at the time it is first mailed to the Company s shareholders, at the time of any amendments or supplements thereto and at the time of the Company Shareholders Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they are made, not misleading. The Proxy Statement shall comply as to form in all material respects with the provisions of the Exchange Act. If at any time prior to obtaining the Company Shareholder Approval, any information relating to the Merger, the Company, Parent, Merger Sub or any of their respective Affiliates, directors or officers should be discovered by the Company or Parent that should be set forth in an amendment or supplement to the Proxy Statement so that such document would not contain any misstatement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, the party that discovers such information shall promptly notify the other parties hereto and the Company shall promptly file with the SEC an appropriate amendment or supplement describing such information and, to the extent required by applicable Law, disseminate such amendment or supplement to the shareholders of the Company. Notwithstanding the foregoing, prior to filing or mailing the Proxy Statement (or any amendment or supplement thereto) or responding to any comments of the SEC with respect thereto, the Company shall give Parent, Merger Sub and their counsel a reasonable opportunity to review and comment on such document or response and shall give due consideration to all reasonable additions, deletions or changes suggested thereto by Parent, Merger Sub and their counsel. The letter to shareholders, notice of meeting, proxy statement and form of proxy and any other soliciting material to be distributed to shareholders in connection with the Merger (including any amendments or supplements) and any schedules required to be filed with the SEC in connection therewith are collectively referred to as the Proxy Statement.

(b) As promptly as practicable after the date hereof (and, in any event, no later than the 10th Business Day hereafter), the Company shall, in consultation with Parent, mail broker search cards with respect to the

Company Shareholders Meeting. Provided there shall not have been an Adverse Recommendation Change specifically permitted by Section 5.3, as promptly as practicable after the date hereof, the Company shall, in consultation with Parent, duly call and establish a record date for a special meeting of its shareholders (the Company Shareholders Meeting) to be held solely for the purpose of obtaining the Company Shareholder Approval. Provided there shall not have been an Adverse Recommendation Change specifically permitted by Section 5.3, as promptly as practicable after the Proxy Statement is cleared by the SEC for mailing to the Company s shareholders, the Company shall give notice of, convene and hold the Company Shareholders Meeting. The Company may postpone or adjourn the Company Shareholders Meeting from its originally noticed date for a reasonable period (i) in order to solicit additional proxies so as to establish a quorum or (ii) to allow time for the filing and dissemination of any supplemental or amended disclosure documents which the Company Board has determined in good faith (after consultation with its outside legal counsel) is necessary to be filed and disseminated under applicable Laws. Except in the case of an Adverse Recommendation Change specifically permitted by Section 5.3, the Company, through the Company Board, shall (A) recommend to its shareholders that they approve this Agreement, the Merger and the other transactions contemplated hereby and (B) include such recommendation in the Proxy Statement. Without limiting the generality of the foregoing, the Company agrees that its obligations pursuant to the first three sentences of this paragraph (b) shall not be affected by the commencement, public proposal, public disclosure or communication to the Company or any other Person of any Acquisition Proposal.

SECTION 5.5 Access to Information; Confidentiality. The Company shall, and shall cause each of its Subsidiaries to, afford to Parent, Merger Sub and their respective Representatives reasonable access during normal business hours, during the period prior to the Effective Time, to all their respective properties, assets, books, contracts, commitments, personnel and records and, during such period, the Company shall, and shall cause each of its Subsidiaries to, furnish promptly to Parent: (a) a copy of each report, schedule, registration statement and other document filed or received by it during such period pursuant to the requirements of federal or state securities laws, and (b) all other information concerning its business, properties and personnel as Parent or Merger Sub may reasonably request (including Tax Returns filed and those in preparation and the workpapers of its auditors); provided, however, that (a) the Company shall not be required to provide such access if it reasonably determines that such access is reasonably likely to materially disrupt or impair the business or operations of the Company or any of its Subsidiaries and (b) the foregoing shall not require the Company to disclose any information to the extent it reasonably determines that such disclosure is reasonably likely to (i) result in a waiver of attorney-client privilege, work product doctrine or similar privilege, (ii) cause competitive harm to the business of the Company and its Subsidiaries if the transactions contemplated by this Agreement are not consummated, or (iii) violate any applicable Law or any confidentiality obligation of such party; provided, however, that in the case that such disclosure is prohibited by applicable Law (including antitrust Law), Parent and the Company each agree to use reasonable best efforts to establish a process that (through use of steps such as targeted redactions, provision of information to counsel to review and summarize for Parent or use of a clean room environment for analysis and review of information by joint integration teams in coordination with counsel and the Company) will provide Parent with timely access to the fullest extent possible to the substance of the information described in this Section 5.5 in a manner that allows the Company to comply with applicable Law. All such information shall be held confidential in accordance with the terms of the Confidentiality Agreement among Hudson Americas LLC, BI-LO, LLC and the Company dated as of February 28, 2011 (the Confidentiality Agreement). No investigation pursuant to this Section 5.5 or information provided, made available or delivered to Parent pursuant to this Agreement shall affect any of the representations, warranties, covenants, rights or remedies, or the conditions to the obligations of, the parties hereunder.

SECTION 5.6 Reasonable Best Efforts.

(a) Upon the terms and subject to the conditions set forth in this Agreement, each of the parties agrees to use reasonable best efforts to take, or cause to be taken, and to cause its Affiliates (including Parent s direct and indirect parent companies and their Affiliates) to cooperate and use reasonable best efforts to take, or cause to be

taken, all actions that are necessary, proper or advisable to consummate and make effective, in the most expeditious manner practicable, the Merger and the other transactions contemplated by this Agreement, including using reasonable best efforts to accomplish the following:

(i) obtain all required consents, approvals or waivers from, or participation in other discussions or negotiations with, third parties, including as required under any Material Contract;

(ii) obtain all necessary actions or nonactions, waivers, consents, approvals, orders and authorizations from Governmental Entities, make all necessary registrations, declarations and filings and take all steps as may be necessary to obtain an approval or waiver from, or to avoid any Action by, any Governmental Entity, including making as soon as practicable after the date of this Agreement, filings under the HSR Act;

(iii) provide as promptly as possible any additional information and documentary materials that may be reasonably requested pursuant to the HSR Act;

(iv) vigorously resist and contest any Action, including administrative or judicial Action, and seek to have vacated, lifted, reversed or overturned any decree, judgment, injunction or other order (whether temporary, preliminary or permanent) that is in effect and that could restrict, prevent or prohibit consummation of the Merger and the other transactions contemplated hereby, including by vigorously pursuing all avenues of administrative and judicial appeal; and

(v) execute and deliver any additional instruments necessary to consummate the Merger and the other transactions contemplated hereby and to fully carry out the purposes of this Agreement;

provided, however, that neither the Company nor any of its Subsidiaries shall commit to the payment of any fee, penalty or other consideration or make any other concession, waiver or amendment under any Contract in connection with obtaining any consent without the prior written consent of Parent (such consent not to be unreasonably withheld, delayed or conditioned).

(b) If any objections are asserted with respect to the transactions contemplated by this Agreement under the HSR Act or if any suit is instituted by any Governmental Entity or any private party challenging the transactions as violative of the HSR Act, each party shall use its reasonable best efforts to (and shall cause its Affiliates, including Parent s direct and indirect parent companies and their Affiliates, to use their respective reasonable best efforts to) resolve any such objection or challenge as such Governmental Entity or private party may have to the transaction so as to permit consummation of the transactions contemplated by this Agreement.

(c) Each of the parties hereto shall (and shall cause its Affiliates, including Parent s direct and indirect parent companies and their Affiliates to) cooperate in all respects with each other in connection with any filing or submission and in connection with any investigation or other inquiry including any proceeding initiated by a private party and they each shall furnish to each other party such necessary information and reasonable assistance as such other party may reasonably request in connection with the foregoing.

(d) Subject to applicable Law relating to the exchange of information, Parent and the Company shall each inform the other party of any communication received by such party from, or given by such party to, any Governmental Entity and each shall have the right to review in advance, and to the extent practicable each shall consult with the other in connection with, all of the information relating to Parent or the Company, as the case may be, and any of their respective Subsidiaries, that appears in any filing made with, or written materials submitted to, any third party or any Governmental Entity in connection with the Merger and the other transactions contemplated by this Agreement. In exercising the foregoing rights, each of Parent and the Company shall act reasonably and as promptly as practicable. Subject to applicable Law and the instructions of any Governmental Entity, the Company and Parent shall keep each other reasonably apprised of the status of matters relating to the completion of the transactions contemplated hereby, including promptly furnishing the other with copies of notices or other written communications received by the Company or Parent, as the case may be, or any of their respective Subsidiaries, from any Governmental Entity or third party with respect to such transactions,

and, to the extent practicable under the circumstances, shall provide the other party and its counsel with the opportunity to participate in any meeting with any Governmental Entity in respect of any filing, investigation or other inquiry in connection with the transactions contemplated hereby.

(e) Notwithstanding anything to the contrary in this Section 5.6, the obligations of Parent and Merger Sub under this Section 5.6 include the obligation of Parent to, and to cause its Affiliates (including Parent s direct and indirect parent companies) to: (i) sell or divest or agree to sell or divest any assets or businesses of Parent and its Subsidiaries, BI-LO Holding and its Subsidiaries and such Affiliates; (ii) agree to sell or divest any assets or businesses of the Company and its Subsidiaries contemporaneously with or subsequent to the Closing; (iii) permit the Company to sell or divest any assets or businesses of the Company or any of its Subsidiaries prior to the Closing; and (iv) license, hold separate or enter into similar arrangements with respect to the assets of Parent and its Subsidiaries, BI-LO Holding and its Subsidiaries, the Company and its Subsidiaries and such Affiliates, in each case in exchange for obtaining the expiration of the waiting period under the HSR Act without further actions being taken or any consent from any Governmental Entity necessary to consummate the Merger and the other transactions contemplated hereby; provided, however, that Parent and its Affiliates shall not be required to take or consent to the taking of any such action that, individually or in the aggregate, would reasonably be likely to cause the Debt Financing to be unavailable at the Closing.

SECTION 5.7 Takeover Laws. Assuming the accuracy in all material respects of Parent s and Merger Sub s representations and warranties in Section 4.6(b), the Company and the Company Board shall (a) take no action to cause any Takeover Law to become applicable to this Agreement, the Merger or any of the other transactions contemplated hereby, and (b) if any Takeover Law is or becomes applicable to this Agreement, the Merger or any of the other transactions contemplated hereby, take all action necessary to ensure that the Merger and the other transactions contemplated hereby may be consummated as promptly as practicable on the terms contemplated by this Agreement and otherwise to minimize the effect of such Takeover Law with respect to this Agreement, the Merger and the other transactions contemplated hereby.

SECTION 5.8 Notification of Certain Matters. The Company and Parent shall promptly notify each other of (a) any notice or other communication received by such party from any Governmental Entity in connection with the Merger or the other transactions contemplated hereby or from any Person alleging that the consent of such Person is or may be required in connection with the Merger or the other transactions contemplated hereby, (b) any other notice or communication from any Governmental Entity in connection with the Merger or the other transactions contemplated hereby, (c) any Action commenced or, to such party s knowledge, threatened against, relating to or involving or otherwise affecting such party or any of its Subsidiaries which relate to the Merger or the other transactions contemplated hereby or (d) any change, condition or event that results or would reasonably be expected to result in any failure of any condition set forth in Article VI to be satisfied hereunder; provided, however, that no such notification shall affect any of the representations, warranties, covenants, rights or remedies, or the conditions to the obligations of, the parties hereunder.

SECTION 5.9 Employees; Benefit Plans.

(a) For a period of one year following the Closing Date (the Continuation Period), Parent shall, or shall cause the Surviving Corporation or any of their respective Subsidiaries or Affiliates to, provide to each individual who, immediately prior to the Effective Time is an employee of the Company or any of its Subsidiaries (each, an Employee) (i) the same base salary or hourly wage rate provided to such Employee immediately prior to the Effective Time, (ii) the same short-term (annual or more frequent) bonus or commission opportunity provided to such Employee immediately prior to the Effective Time, and (iii) other compensation and benefits (excluding equity and equity-based awards, which will remain discretionary) that are no less favorable for all Employees in the aggregate as those provided to such Employees in the aggregate under the Company s and its Subsidiaries compensation and benefit plans, programs, policies, agreements and arrangements in effect immediately prior to the Effective Time. Notwithstanding anything to the contrary set forth herein, after the Effective Time, nothing herein shall preclude the Surviving Corporation or any of its Subsidiaries from terminating the employment of any Employee for any lawful reason.

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(b) Parent shall, or shall cause the Surviving Corporation and each of their respective Subsidiaries and Affiliates to, honor all Company Plans (including all severance, change of control and similar plans and agreements) in accordance with their terms as in effect immediately prior to the Effective Time, subject to any amendment or termination thereof that may be permitted by such Company Plans to the extent not in violation of any requirements hereunder; provided, however, that nothing herein shall prevent the amendment or termination of any specific plan, program, policy, agreement or arrangement, or interfere with Parent s, the Surviving Corporation s or any of their respective Subsidiaries or Affiliates rights or obligations to make such changes as are necessary to comply with applicable Law. During the Continuation Period, Parent shall provide each Employee who suffers a termination of employment under circumstances that would have given the Employee a right to severance payments and benefits under the Company s severance policy in effect immediately prior to the Effective Time (the Company Severance Plan) with severance payments and benefits no less favorable than those that would have been provided to such Employee under the Company Severance Plan.

(c) For all purposes under all employee benefit plans (excluding (x) for benefit accrual under any pension plans or (y) equity compensation plans) of Parent, the Surviving Corporation and their respective Subsidiaries and Affiliates providing benefits to any Employee after the Effective Time (the New Plans), each Employee shall receive full credit for such Employee s years of service with the Company and its Subsidiaries before the Effective Time (including predecessor or acquired entities or any other entities for which the Company and its Subsidiaries have given credit for prior service), to the same extent as such Employee was entitled, prior to the Effective Time, to credit for such service under any similar or comparable Company Plan and, with respect to any New Plan for which there is no similar or comparable Company Plan, to the same extent as such service would be recognized if it had been performed as an employee of Parent, the Surviving Corporation or their respective Subsidiaries or Affiliates (in each case except to the extent such credit would result in a duplication of accrual of benefits). In addition, where applicable, and without limiting the generality of the foregoing: (i) at the Effective Time, each Employee immediately shall be eligible to participate, without any waiting time, in each New Plan to the extent such waiting time was satisfied under a similar or comparable Company Plan in which such Employee participated immediately before the Effective Time (such plans, collectively, the Old Plans); (ii) Parent shall cause all pre-existing condition exclusions or limitations and actively-at-work requirements of each New Plan to be waived or satisfied for such Employee and his or her covered dependents to the extent waived or satisfied under the analogous Old Plan as of the Effective Time; and (iii) Parent shall cause all eligible expenses incurred by each Employee and his or her covered dependents during the portion of the plan year of the Old Plan ending on the date such Employee s participation in the corresponding New Plan begins to be taken into account under such New Plan for purposes of satisfying all deductible, coinsurance and maximum out-of-pocket requirements applicable to such Employee and his or her covered dependents for the applicable plan year as if such amounts had been paid in accordance with such New Plan.

(d) With respect to any accrued but unused vacation time to which any Employee is entitled pursuant to the vacation policy applicable to such Employee immediately prior to the Effective Time (the Vacation Policy), Parent shall, or shall cause the Surviving Corporation or any of their respective Subsidiaries or Affiliates to, (i) allow such Employee to use such accrued vacation (subject to any maximums which may prohibit the Employee from accruing any new vacation time until such prior time is used), and (ii) if any Employee s employment terminates during the Continuation Period under circumstances entitling the Employee to severance pay under the Company Severance Plan, pay the Employee, in cash, an amount equal to the value of the accrued vacation time.

(e) Nothing in this Section 5.9, whether express or implied, shall confer upon any current or former employee of the Company, Parent, the Surviving Corporation or any of their respective Subsidiaries or Affiliates, any rights or remedies including any right to employment or continued employment for any specified period, of any nature or kind whatsoever under or by reason of this Section 5.9. No provision of this Section 5.9 is intended to modify, amend or create any employee benefit plan of the Company, Parent, Surviving Corporation or any of their respective Subsidiaries or Affiliates.

SECTION 5.10 Indemnification, Exculpation and Insurance.

(a) Parent and Merger Sub agree that all rights to indemnification, advancement of expenses and exculpation existing in favor of the current or former directors, officers and employees of the Company and its Subsidiaries and the fiduciaries of any Company Plans (the Indemnified Persons) as provided in (i) the Company Charter or Company Bylaws, (ii) the certificates of incorporation or bylaws or other organizational documents of such Subsidiaries, (iii) such Company Plans, or (iv) any agreements between an Indemnified Person and the Company or one of its Subsidiaries and which is included in the Company SEC Documents or listed in Section 5.10 of the Company Disclosure Letter, in each case as in effect on the date of this Agreement, with respect to acts or omissions occurring prior to the Effective Time, shall survive the Merger and shall continue in full force and effect in accordance with their terms for a period of six years after the Effective Time or, if longer, for such period as is set forth in any such agreement with an Indemnified Person, in each case with respect to any claims against such Indemnified Persons arising out of such acts or omissions, except as otherwise required by applicable Law.

(b) For a period of six years after the Effective Time, Parent shall cause to be maintained in effect the Company s current directors and officers liability insurance covering each Person currently covered by the Company s directors and officers liability insurance policy (a correct and complete copy of which has been heretofore made available to Parent) for acts or omissions occurring prior to the Effective Time; provided, that Parent may (i) substitute therefor policies of an insurance company the material terms of which, including coverage and amount, are no less favorable in any material respect to such directors and officers than the Company s existing policies as of the date hereof, or (ii) request that the Company obtain prior to the Effective Time such extended reporting period coverage under its existing insurance programs; and provided, further, that in no event shall Parent or the Company be required to pay annual premiums for insurance under this Section 5.10 in excess of 250% of the amount of the annual premiums paid by the Company for fiscal year 2011 for such purpose (which fiscal year 2011 premiums are hereby represented and warranted by the Company to be as set forth in Section 5.10 of the Company Disclosure Letter), it being understood that Parent shall nevertheless be obligated to provide as much coverage as may be obtained for such 250% amount. Notwithstanding the foregoing, in lieu of the arrangements contemplated by this Section 5.10(b), before the Effective Time, the Company shall be entitled to purchase a tail directors and officers liability insurance policy covering the matters described in this Section 5.10(b) so long as the Company does not pay more than the amount set forth on Section 5.10 of the Company Disclosure Letter, and, if the Company elects to purchase such a policy before the Effective Time, then Parent s obligations under this Section 5.10(b) shall be satisfied so long as Parent causes such policy to be maintained in effect for a period of six years following the Effective Time.

(c) For a period of six years after the Effective Time, Parent and the Surviving Corporation shall indemnify and hold harmless each Indemnified Person against all claims, losses, liabilities, damages, judgments and fines (and reasonable fees, costs and expenses, including attorneys fees and disbursements) incurred in connection with any Action, whether civil, criminal, administrative or investigative, arising out of or pertaining to the fact that the Indemnified Person is or was an officer, director or employee of the Company or any of its Subsidiaries with respect to matters existing or occurring at or prior to the Effective Time (including this Agreement and the transactions contemplated hereby), whether asserted or claimed prior to, at or after the Effective Time, to the fullest extent permitted under applicable Law; provided, that the foregoing indemnification shall be unavailable if the Indemnified Person is determined in a final non-appealable judgment of a court of competent jurisdiction to have failed to act in good faith and in a manner such Indemnified Person reasonably believed to be in the best interests of the Company or, in the case of a criminal action or proceeding, to have had reasonable cause to believe that such Indemnified Person s conduct was unlawful. In the event of any such Action, each Indemnified Person shall be entitled to advancement of expenses incurred in the defense of such Action; provided, that any Person to whom expenses are advanced provides an undertaking to repay such advances if it is ultimately determined that such Person is not entitled to indemnification hereunder. In the event of any such Action, (i) each of Parent and the Surviving Corporation shall cooperate with the Indemnified Person in the defense of any such Action and (ii) neither Parent nor the Surviving Corporation shall settle, compromise or consent to the entry of

any judgment in any Action pending or threatened in writing to which an Indemnified Person is a party (and in respect of which indemnification could be sought by such Indemnified Person hereunder), unless such settlement, compromise or consent includes an unconditional release of such Indemnified Person from all liability arising out of such Action.

(d) In the event that Parent, the Surviving Corporation or any of its successors or assigns shall (i) consolidate with or merge into any other Person and shall not be the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfer all or substantially all its properties and assets to any Person, then, and in each such case, Parent and the Surviving Corporation shall cause proper provision to be made so that the successor and assign of Parent or the Surviving Corporation assumes the obligations set forth in this Section 5.10.

(e) The provisions of this Section 5.10 shall survive consummation of the Merger and are intended to be for the benefit of, and shall be enforceable by, each Indemnified Person, his or her heirs and his or her legal representatives.

SECTION 5.11 Financing.

(a) Each of Parent and Merger Sub shall use reasonable best efforts to cause BI-LO Holding, LLC (BI-LO Holding) to obtain the Debt Financing on the terms and conditions described in the Debt Financing Commitments and the Fee Letter, including using reasonable best efforts to (i) negotiate definitive agreements with respect thereto on the terms and conditions contained therein, (ii) satisfy on a timely basis all conditions applicable to BI-LO Holding, Parent and Merger Sub in the Debt Financing Commitments and the Fee Letter that are within its or their respective Affiliates control (including their respective direct and indirect parent companies and their Affiliates), (iii) comply with its obligations under the Financing Commitments, and (iv) consummate the Financing at or prior to the Closing Date (it being understood that it is not a condition to Closing under this Agreement, nor the consummation of the Merger, for Parent or Merger Sub to obtain the Financing or any alternative financing). Notwithstanding anything to the contrary in the immediately preceding sentence, Parent and Merger Sub shall, and shall cause each of BI-LO Holding and the Sponsor and their respective Affiliates to, take all actions reasonably necessary to maintain in effect the Financing Commitments.

(b) Parent shall keep the Company informed on a regular basis and in reasonable detail of the status of its and BI-LO Holding s efforts to arrange the Debt Financing (including promptly providing the Company with copies of all definitive agreements related to the Debt Financing). Parent shall give the Company prompt notice (i) of any material breach or default by any party to any of the Financing Commitments or definitive agreements related to the Financing of which Parent becomes aware, (ii) of the receipt of any written notice or other written communication, in each case from any Financing Source with respect to (A) any material actual or potential breach or default, or any termination or repudiation by any party to any of the Financing Commitments or definitive agreements related to the Financing of any provisions of the Financing Commitments or definitive agreements related to the Financing or (B) any material dispute or disagreement between or among any parties to any of the Financing Commitments or definitive agreements related to the Financing with respect to the obligation to fund the Financing or the amount of the Financing to be funded at Closing, and (iii) if at any time for any reason Parent believes in good faith that it or BI-LO Holding will not be able to obtain all or any material portion of the Financing on the terms and conditions, in the manner or from the sources contemplated by any of the Financing Commitments and the Fee Letter or definitive agreements related to the Financing. As soon as practicable after the Company delivers to Parent a written request, Parent shall provide any information reasonably requested by the Company relating to any circumstance referred to in clause (i), (ii) or (iii) of the immediately preceding sentence.

(c) Parent and BI-LO Holding shall have the right from time to time to amend, replace, supplement or otherwise modify, or waive any of its rights under the Debt Financing Commitments, or substitute other debt or equity financing for all or any portion of the Financing from the same or alternative Financing Sources; provided,

that any such amendment, replacement, supplement, modification or waiver shall not (i) expand upon the conditions precedent to the Financing as set forth in the Financing Commitments and the Fee Letter in any way or (ii) be reasonably expected to prevent or cause any delay of the consummation of the Merger and the other transactions contemplated by this Agreement (taking into account any market flex provisions). For purposes of this Section 5.11, references to Financing shall include the financing contemplated by the Financing Commitments and the Fee Letter as permitted to be amended or modified by this paragraph (c) and references to Financing Commitments and Debt Financing Commitments shall include such documents as permitted to be amended or modified by this paragraph (c). In the event any portion of the Debt Financing becomes unavailable on the terms and conditions (including the flex provisions) contemplated in the Debt Financing Commitments and the Fee Letter, Parent shall promptly so notify the Company and shall cause BI-LO Holding to use reasonable best efforts to promptly obtain alternative financing on terms not materially less beneficial to BI-LO Holding and Parent (as determined in the reasonable judgment of BI-LO Holding and Parent, taking into account the flex provisions set forth in the Fee Letter) and in an amount sufficient to consummate the Merger, the Refinancing and the other transactions contemplated by this Agreement, as promptly as practicable following the occurrence of such event.

(d) The Company shall use its reasonable best efforts to, and shall cause its Subsidiaries and its and their respective Representatives to use their reasonable best efforts to, at Parent s sole cost and expense, promptly provide to Parent and Merger Sub all cooperation reasonably requested by Parent in connection with the Financing (provided that such requested cooperation does not unreasonably interfere with the ongoing operations of the Company or any of its Subsidiaries), including:

(i) participating in a reasonable number of meetings (including customary one-on-one meetings with the parties acting as lead arrangers or agents for, and prospective lenders and purchasers of, the Financing and the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer and General Counsel of the Company and other members of senior management and Representatives of the Company), presentations, road shows, due diligence sessions, drafting sessions and sessions with rating agencies in connection with the Financing, in each case, with reasonable advance notice and at reasonable locations;

(ii) cooperating reasonably with the marketing efforts of Parent, BI-LO Holding and the Financing Sources for all or any portion of the Debt Financing;

(iii) assisting reasonably with the preparation of rating agency presentations, offering documents, bank information memoranda, lender presentations and similar documents necessary or customary for use in connection with the Financing, including execution and delivery of customary representation letters in connection with bank information memoranda;

(iv) as promptly as practical and to the extent not furnished to Parent prior to the date hereof, furnishing Parent and the Financing Sources (A) audited consolidated balance sheets and related statements of income, stockholders equity and cash flows of the Company (or its predecessors, as applicable) for each of the three fiscal years most recently ended at least 75 days prior to the Closing Date, which shall be prepared in accordance with GAAP, and (B) unaudited consolidated balance sheets and related statements of income, stockholders equity and cash flows of the Company (or its predecessors, as applicable) for each fiscal quarter ended at least 40 days prior to the Closing Date (other than the fourth fiscal quarter of any year), which shall be prepared in accordance with GAAP (such information, the Required Information);

(v) providing all relevant information with respect to collateral and providing access to Parent and its Financing Sources to allow them to conduct audit examinations and appraisals with respect to such collateral;

(vi) obtaining, no sooner than the Effective Time, surveys, title insurance and other like documentation customary for financing similar to the Debt Financing (except that the Company shall not be required to obtain or provide any legal opinions from any counsel to the Company);

(vii) executing and delivering, as of the Effective Time, definitive financing documentation, including pledge and security documents and certificates, documents and instruments relating to guarantees, collateral

and other matters ancillary to the Financing (including a customary certificate of the Chief Financial Officer of the Company with respect to solvency matters), and otherwise reasonably facilitating the pledging of collateral and the providing of the guarantees; provided that no obligation of the Company under any such agreement, pledge or grant shall be effective until the Effective Time;

(viii) cooperating reasonably in facilitating the termination of the Second Amended and Restated Credit Agreement, dated March 18, 2011, by and among the Company, the lenders party thereto, and Wells Fargo Bank, National Association, as administration agent, and obtaining all documentation reasonably requested by the Financing Sources evidencing the termination of such Indebtedness and the release of all related liens;

(ix) cooperating reasonably in facilitating the cancellation and replacement, or rollover into the Debt Financing, of all outstanding letters of credit and the termination of any related letter of credit agreements to which the Company or any of its Subsidiaries is a party and obtaining all documentation reasonably requested by the Financing Sources evidencing the termination of such Indebtedness and the release of all related liens; and

(x) taking at the Effective Time all corporate actions reasonably necessary to permit the consummation of the Debt Financing and to permit the proceeds thereof, together with the cash at the Company and its Subsidiaries, to be made available to Parent on the Closing Date to consummate the Merger.

The Company will periodically update the Required Information included in any bank information or other similar offering memorandum to be used to obtain the Debt Financing in order to ensure that such Required Information does not contain any untrue statement of material fact or omit to state any material fact necessary in order to make the statements contained therein not misleading.

(e) The Company hereby consents to the use of its and its Subsidiaries logos in connection with the Debt Financing so long as such logos are used solely in a manner that is not intended to nor reasonably likely to harm or disparage the Company and its Subsidiaries.

(f) Parent shall, promptly upon request by the Company, reimburse the Company for all documented and reasonable out-of-pocket costs and expenses incurred by the Company or its Subsidiaries in connection with their cooperation as described in this Section 5.11. Parent and Merger Sub acknowledge and agree that the Company and its Affiliates and their respective Representatives shall not have any responsibility for, or incur any liability to any Person under or in connection with, the arrangement of the Financing or any alternative financing that Parent or Merger Sub may raise in connection with the transactions contemplated by this Agreement if the Closing does not occur. Parent and Merger Sub shall, on a joint and several basis, indemnify and hold harmless the Company, its Subsidiaries and their respective Representatives from and against any and all damages suffered or incurred by them in connection with the arrangement of the Financing and any information utilized in connection therewith (other than information provided in writing by the Company or its Subsidiaries expressly for use in connection therewith). Notwithstanding anything to the contrary in this Section 5.11, the Company shall not be required to become subject to any obligations or liabilities with respect to any document or agreement prior to the Effective Time.

(g) The obligations of the Company set forth in this Section 5.11 are the sole obligations of the Company with respect to the Debt Financing and no other provision of this Agreement shall be deemed to expand or modify such obligations.

SECTION 5.12 Public Announcements. Each of Parent and Merger Sub, on the one hand, and the Company, on the other hand, shall, to the extent reasonably practicable, consult with each other before issuing, and give each other a reasonable opportunity to review and comment upon, any press release or other public statements (including employee communications) with respect to this Agreement, the Merger and the other transactions contemplated hereby and shall not issue any such press release or make any such public statement prior to such consultation and review, except as may be required by applicable Law, court process or by obligations pursuant to any rule or regulation of Nasdaq.

SECTION 5.13 Section 16 Matters. Prior to the Effective Time, the Company Board shall use its reasonable best efforts to take all such steps as may be necessary or appropriate to cause the transactions contemplated by this Agreement, including any dispositions of Shares (including derivative securities with respect to such Shares) resulting from the transactions contemplated by this Agreement by each individual who is or will be subject to the reporting requirements of Section 16(a) of the Exchange Act with respect to the Company, to be exempt under Rule 16b 3 promulgated under the Exchange Act.

SECTION 5.14 Tax Accounting Election Change. Prior to the earlier of (a) the Company s filing of its federal income Tax Return for the taxable year ended June 29, 2011 and (b) March 15, 2012, the Company and all applicable direct and indirect Subsidiaries of the Company shall change the Company s and each such Subsidiary s method of valuing inventory for federal and state income Tax purposes from the last-in, first-out method to the first-in, first-out method for the Company s taxable year ended June 29, 2011. The Company and each such Subsidiary shall properly prepare and timely file any required documentation, including Internal Revenue Service Form 3115 and any other applicable documents required for federal, state, local or foreign income Tax purposes (together, the Accounting Change Documents), in accordance with the automatic accounting method change consent provisions of Rev. Proc. 2011-14, 2011-4 IRB 330 and any other applicable state, local or foreign procedures. The Company shall provide Parent with a copy of all Accounting Change Documents at least 10 days prior to the filing thereof. Parent shall provide comments to the Company with respect to the Accounting Change Documents no later than five days after receipt thereof and the Company shall make such changes to the Accounting Change Documents as are reasonably requested by Parent prior to filing.

ARTICLE VI

CONDITIONS PRECEDENT

SECTION 6.1 Conditions to Each Party s Obligation to Effect the Merger. The obligation of each party to effect the Merger is subject to the satisfaction at or prior to the Effective Time of the following conditions:

(a) Shareholder Approval. The Company Shareholder Approval shall have been obtained.

(b) HSR Act; Antitrust. Any applicable waiting period (and any extension thereof) under the HSR Act relating to the transactions contemplated by this Agreement shall have expired or been terminated.

(c) No Injunctions or Legal Restraints; Illegality. No temporary restraining order, preliminary or permanent injunction or other judgment, order or decree issued by any court of competent jurisdiction or other legal restraint or prohibition shall be in effect, and no Law shall have been enacted, entered, promulgated, enforced or deemed applicable by any Governmental Entity that, in any such case, prohibits or makes illegal the consummation of the Merger.

SECTION 6.2 Conditions to the Obligations of Parent and Merger Sub. The obligation of Parent and Merger Sub to effect the Merger is also subject to the satisfaction, or waiver by Parent, at or prior to the Effective Time of the following conditions:

(a) Representations and Warranties. (i) Each of the representations and warranties of the Company set forth in Sections 3.2(a)(i), 3.2(a)(iii) and 3.2(b)(i) shall be true and correct as of the date of this Agreement and as of the Closing Date as if made as of the Closing Date (except to the extent such representations and warranties expressly relate to an earlier date, in which case as of such earlier date), except for any failures to be true and correct that, individually or in the aggregate, are de minimis; (ii) the representation and warranty of the Company set forth in Section 3.8(b) shall be true and correct as of the date of this Agreement; (iii) each of the representations and warranties of the Company set forth in Sections 3.1, 3.2(a)(ii), 3.2(a)(iv), 3.2(b)(ii), 3.4, 3.19 and 3.20 that is qualified as to materiality or Material Adverse Effect shall be true and correct, and those not so qualified shall be true and correct in all material respects, in each case as of the date of this Agreement and as of

the Closing Date as if made as of the Closing Date (except to the extent such representations and warranties expressly relate to an earlier date, in which case as of such earlier date); and (iv) each of the remaining representations and warranties of the Company set forth in this Agreement shall be true and correct as of the date of this Agreement and as of the Closing Date as if made as of the Closing Date (except to the extent such representations and warranties expressly relate to an earlier date, in which case as of such earlier date), except, in the case of this clause (iv), for inaccuracies of such representations and warranties the circumstances giving rise to which, individually or in the aggregate, have not had and would not reasonably be expected to have a Material Adverse Effect (provided, that for purposes of determining the accuracy of such representations and warranties, all knowledge, materiality and Material Adverse Effect qualifications and exceptions contained in such representations and warranties shall be disregarded).

(b) Performance of Obligations of the Company. The Company shall have performed in all material respects all material obligations required to be performed by it under this Agreement at or prior to the Effective Time.

(c) Absence of Material Adverse Effect. Since the date of this Agreement, there shall not have occurred any event, change, circumstance, occurrence, effect or state of facts that, individually or in the aggregate, has had or would reasonably be expected to have a Material Adverse Effect.

(d) Officers Certificate. Parent shall have received a certificate dated the Closing Date and signed by an executive officer of the Company certifying as to the matters set forth in paragraphs (a), (b) and (c) above.

SECTION 6.3 Conditions to the Obligations of the Company. The obligation of the Company to effect the Merger is also subject to the satisfaction, or waiver by the Company, at or prior to the Effective Time of the following conditions:

(a) Representations and Warranties. Each of the representations and warranties of Parent and Merger Sub set forth in this Agreement shall be true and correct as of the date of this Agreement and as of the Closing Date as if made as of the Closing Date (except to the extent such representations and warranties expressly relate to an earlier date, in which case as of such earlier date), except for inaccuracies of such representations and warranties the circumstances giving rise to which, individually or in the aggregate, have not had and would not reasonably be expected to have a Parent Material Adverse Effect (provided, that for purposes of determining the accuracy of such representations and warranties, all materiality and Parent Material Adverse Effect qualifications and exceptions contained in such representations and warranties shall be disregarded).

(b) Performance of Obligations of Parent and Merger Sub. Parent and Merger Sub shall have performed in all material respects all material obligations required to be performed by them under this Agreement at or prior to the Effective Time.

(c) Officers Certificate. The Company shall have received a certificate signed by an executive officer of Parent certifying as to the matters set forth in paragraphs (a) and (b).

SECTION 6.4 Frustration of Closing Conditions. None of Parent, Merger Sub or the Company may rely on the failure of any condition set forth in this Article VI to be satisfied if such failure was caused by such party s breach of this Agreement.

ARTICLE VII

TERMINATION, AMENDMENT AND WAIVER

SECTION 7.1 Termination. This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, whether before or after the Company Shareholder Approval has been obtained (with any termination by Parent also being an effective termination by Merger Sub):

(a) by mutual written consent of Parent and the Company;

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(b) by either Parent or the Company:

(i) if the Merger shall not have been consummated on or before the date that is the 180th day after the date hereof (the Outside Date); provided, that no party shall have the right to terminate this Agreement pursuant to this paragraph (i) if the failure of such party to perform or comply in all material respects with the covenants and agreements of such party set forth in this Agreement shall have been the cause of, or resulted in, the failure of the Merger to be consummated by the Outside Date;

(ii) if any court of competent jurisdiction or other Governmental Entity of the United States shall have issued a judgment, order, injunction, rule or decree, or taken any other action restraining, enjoining or otherwise prohibiting the consummation of the Merger and such judgment, order, injunction, rule, decree or other action shall have become final and nonappealable; provided, that the party seeking to terminate this Agreement pursuant to this paragraph (ii) shall have used its reasonable best efforts to contest, appeal and remove such judgment, order, injunction, rule, decree, ruling or other action in accordance with Section 5.6; or

(iii) if the Company Shareholder Approval shall not have been obtained at the Company Shareholders Meeting duly convened therefor or at any adjournment or postponement thereof at which a vote on the approval of this Agreement was taken;

(c) by Parent:

(i) if the Company shall have breached or failed to perform any of its representations, warranties, covenants or agreements set forth in this Agreement (other than with respect to a breach of Section 5.3 or 5.4(b), as to which Section 7.1(c)(ii) will apply), or if any representation or warranty of the Company shall have become untrue, which breach or failure to perform or to be true, either individually or in the aggregate, if occurring or continuing at the Effective Time, (A) would result in the failure of any of the conditions set forth in Section 6.1 or 6.2 and (B) cannot be or has not been cured on or prior to the earlier of (1) the day immediately before the Outside Date and (2) the 30th day after the giving of written notice to the Company of such breach or failure; provided, that Parent shall not have the right to terminate this Agreement pursuant to this paragraph (i) if Parent or Merger Sub is then in material breach of any of its covenants or agreements set forth in this Agreement;

(ii) (A) if the Company shall have breached or failed to perform in any material respect any of its obligations set forth in Section 5.3, or (B) if the Company shall have breached or failed to perform in any material respect any of its obligations set forth in Section 5.4(b), and, in the case of this clause (B), such breach or failure cannot be or has not been cured on or prior to the earlier of (1) the day immediately before the Outside Date and (2) the 10th day after the giving of written notice to the Company of such breach or failure; provided, that Parent shall not have the right to terminate this Agreement pursuant to this paragraph (ii) if Parent or Merger Sub is then in material breach of any of its covenants or agreements set forth in this Agreement; or

(iii) if (A) an Adverse Recommendation Change occurs, (B) the Company or the Company Board (or any committee thereof) shall approve or recommend, or cause or permit the Company to enter into, an Alternative Acquisition Agreement, (C) the Company fails publicly to reaffirm its recommendation of the Merger within 10 Business Days after the date any Acquisition Proposal or any material modification thereto is first commenced, published or sent or given to the Company s shareholders upon a request to do so by Parent (which request may only be given once with respect to each of any such Acquisition Proposal or any such material modification), or (D) the Company or the Company Board (or any committee thereof) shall formally resolve or publicly authorize or propose to take any of the foregoing actions;

(d) by the Company:

(i) if Parent or Merger Sub shall have breached or failed to perform any of its representations, warranties, covenants or agreements set forth in this Agreement, or if any representation or warranty of Parent or Merger Sub shall have become untrue, which breach or failure to perform or to be true, either

individually or in the aggregate, if occurring or continuing at the Effective Time, (A) would result in the failure of any of the conditions set forth in Section 6.1 or 6.3 and (B) cannot be or has not been cured on or prior to the earlier of (1) the day immediately before the Outside Date and (2) the 30th day after the giving of written notice to Parent of such breach or failure; provided, that the Company shall not have the right to terminate this Agreement pursuant to this paragraph (i) if it is then in material breach of any of its covenants or agreements set forth in this Agreement;

(ii) at any time prior to obtaining the Company Shareholder Approval, in order to accept a Superior Proposal in accordance with Section 5.3(b); provided, that the Company shall have (A) simultaneously with such termination entered into the associated Alternative Acquisition Agreement, (B) otherwise complied in all material respects with all provisions of Section 5.3(b), including the notice provisions thereof, and (C) paid all amounts due pursuant to Section 7.3; or

(iii) if the Merger shall not have been consummated on or before the date required by Section 1.2, all of the conditions set forth in Sections 6.1 and 6.2 would be satisfied at the time of such termination if the Closing were held at the time of such termination (other than conditions that, by their nature, are to be satisfied at the Closing), and the Company stood ready, willing and able to consummate the Merger on the date required by Section 1.2 and at the time of termination.

The party desiring to terminate this Agreement pursuant to this Section 7.1 (other than Section 7.1(a)) shall give notice of such termination to the other party.

SECTION 7.2 Effect of Termination. In the event of termination of this Agreement, this Agreement shall immediately become void and have no effect, without any liability or obligation on the part of Parent, Merger Sub or the Company; provided, that:

(a) except as set forth in paragraph (b) below, the Confidentiality Agreement, the Limited Guarantee (only to the extent reflected therein) and the provisions of Sections 3.22, 4.5, 5.11(f), 5.12, this Section 7.2, Sections 7.3, 7.4 and 7.5, and Article VIII shall survive the termination hereof;

(b) in the event of a termination pursuant to Section 7.1(c)(iii) in connection with an Intervening Event, Section 7 of the Confidentiality Agreement shall not survive the termination hereof and shall thereupon become of no further force or effect;

(c) the Company or Parent may have liability as provided in Section 7.3;

(d) subject to Section 7.3(f) and (g) (including the limitation on liability set forth therein) and paragraphs (e) and (g) below, no such termination shall relieve any party from any liability or damages resulting from a Willful and Material Breach of this Agreement or fraud, in which case the non-breaching party shall be entitled to all rights and remedies available at law or in equity. Willful and Material Breach shall mean a deliberate act or a deliberate failure to act, which act or failure to act constitutes in and of itself a material breach of this Agreement, regardless of whether breaching was the conscious object of the act or failure to act (including, in the case of Parent and with respect to Sections 5.2, 5.6 and 5.11, any such act or failure to act by its direct or indirect parent companies and their Affiliates);

(e) notwithstanding anything to the contrary in this Agreement, in no event shall any party hereto be liable for (i) punitive damages or (ii) special, indirect or other similar damages that, in any such case, are not reasonably foreseeable;

(f) in the case of any damages sought by the Company from Parent or Merger Sub, including for any Willful and Material Breach, such damages can be based on the consideration that would have otherwise been payable to the shareholders and equity awardholders of the Company pursuant to this Agreement or based on loss of market value or price of the Shares and implied value of any equity awards; and

(g) in the case of any damages sought by Parent or Merger Sub from the Company, including for any Willful and Material Breach, such damages may not be based on foregone synergies that could have obtained between the business of the Company and its Subsidiaries and the business of any Affiliate of Parent or Merger Sub should the Merger have been consummated.

SECTION 7.3 Fees and Expenses; Limitation of Liability.

(a) Generally. Except as otherwise provided in this Section 7.3, all fees and expenses incurred in connection with this Agreement, the Merger and the other transactions contemplated hereby shall be paid by the party incurring such fees or expenses, whether or not the Merger is consummated.

(b) Breakup Fee. In the event that:

(i) (A) an Acquisition Proposal (whether or not conditional) or intention to make an Acquisition Proposal (whether or not conditional) is made directly to the Company s shareholders or is otherwise publicly disclosed, or is otherwise communicated to senior management of the Company or the Company Board, before receipt of the Company Shareholder Approval, (B) this Agreement is terminated by the Company or Parent pursuant to Section 7.1(b)(i) or (b)(iii), and (C) within 12 months after the date of such termination, the Company enters into an agreement in respect of any Acquisition Proposal and the transaction contemplated by such Acquisition Proposal is subsequently consummated, or a transaction in respect of any Acquisition Proposal is consummated, which, in each case, need not be the same Acquisition Proposal that was made, disclosed or communicated prior to termination hereof (provided, that for purposes of this clause (C), each reference to 15% in the definition of Acquisition Proposal shall be deemed to be a reference to 50%);

(ii) this Agreement is terminated by Parent pursuant to Section 7.1(c)(iii); or

(iii) this Agreement is terminated by the Company pursuant to Section 7.1(d)(ii);

then, in any such event, the Company shall pay to Parent a fee of $19,600,000 (nineteen million six-hundred thousand dollars) (the Breakup Fee). In no event shall the Company be required to pay the Breakup Fee on more than one occasion.

(c) Closing Failure Fee. In the event that:

(i) this Agreement is terminated by the Company pursuant to Section 7.1(d)(i);

(ii) this Agreement is terminated by the Company pursuant to Section 7.1(d)(iii); or

(iii) this Agreement is terminated by either the Company or Parent pursuant to Section 7.1(b)(ii) as a result of Parent failing to take actions contemplated by Section 5.6(e) in reliance on the proviso at the end of Section 5.6(e) permitting Parent and its Affiliates not to take any such actions that, individually or in the aggregate, would reasonably be likely to cause the Debt Financing to be unavailable at the Closing;

then, in any such event, Parent shall pay to the Company a fee of $72,825,000 (seventy-two million eight hundred twenty-five thousand dollars) (the Closing Failure Fee), it being understood that in no event shall Parent be required to pay the Closing Failure Fee on more than one occasion.

(d) Payment Procedures. Payment of the Breakup Fee shall be made by wire transfer of same day funds to the accounts designated by Parent (i) on consummation of any transaction contemplated by an Acquisition Proposal, as applicable, in the case of a Breakup Fee payable pursuant to Section 7.3(b)(i), (ii) as promptly as reasonably practicable after termination (and, in any event, within five Business Days thereof), in the case of termination by Parent pursuant to Section 7.1(c)(iii), or (iii) simultaneously with, and as a condition to the effectiveness of, termination, in the case of a termination by the Company pursuant to Section 7.1(d)(ii). Payment of the Closing Failure Fee shall be made by wire transfer of same day funds to the accounts designated by the Company as promptly as reasonably practicable after termination of this Agreement (and, in any event, within five Business Days thereof).

(e) Costs of Recovery. Each of the parties acknowledges that the agreements contained in this Section 7.3 are an integral part of the transactions contemplated by this Agreement and that, without these agreements, the other parties would not enter into this Agreement. Accordingly, if any party fails to pay any amounts due pursuant to this Section 7.3, and, in order to obtain such payment, the owed party commences a suit that results in a judgment against the owing party for the amounts set forth in this Section 7.3, the owing party shall pay to the owed party its costs and expenses (including reasonable attorneys fees and expenses) in connection with such suit, together with interest on the amounts due pursuant to this Section 7.3 from the date such payment was required to be made until the date of payment at the prime lending rate as published in The Wall Street Journal in effect on the date such payment was required to be made.

(f) Limitation of Liability of Parent Parties; Effect of Payment of Closing Failure Fee. Notwithstanding anything to the contrary in this Agreement:

(i) No Parent Party, except Parent, Merger Sub and the Guarantor (but only to the extent set forth in the Limited Guarantee), shall have any liability to the Company, any of its Affiliates or any of its or their stockholders or equityholders for any obligation or liability of the parties to this Agreement or for any claim for any loss suffered as a result of any breach of this Agreement, the Limited Guarantee or the Financing Commitments (including any Willful and Material Breach), or the failure of the Merger or any other transaction contemplated hereby or thereby to be consummated, or in respect of any oral representation made or alleged to be have been made in connection herewith or therewith, whether in equity or at law, in contract, in tort or otherwise.

(ii) Without limiting the right of the Company to seek specific performance in accordance with Section 8.10, the maximum aggregate monetary liability of Parent, Merger Sub and the Guarantor to the Company, its Affiliates and its and their stockholders and equityholders for any loss suffered as a result of any breach of this Agreement, the Limited Guarantee or the Financing Commitments (including any Willful and Material Breach), or the failure of the Merger or any other transaction contemplated hereby or thereby to be consummated, or in respect of any oral representation made or alleged to be have been made in connection herewith or therewith, whether in equity or at law, in contract, in tort or otherwise, shall be limited to $72,825,000 (seventy-two million eight hundred twenty-five thousand dollars), plus any payment obligations pursuant to Sections 5.11(f) and 7.3(e), in the aggregate (inclusive of the Closing Failure Fee), and in no event shall the Company seek to recover any money damages (including consequential, indirect or punitive damages) in excess of such amount.

(iii) Upon payment of the Closing Failure Fee, plus any payment obligations pursuant to Sections 5.11(f) and 7.3(e), neither Parent, Merger Sub nor the Guarantor (nor any other Parent Party) shall have any further liability or obligation to the Company, its Affiliates or its or their stockholders or equityholders relating to or arising out of this Agreement, the Limited Guarantee or the Financing Commitments, or the failure of the Merger or any other transaction contemplated hereby or thereby to be consummated, or in respect of any oral representation made or alleged to be have been made in connection herewith or therewith, whether in equity or at law, in contract, in tort or otherwise, and in such event, the Company shall not seek to recover any money damages (including consequential, indirect or punitive damages, or damages on account of a Willful and Material Breach) or obtain any equitable relief from any Parent Party.

(g) Effect of Payment of Breakup Fee. Without limiting the right of Parent and Merger Sub to refuse payment of the Breakup Fee and, in lieu thereof, seek money damages or equitable relief from the Company, and notwithstanding anything to the contrary in this Agreement, upon payment of the Breakup Fee, plus any costs of recovery pursuant to Section 7.3(e), the Company shall not have any further liability or obligation relating to or arising out of this Agreement or the failure of the Merger or any other transaction contemplated hereby to be consummated, or in respect of any oral representation made or alleged to be have been made in connection herewith or therewith, whether in equity or at law, in contract, in tort or otherwise, and in such event, Parent and Merger Sub shall not, and shall cause the Parent Parties not to, seek to recover any money damages (including consequential, indirect or punitive damages, or damages on account of a Willful and Material Breach) or obtain any equitable relief from the Company.

SECTION 7.4 Amendment or Supplement. This Agreement may be amended, modified or supplemented by the parties at any time prior to the Effective Time, whether before or after the Company Shareholder Approval has been obtained; provided, however, that after the Company Shareholder Approval has been obtained, no amendment shall be made that pursuant to applicable Law requires further approval or adoption by the shareholders of the Company without such further approval or adoption. This Agreement may not be amended, modified or supplemented in any manner, whether by course of conduct or otherwise, except by an instrument in writing specifically designated as an amendment hereto, signed on behalf of each of the parties hereto. Notwithstanding anything to the contrary contained herein, Sections 7.3(f), 8.6(b), 8.8(b), 8.8(c), 8.12 and this Section 7.4 (and any provision of this Agreement to the extent a modification, waiver or termination of such provision would modify the substance of Sections 7.3(f), 8.6(b), 8.8(b), 8.8(c) or 8.12 or this Section 7.4) may not be modified, waived or terminated in a manner that impacts or is adverse in any respect to the Financing Sources without the prior written consent of the Financing Sources.

SECTION 7.5 Extension of Time; Waiver. At any time prior to the Effective Time, Parent and Merger Sub, on the one hand (who shall together be deemed one party for the purposes of this Section 7.5), and the Company, on the other hand, may (a) extend the time for the performance of any of the obligations of the other party, (b) waive any inaccuracies in the representations and warranties of the other party set forth in this Agreement or any document delivered pursuant hereto, or (c) subject to applicable Law, waive compliance with any of the agreements or conditions of the other party contained herein; provided, however, that after the Company Shareholder Approval has been obtained, no waiver may be made that pursuant to applicable Law requires further approval or adoption by the shareholders of the Company without such further approval or adoption. Any agreement on the part of a party to any such waiver shall be valid only if set forth in a written instrument executed and delivered by a duly authorized officer on behalf of such party. No failure or delay of any party in exercising any right or remedy hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right or power, or any abandonment or discontinuance of steps to enforce such right or power, or any course of conduct, preclude any other or further exercise thereof or the exercise of any other right or power. The rights and remedies of the parties hereunder are cumulative and are not exclusive of any rights or remedies which they would otherwise have hereunder.

ARTICLE VIII

GENERAL PROVISIONS

SECTION 8.1 Nonsurvival of Representations and Warranties. None of the representations, warranties, covenants or agreements in this Agreement or in any instrument delivered pursuant to this Agreement shall survive the Effective Time, other than those covenants or agreements of the parties which by their terms apply, or are to be performed in whole or in part, after the Effective Time.

SECTION 8.2 Notices. All notices and other communications hereunder shall be in writing and shall be deemed duly given (a) on the date of delivery if delivered personally, or if by facsimile or email, upon written confirmation of receipt by facsimile or email, (b) on the first Business Day following the date of dispatch if delivered utilizing a next-day service by a recognized next-day courier, or (c) on the earlier of confirmed receipt or the fifth Business Day following the date of mailing if delivered by registered or certified mail, return receipt requested, postage prepaid. All notices hereunder shall be delivered to the addresses set forth below, or pursuant to such other instructions as may be designated in writing by the party to receive such notice:

(i) if to Parent, Merger Sub or the Surviving Corporation, to:

Opal Holdings, LLC

Opal Merger Sub, Inc.

208 Bi-Lo Blvd

Greenville, SC 296067

Attention: Legal Department

Facsimile: (864) 987-8982

with a copy (which shall not constitute notice) to:

Hudson Advisors, LLC

2711 North Haskell Avenue, Suite 1800

Dallas, TX 75204

Attention: Kyle Volluz

Facsimile: (214) 515-6924

Email: kvolluz@hudson-advisors.com

and

Gibson, Dunn & Crutcher LLP

2100 McKinney Avenue

Suite 1100

Dallas, TX 75201-6912

Attention: Jeffrey Chapman

Eduardo Gallardo

Facsimile: (214) 571 2920

(212) 351 5245

Email: jchapman@gibsondunn.com

egallardo@gibsondunn.com

(ii) if to Company, to:

Winn-Dixie Stores, Inc.

5050 Edgewood Court

Jacksonville, FL 32254

Attention: Timothy L. Williams

Facsimile: (904) 783-5651

Email: timwilliams@winn-dixie.com

with a copy (which shall not constitute notice) to:

King & Spalding

1180 Peachtree Street, NE

Atlanta, GA 30309-3521

Attention: C. William Baxley

Michael J. Egan

Facsimile: (404) 572-5100

Email: bbaxley@kslaw.com

megan@kslaw.com

and

Paul, Weiss, Rifkind, Wharton & Garrison LLP

1285 Avenue of the Americas

New York, NY 10019

Attention: Robert B. Schumer

Jeffrey D. Marell

Facsimile: (212) 757-3990

Email: rschumer@paulweiss.com

jmarell@paulweiss.com

SECTION 8.3 Certain Definitions. For purposes of this Agreement:

Affiliate of any Person means any other Person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, such first Person.

Business Day means any day other than a Saturday, a Sunday or a day on which banks in New York, New York are authorized or required by applicable Law to be closed.

control (including the terms controlled, controlled by and under common control with) means the possession, directly or indirectly, of the powe to direct or cause the direction of the management policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

Financing Sources means the entities that have committed to provide or otherwise entered into agreements in connection with the Financing or other financings in connection with the transactions contemplated hereby, including the parties to the Financing Commitments and any joinder agreements or credit agreements (including the definitive agreements executed in connection with the Debt Financing Commitments) relating thereto.

Indebtedness means, with respect to any Person, (a) all obligations of such Person for borrowed money, or with respect to unearned advances of any kind to such Person, (b) all obligations of such Person evidenced by bonds, debentures, notes or similar instruments, (c) all capitalized lease obligations of such Person, (d) all obligations of such Person under installment sale contracts, (e) all guarantees and arrangements having the economic effect of a guarantee of such Person of any Indebtedness of any other Person, and (f) all obligations or undertakings of such Person to maintain or cause to be maintained the financial position of others or to purchase the obligations of others.

knowledge means, with respect to the Company, the actual knowledge of any executive officer of the Company, and, with respect to Parent and Merger Sub, the actual knowledge of any executive officer of Parent or Merger Sub, and any fact or matter which any such officer would reasonably be expected to discover or otherwise become aware after due inquiry concerning the relevant matter.

Material Adverse Effect means any event, change, circumstance, occurrence, effect or state of facts that (a) is materially adverse to the business, assets, condition (financial or otherwise) or results of operations of the Company and its Subsidiaries, taken as a whole, or (b) materially impairs, or prevents or materially delays, the ability of the Company to consummate the Merger or any of the other transactions contemplated by this Agreement; provided, however, that in the case of clause (a) only, the determination of a Material Adverse Effect shall exclude the following events, changes, circumstances, occurrences, effects and states of fact: (i) those generally affecting the industry of the Company, or the economy or the financial or securities markets of the United States, including effects on such industry, economy or markets resulting from any regulatory and political conditions or developments in general; (ii) any outbreak or escalation of hostilities or declared or undeclared acts of war or terrorism; (iii) changes or proposed changes in Law or GAAP; (iv) customary seasonal fluctuations in the business of the Company and its Subsidiaries; (v) any change, in and of itself, in the market price or trading volume of any securities or Indebtedness of the Company, or any change of or failure to meet, in and of itself, any internal or public projections, forecasts, budgets or estimates of or relating to the Company or any of its Subsidiaries for any period (it being understood that the underlying causes of such change or failure shall, if they are not otherwise excluded from the definition of Material Adverse Effect, be taken into account in determining whether a Material Adverse Effect has occurred); (vi) any hurricane, tropical storm, flood, forest fire, earthquake or other similar natural disaster; (vii) the execution, announcement, performance and existence of this Agreement, including any actual or potential loss or impairment after the date hereof of any Contract as a result thereof; (viii) any action taken or not taken by the Company at the written request of Parent (provided, that the exercise of Parent or Merger Sub of its rights under this Agreement, including any decision to not provide the Company with a waiver of Section 5.1, shall not be considered such a written instruction of Parent); and (ix) any action taken by Parent, Merger Sub or any of their Affiliates (provided, that the exercise of Parent or Merger Sub of its rights under this Agreement, including any decision to not provide the Company with a waiver of the terms of this Agreement, shall not be excluded pursuant to this clause (ix)); provided, further, that, (A) with respect to clauses (i) through (vi), such matters shall be excluded solely to the extent that the impact of such matters is not disproportionately adverse to the Company and its Subsidiaries in comparison to similarly situated businesses (in which case the disproportionate impact shall be taken into account), and (B) clause (vii) shall not apply with respect to references to Material Adverse Effect in Section 3.5.

Parent Material Adverse Effect means any event, change, circumstance, occurrence, effect or state of facts that materially impairs or materially delays, or prevents, the ability of Parent or Merger Sub to consummate Merger or any of the other transactions contemplated by this Agreement.

Parent Parties means, collectively, Parent, Merger Sub, the Guarantor, BI-LO Holding, the Financing Sources and any of their respective current, former or future directors, officers, general or limited partners, shareholders, members, managers, controlling persons, Affiliates, employees, representatives or agents.

Person means an individual, corporation, partnership, limited liability company, association, trust or other entity or organization, including any Governmental Entity.

Subsidiary means, with respect to any Person, any other Person of which stock or other equity interests having ordinary voting power to elect more than 50% of the board of directors or other governing body are owned, directly or indirectly, by such first Person.

SECTION 8.4 Interpretation. When a reference is made in this Agreement to an Article, Section, paragraph or Exhibit, such reference shall be to an Article, Section, paragraph or Exhibit of this Agreement unless otherwise indicated. The table of contents and headings contained in this Agreement are for convenience of reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. All words used in this Agreement will be construed to be of such gender or number as the circumstances require. All Exhibits annexed hereto or referred to herein are hereby incorporated in and made a part of this Agreement as if set forth herein. The word including and words of similar import when used in this Agreement will mean including, without limitation, unless otherwise specified. The words hereof, hereto, hereby, herein and hereunder and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. The term or is not exclusive. The word extent in the phrase to the extent shall mean the degree to which a subject or other thing extends, and such phrase shall not mean simply if. The word will shall be construed to have the same meaning and effect as the word shall. The words assets and properties shall be deemed to have the same meaning, and to refer to all assets and properties, whether real or personal, tangible or intangible. Any agreement, instrument or Law defined or referred to herein means such agreement, instrument or Law as from time to time amended, modified or supplemented, unless otherwise specifically indicated. References to a Person are also to its permitted successors and assigns. Unless otherwise specifically indicated, all references to dollars and $ will be deemed references to the lawful money of the United States of America.

SECTION 8.5 Entire Agreement. This Agreement (including the Exhibits hereto), the Company Disclosure Letter, the Confidentiality Agreement, the Financing Commitments and the Limited Guarantee constitute the entire agreement, and supersede all prior written agreements, arrangements, communications and understandings and all prior and contemporaneous oral agreements, arrangements, communications and understandings among the parties with respect to the subject matter hereof and thereof.

SECTION 8.6 No Third Party Beneficiaries.

(a) Nothing in this Agreement, express or implied, is intended to or shall confer upon any Person other than the parties and their respective successors and permitted assigns any legal or equitable right, benefit or remedy of any nature under or by reason of this Agreement.

(b) Notwithstanding Section 8.6(a):

(i) following the Effective Time, the provisions of Section 5.10 shall be enforceable as provided therein;

(ii) the provisions of Sections 7.3(f) shall be enforceable against the Company (but not Parent or Merger Sub) by each Financing Source and its successors and assigns; the provisions of this Section 8.6 and Sections 8.8 and 8.12 shall be enforceable against all parties to this Agreement by each Financing Source and its successors and assigns; and

(iii) following the Effective Time, the provisions of Article II shall be enforceable by each holder of Shares, Company Stock Options and RSUs as of the Effective Time solely to the extent necessary for any such Person to receive the consideration to which it is entitled pursuant to Article II.

(c) The representations and warranties in this Agreement are the product of negotiations among the parties hereto and are for the sole benefit of the parties hereto. Any inaccuracies in such representations and warranties are subject to waiver by the parties hereto in accordance with Section 7.5 without notice or liability to any other Person. In some instances, the representations and warranties in this Agreement may represent an allocation among the parties hereto of risks associated with particular matters regardless of the knowledge of any of the parties hereto. Consequently, Persons other than the parties hereto may not rely upon the representations and warranties in this Agreement as characterizations of actual facts or circumstances as of the date of this Agreement or as of any other date.

SECTION 8.7 Governing Law. This Agreement and all disputes or controversies arising out of or relating to this Agreement or the transactions contemplated hereby shall be governed by, and construed in accordance with, the internal laws of the State of New York, without regard to the laws of any other jurisdiction that might be applied because of the conflicts of laws principles of the State of New York; except for such provisions where Florida law is mandatorily applicable, which provisions shall be governed by and construed in accordance with the laws of the State of Florida.

SECTION 8.8 Submission to Jurisdiction; Limitation on Suits Against Parent Parties and Financing Sources.

(a) Submission to Jurisdiction. Each of the parties irrevocably agrees that any legal action or proceeding arising out of or relating to this Agreement brought by any party or its Affiliates against any other party or its Affiliates shall be brought and determined only in the Supreme Court of the State of New York, County of New York, or, if under applicable Law exclusive jurisdiction is vested in the federal courts, the United States District Court for the Southern District of New York (and appellate courts thereof). Each of the parties hereby irrevocably submits to the jurisdiction of the aforesaid courts for itself and with respect to its property, generally and unconditionally, with regard to any such action or proceeding arising out of or relating to this Agreement and the transactions contemplated hereby. Each of the parties agrees not to commence any action, suit or proceeding relating thereto except in the courts described above in New York, other than actions in any court of competent jurisdiction to enforce any judgment, decree or award rendered by any such court in New York as described herein. Each of the parties further agrees that notice as provided herein shall constitute sufficient service of process and the parties further waive any argument that such service is insufficient. Each of the parties hereby irrevocably and unconditionally waives, and agrees not to assert, by way of motion or as a defense, counterclaim or otherwise, in any action or proceeding arising out of or relating to this Agreement or the transactions contemplated hereby, (i) any claim that it is not personally subject to the jurisdiction of the courts in New York as described herein for any reason, (ii) that it or its property is exempt or immune from jurisdiction of any such court or from any legal process commenced in such courts (whether through service of notice, attachment prior to judgment, attachment in aid of execution of judgment, execution of judgment or otherwise) and (iii) that (A) the suit, action or proceeding in any such court is brought in an inconvenient forum, (B) the venue of such suit, action or proceeding is improper or (C) this Agreement, or the subject matter hereof, may not be enforced in or by such courts.

(b) Limitation on Suits Against Parent Parties. Without limiting Sections 7.3(f) or 8.8(c), this Agreement may only be enforced by the Company against, and claims or causes of action that are based upon, arise out of or relate to this Agreement or the negotiation, execution or performance of this Agreement may only be made by the Company against, Parent, Merger Sub and the Guarantor (but only to the extent set forth in the Limited Guarantee), and the Company shall not seek to enforce this Agreement against, or make any claims or causes of action that are based upon, arise out of or relate to this Agreement or the negotiation, execution or performance of this Agreement against, any other Parent Party.

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(c) Limitation on Suits Against Financing Sources. Without limiting Sections 7.3(f) or 8.8(b), each of the parties hereto agrees that it will not bring or support any action, cause of action, claim, cross-claim or third-party claim of any kind or description, whether in law or in equity, whether in contract or in tort or otherwise, against the Financing Sources in any way relating to this Agreement or any of the transactions contemplated by this Agreement, including any dispute arising out of or relating in any way to the Debt Financing Commitments or the performance thereof, in any forum other than the Supreme Court of the State of New York, County of New York, or, if under applicable law exclusive jurisdiction is vested in the federal courts, the United States District Court for the Southern District of New York (and appellate courts thereof).

SECTION 8.9 Assignment; Successors. Neither this Agreement nor any of the rights, interests or obligations under this Agreement may be assigned or delegated, in whole or in part, by operation of law or otherwise, by any party without the prior written consent of the other parties, and any such assignment without such prior written consent shall be null and void; provided, however, that Parent and Merger Sub may assign, in its sole discretion, any or all of its rights, interests and obligations under this Agreement (a) to Parent or any of its Affiliates at any time, in which case all references herein to Parent or Merger Sub shall be deemed references to such other Affiliate, except that all representations and warranties made herein with respect to Parent or Merger Sub as of the date of this Agreement shall be deemed to be representations and warranties made with respect to such other Affiliate as of the date of such assignment or (b) after the Effective Time, to any Person. Subject to the preceding sentence, this Agreement will be binding upon, inure to the benefit of, and be enforceable by, the parties and their respective successors and assigns.

SECTION 8.10 Specific Performance.

(a) The parties agree that irreparable damage would occur in the event that the parties hereto do not perform the provisions of this Agreement in accordance with its terms or otherwise breach such provisions. Accordingly, subject to Sections 8.10(b) and (c), the parties acknowledge and agree that the parties shall be entitled to an injunction, specific performance and other equitable relief to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof, this being in addition to any other remedy to which they are entitled at law or in equity.

(b) Notwithstanding anything herein to the contrary, the Company shall be entitled to specific performance to cause Parent and Merger Sub to draw down the Equity Financing or to consummate the Merger only if:

(i) all conditions in Sections 6.1 and 6.2 (other than those conditions that by their nature are to be satisfied at the Closing) have been satisfied;

(ii) Parent and Merger Sub have failed to complete the Closing by the date the Closing is required to occur pursuant to Section 1.2;

(iii) the Debt Financing has been funded or is expected to be funded at the Closing if the Equity Financing is funded at the Closing (provided, that Parent and Merger Sub shall not be required to draw down the Equity Financing or to consummate the Merger if the Debt Financing is not in fact funded at the Closing); and

(iv) the Company has irrevocably confirmed that if specific performance is granted and the Equity Financing and Debt Financing are funded, then the Closing will occur.

(c) Notwithstanding anything herein to the contrary, the Company shall be entitled to specific performance to cause Parent and Merger Sub to draw down the Debt Financing (or any replacement debt financing) only if the Closing (including consummation of the Merger) will occur substantially simultaneously with such draw down.

(d) Each of the parties agrees that it will not oppose the granting of an injunction, specific performance and other equitable relief as provided herein on the basis that (i) it has an adequate remedy at law or (ii) an award of specific performance is not an appropriate remedy for any reason at law or equity. Any party seeking an

injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement shall not be required to provide any bond or other security in connection with any such order or injunction.

(e) In no event shall the exercise of the Company s right to seek specific performance pursuant to this Section 8.10 reduce, restrict or otherwise limit the Company s right to terminate this Agreement pursuant to Section 7.1(d)(i) or 7.1(d)(iii) and be paid the Closing Failure Fee.

SECTION 8.11 Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of Law, or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as either the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party or such party waives its rights under this Section with respect thereto. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner to the end that the transactions contemplated hereby are fulfilled to the extent possible.

SECTION 8.12 Waiver of Jury Trial. EACH OF THE PARTIES TO THIS AGREEMENT HEREBY IRREVOCABLY WAIVES ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

SECTION 8.13 Counterparts. This Agreement may be executed in two or more counterparts, all of which shall be considered one and the same instrument and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other party. Delivery of an executed counterpart of this Agreement by facsimile or other electronic image scan transmission shall be effective as delivery of an original counterpart hereof.

SECTION 8.14 No Presumption against Drafting Party. Each of Parent, Merger Sub and the Company acknowledges that each party to this Agreement has been represented by counsel in connection with this Agreement and the transactions contemplated by this Agreement. Accordingly, any rule of law or any legal decision that would require interpretation of any claimed ambiguities in this Agreement against the drafting party has no application and is expressly waived.

[*the remainder of this page is intentionally left blank; signature page follows*]

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IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the date first written above by their respective officers thereunto duly authorized.

WINN-DIXIE STORES, INC.

By: /s/ Peter Lynch
Name: Peter Lynch
Title: President, CEO and Chairman of the Board

OPAL HOLDINGS, LLC

By: /s/ Jennifer Lamprecht
Name: Jennifer Lamprecht
Title: Vice President

OPAL MERGER SUB, INC.

By: /s/ Jennifer Lamprecht
Name: Jennifer Lamprecht
Title: Vice President

[SIGNATURE PAGE TO MERGER AGREEMENT]

A-51

Annex B

[Letterhead of Goldman, Sachs & Co.]

PERSONAL AND CONFIDENTIAL

December 16, 2011

Special Committee of the Board of Directors

Winn-Dixie Stores, Inc.

5050 Edgewood Court

Jacksonville, Florida 32254

Ladies and Gentlemen:

You have requested our opinion as to the fairness from a financial point of view to the holders of the outstanding shares of common stock, par value $0.001 per share (the Shares), of Winn-Dixie Stores, Inc. (the Company) of the $9.50 per Share in cash to be paid to such holders pursuant to the Agreement and Plan of Merger, dated as of December 16, 2011 (the Agreement), by and among Opal Holdings, LLC (Opal Holdings), Opal Merger Sub, Inc., a wholly-owned subsidiary of Opal Holdings, and the Company.

Goldman, Sachs & Co. and its affiliates are engaged in investment banking and financial advisory services, commercial banking, securities trading, investment management, principal investment, financial planning, benefits counseling, risk management, hedging, financing, brokerage activities and other financial and non-financial activities and services for various persons and entities. In the ordinary course of these activities and services, Goldman, Sachs & Co. and its affiliates may at any time make or hold long or short positions and investments, as well as actively trade or effect transactions, in the equity, debt and other securities (or related derivative securities) and financial instruments (including bank loans and other obligations) of the Company, Opal Holdings and any of their respective affiliates and third parties, including Lone Star Fund V (U.S.), L.P., an affiliate of Opal Holdings, and the family of investment funds commonly known as Lone Star Funds (collectively, Lone Star) and their affiliates and portfolio companies, or any currency or commodity that may be involved in the transaction contemplated by the Agreement (the Transaction) for their own account and for the accounts of their customers. We have acted as financial advisor to the Special Committee of the Board of Directors of the Company (the Special Committee) in connection with, and have participated in certain of the negotiations leading to, the Transaction. We expect to receive fees for our services in connection with the Transaction, the principal portion of which is contingent upon consummation of the Transaction, and the Company has agreed to reimburse our expenses arising, and indemnify us against certain liabilities that may arise, out of our engagement. We have provided certain investment banking services to Lone Star and its affiliates and portfolio companies from time to time for which our Investment Banking Division has received, and may receive, compensation. We may also in the future provide investment banking services to the Company, Opal Holdings and their respective affiliates and Lone Star and its affiliates and portfolio companies for which our Investment Banking Division may receive compensation. Affiliates of Goldman, Sachs & Co. also may have co-invested with Lone Star and its affiliates from time to time and may have invested in limited partnership units of affiliates of Lone Star from time to time and may do so in the future.

In connection with this opinion, we have reviewed, among other things: the Agreement; annual reports to the shareholders of the Company and Annual Reports on Form 10-K of the Company for the five fiscal years ended June 29, 2011; certain interim reports to the shareholders of the Company and Quarterly Reports on Form 10-Q of the Company; certain other communications from the Company to its shareholders; certain publicly available research analyst reports for the Company; and certain internal financial analyses and forecasts for the Company prepared by its management, as approved for our use by the Company (the Forecasts). We have also held discussions with members of the senior management of the Company regarding their assessment of the past and current business operations, financial condition and future prospects of the Company; reviewed the reported price and trading activity for the Shares; compared certain financial and stock market information for the Company with similar information for certain other companies the securities of which are publicly traded; reviewed the financial terms of certain recent business combinations in the food retail industry and in other industries; and performed such other studies and analyses, and considered such other factors, as we deemed appropriate.

Special Committee of the Board of Directors

Winn-Dixie Stores, Inc.

December 16, 2011

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For purposes of rendering this opinion, we have relied upon and assumed, without assuming any responsibility for independent verification, the accuracy and completeness of all of the financial, legal, regulatory, tax, accounting and other information provided to, discussed with or reviewed by, us. In that regard, we have assumed with your consent that the Forecasts have been reasonably prepared on a basis reflecting the best currently available estimates and judgments of the management of the Company. We have not made an independent evaluation or appraisal of the assets and liabilities (including any contingent, derivative or other off-balance-sheet assets and liabilities) of the Company or any of its subsidiaries and we have not been furnished with any such evaluation or appraisal. We have assumed that all governmental, regulatory or other consents and approvals necessary for the consummation of the Transaction will be obtained without any adverse effect on the expected benefits of the Transaction in any way meaningful to our analysis. We also have assumed that the Transaction will be consummated on the terms set forth in the Agreement, without the waiver or modification of any term or condition the effect of which would be in any way meaningful to our analysis.

Our opinion does not address the underlying business decision of the Company to engage in the Transaction, or the relative merits of the Transaction as compared to any strategic alternatives that may be available to the Company; nor does it address any legal, regulatory, tax or accounting matters. This opinion addresses only the fairness from a financial point of view, as of the date hereof, of the $9.50 per Share in cash to be paid to the holders of Shares pursuant to the Agreement. We do not express any view on, and our opinion does not address, any other term or aspect of the Agreement or Transaction or any term or aspect of any other agreement or instrument contemplated by the Agreement or entered into or amended in connection with the Transaction, including, without limitation, the fairness of the Transaction to, or any consideration received in connection therewith by, the holders of any other class of securities, creditors, or other constituencies of the Company; nor as to the fairness of the amount or nature of any compensation to be paid or payable to any of the officers, directors or employees of the Company, or class of such persons, in connection with the Transaction, whether relative to the $9.50 per Share in cash to be paid to the holders of Shares pursuant to the Agreement or otherwise. We are not expressing any opinion as to the impact of the Transaction on the solvency or viability of the Company, BI-LO Holding, LLC or any of its subsidiaries (including Opal Holdings and its subsidiaries) or the ability of the Company, BI-LO Holding, LLC or any of its subsidiaries (including Opal Holdings and its subsidiaries) to pay their respective obligations when they come due. Our opinion is necessarily based on economic, monetary, market and other conditions as in effect on, and the information made available to us as of, the date hereof and we assume no responsibility for updating, revising or reaffirming this opinion based on circumstances, developments or events occurring after the date hereof. Our advisory services and the opinion expressed herein are provided for the information and assistance of the Special Committee in connection with its consideration of the Transaction and such opinion does not constitute a recommendation as to how any holder of Shares should vote with respect to such Transaction or any other matter. This opinion has been approved by a fairness committee of Goldman, Sachs & Co.

Based upon and subject to the foregoing, it is our opinion that, as of the date hereof, the $9.50 per Share in cash to be paid to the holders of Shares pursuant to the Agreement is fair from a financial point of view to such holders.

Very truly yours,

/s/ Goldman, Sachs & Co.
(GOLDMAN, SACHS & CO.)

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VOTE BY INTERNET - www.proxyvote.com

WINN-DIXIE STORES, INC.

5050 EDGEWOOD COURT BOX B

JACKSONVILLE, FL 32254

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Standard Time, March 8, 2012. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Standard Time, March 8, 2012. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

KEEP THIS PORTION FOR YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

WINN-DIXIE STORES, INC.

The Board of Directors recommends a vote FOR Proposals 1,2 and 3.

	For	Against	Abstain
1.	¨	¨	¨

	A proposal to approve the Agreement and Plan of Merger, dated as of December 16, 2011, among Opal Holdings, LLC, Opal Merger Sub, Inc., and Winn-Dixie Stores, Inc.			
2.	A proposal to approve, on a non-binding basis, the compensation that may become payable to our named executive officers in connection with the merger.	¨	¨	¨
3.	A proposal to adjourn the Special Meeting (if necessary or appropriate) to solicit additional proxies if there are insufficient votes at the time of the Special Meeting to approve the merger agreement.	¨	¨	¨

	Yes	No
I plan to attend the Special Meeting.	¨	¨

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name, by authorized officer.

Signature [PLEASE SIGN WITHIN BOX]   Date   Signature (Joint Owners)   Date

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Important Notice Regarding the Availability of Proxy Materials for the Special Meeting:

The Notice and Proxy Statement are available at :

http://phx.corporate-ir.net/phoenix.zhtml?c=78738&p=proxy

WINN-DIXIE STORES, INC.

Special Meeting of Shareholders

March 9, 2012

9:00 AM Eastern Standard Time

This proxy is solicited by the Board of Directors

The undersigned hereby appoints Peter L. Lynch and Terry Peets, and each of them, with power to act without the other and with power of substitution, as proxies and attorneys-in-fact to represent and vote all the shares of WINN-DIXIE STORES, INC. (the Company) common stock which the undersigned is entitled to vote at the Special Meeting of Shareholders to be held at 9:00 AM, Eastern Standard Time, on March 9, 2012 at 5050 Edgewood Court, Jacksonville, FL 32254-3699, and any adjournment or postponement thereof, with all powers the undersigned would possess if personally present. The undersigned hereby revokes any proxies previously given with respect to such meeting.

THIS PROXY CARD, WHEN PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED. IF NO DIRECTION IS MADE BUT THE CARD IS SIGNED, THIS PROXY CARD WILL BE VOTED FOR PROPOSAL 1, FOR PROPOSAL 2, AND FOR PROPOSAL 3, AND IN ACCORDANCE WITH THE RECOMMENDATION OF THE BOARD OF DIRECTORS WITH RESPECT TO SUCH OTHER BUSINESS AS MAY PROPERLY COME BEFORE THE MEETING, IF ANY.

Continued and to be signed on reverse side.

N-US style="FONT-SIZE: 10pt" face=arial,sans-serif>For fair value hedges relating to items carried at amortized cost, any adjustment to carrying amount is amortized through profit or loss over the remaining term of the hedge using the effective interest method. The effective interest rate amortization may begin as soon as any adjustment exists and no later than the point that the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

If the hedged item is derecognized, the unamortized fair value is recognized immediately in the income statement.

When an unrecognized firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognized as an asset or

liability with a corresponding gain or loss recognized in profit and loss.

l.3) Classification between current and noncurrent

Derivative financial instruments are classified as current and noncurrent or segregated into short and long term portions based on an evaluation of the contractual cash flows.

When the Company maintains a derivative as economic hedge (and does not apply hedge accounting), for a period exceeding 12 months after balance sheet date, the derivative is classified as noncurrent (or segregated into current and noncurrent portions), in line with the classification of the corresponding item.

Derivative instruments that are designated as effective hedging instruments are classified consistently with the classification of the underlying hedged item.

The derivative instrument is segregated into current and noncurrent portions only when amounts can be reliably allocated.

m) Loans and financing

Loans and financing obtained are initially recognized at fair value, net of costs incurred to obtain them and subsequently measured at amortized cost (plus charges and pro rata interest), considering the effective interest rate of each operation.

These are classified as current, unless the Company has an unconditional right to settle the liability for at least 12 months after year end.

n) Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a period of time exceeding 18 months to prepare for its intended use or sale form part of the cost of that asset.

All other borrowing costs are recorded in the period they are incurred. Borrowing costs include interest and other costs incurred by an entity in connection with the borrowing of funds.

In 2017 and 2016, the Company did not capitalize amounts related to borrowing costs.

o) Interest on equity and dividends

o.1) Interest on equity

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Brazilian legislation allows companies to pay interest on equity, which is similar to payment of dividends; however, this is deductible for income tax calculation purposes. In order to comply with Brazilian tax legislation the Company and its subsidiaries provision, in its accounting records the amount due to match against the financial expenses account in the income statement for the year. For the presentation of these financial statements, that expense is reversed against a direct charge to equity, resulting in the same accounting treatment adopted for dividends. The distribution of interest on equity to shareholders is subject to withholding income tax at a 15% rate.

o.2) Dividends

Minimum mandatory dividends are stated in the balance sheet as legal obligations (provisions in current liabilities). Dividends in excess of such minimum amount, not yet approved in the Shareholders' Meeting, are recorded in equity as proposed additional dividends. After approval at the Shareholders' meeting, the dividends in excess of minimum mandatory are transferred to current liabilities, and classified as legal obligations.

p) Provisions

p.1) General

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, when it is probable that economic benefits are required to settle the obligation and a reliable estimate of the value of the obligation can be made. Provisions are restated at the balance sheet date considering the likely amount of loss and the nature of each contingency.

Provisions for contingencies are presented at their gross amount, less the corresponding judicial deposits, and are classified as provisions for civil, labor, tax and regulatory contingencies.

Judicial deposits are classified as assets given that the conditions required for their net presentation with the provision do not exist.

p.2) Provisions for civil, labor, tax and regulatory legal claims

The Company is party to labor, tax, civil and regulatory administrative and legal proceedings and set up a provision for contingencies whose likelihood of loss was estimated as probable. The assessment of the likelihood of loss includes an analysis of available evidence, the hierarchy of laws, available case law, the latest court decisions law and their relevance in the legal system, as well as the opinion of outside legal counsel. Provisions are reviewed and adjusted considering changes in existing circumstances, such as the applicable statute of limitations, tax audit conclusions, or additional exposures identified based on new matters or court decisions.

p.3) Provision for decommissioning of assets

This refers to costs to be incurred due to returning sites to owners (locations intended for tower and equipment installation on leased property) in the same condition as these were found at the time of execution of the initial lease agreement.

These costs are provisioned at the present value of amounts expected to settle the obligation using estimated cash flows and are recognized as part of the cost of the corresponding asset. The cash flows are discounted at a current pre-tax rate that reflects the risks specific to decommissioning of assets. The financial effect of the discount is recorded as incurred and recognized in the income statement as a finance cost. The estimated future costs of decommissioning are reviewed annually and adjusted as appropriate. Changes in the estimated future costs or in the discount rate applied are added to, or deducted from, the cost of the asset.

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p.4) Contingent liabilities recognized in a business combination

A contingent liability recognized in business combination is initially measured at fair value.

q) Taxes

q.1) Current taxes

Current tax assets and liabilities for the current and prior years are measured at the estimated amount recoverable from, or payable to, the tax authorities. The tax rates and laws used in calculating the amounts referred to above are those in effect, or substantially in effect, at year end. In the balance sheet, current taxes are presented net of prepayments over the year.

Current income and social contribution taxes related to items directly recognized in equity are also recognized in equity. Management regularly assesses the tax position in circumstances in which tax regulation requires interpretation, and sets up provisions therefor when appropriate.

q.2) Deferred taxes

Deferred taxes arise from temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amount.

Deferred tax assets are recognized for all deductible temporary differences, unused tax credits and losses, to the extent that taxable profit is likely to be available for realization of deductible temporary differences, and unused tax credits and losses are likely to be used, except: (i) when the deferred tax asset related to

the deductible temporary difference arises from initial recognition of an asset or liability in a transaction other than a business combination and does not impact, at the transaction date, the book profit, income or loss for tax purposes; and (ii) on deductible temporary differences related to investments in subsidiaries, where deferred tax assets are recognized only to the extent that it is probable that temporary differences will be reversed in the near future and taxable profit is likely be available so that temporary differences can be used.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit shall be available to allow all or part of the deferred tax asset to be used. Derecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax liabilities are recognized on all temporary tax differences, except: (i) when the deferred tax liability arises from initial recognition of goodwill, or an asset or liability in a transaction other than a business combination, and does not affect book profit or taxable profit or tax losses on the transaction date; and (ii) on temporary tax differences related to investments in subsidiaries, in which the temporary difference reversal period can be controlled and temporary differences are not likely to be reversed in the near future.

Deferred tax assets and liabilities are measured at the tax rate expected to be applicable for the year the asset will be realized or the liability will be settled, based on the rates provided in tax legislation and that were published as of year-end.

Deferred tax assets and liabilities are not discounted to present value and are classified in the balance sheet as noncurrent, irrespective of their expected realization.

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The tax effects of items recorded directly in equity are also recognized in equity. Deferred tax items are recognized based on the transaction which gave rise to that deferred tax, in comprehensive income or directly in equity.

Deferred tax assets and liabilities are presented net when there is a legal or constructive right to offset a tax asset against a tax liability and deferred taxes relate to the same taxpaying entity and are subject to the same tax authority.

q.3) Sales taxes

Revenues are recognized net of value added taxes, which from services rendered is subject to State Value-Added Tax (ICMS) or Service Tax (ISS) at the rates in force in each region as well as and to Social Contribution Tax on Gross Revenue for Social Integration Program (PIS) and Social Contribution Tax on Gross Revenue for Social Security Financing (COFINS) taxation on a cumulative basis for revenue from telecommunication services.

Other revenue earned by the Company, including revenue from resale of goods, on a noncumulative basis, is taxed at for PIS, COFINS and by ICMS at the rates in force in each State.

Prepayments or recoverable amounts are stated in current or noncurrent assets, based on their estimated realization.

r) Other assets and liabilities

Assets are recognized in the balance sheet when it is likely that their future economic benefits will flow to the Company, and their cost or value can be reliably measured.

A liability is recognized in the balance sheet when the Company or its subsidiaries have a legal or constructive obligation as a result of a past event, the settlement of which is likely to generate an outflow of economic benefits.

Assets and liabilities are presented in the balance sheet classified as current or noncurrent.

An asset is classified as current when: (i) it is expected to be realized or is intended to be sold or used in the ordinary operational cycle; (ii) it is mainly held for trading purposes; (iii) it is expected to be realized within 12 months from the reporting period; or (iv) cash and cash equivalents, unless there are restrictions upon exchange thereof, i.e., when used to settle a liability within 12 months from the reporting period. All other assets are classified as noncurrent.

A liability is classified as current when: (i) it is expected to be settled in the ordinary operational cycle; (ii) it is mainly held for trading purposes; (iii) It is expected to be settled within 12 months from the reporting period; or (iv) there is no unconditional right to defer settlement of the liability within 12 months from the reporting period. All other liabilities are classified as noncurrent.

s) Present value adjustment of assets and liabilities

Current and noncurrent monetary assets and liabilities are adjusted to their present value when the effect on the overall financial statements is considered significant. The present value adjustment is calculated using contractual cash flows and the explicit, and sometimes implicit, interest rates of the respective assets and liabilities.

Accordingly, the interest rate embedded in revenues, expenses and related costs is discounted, so that these assets and liabilities are recognized on an accrual basis. This interest is subsequently reallocated to financial income and expenses in P&L through use of the effective interest method in relation to contractual cash flows. Implicit interest rates were determined based on assumptions, and accounting estimates are considered.

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t) Government grants and assistance

Government grants are recognized when there is reasonable certainty that the benefit will be received and that all the related conditions will be met. When the benefit refers to an expense item, it is recognized as revenue along the benefit period, on a systematic basis in relation to the costs the benefit it intends to offset.

When the Company receives non-monetary grants, the asset and the benefit are recorded at nominal amounts and reflected in the income statements over the expected useful life of the asset by equal annual installments. A loan or assistance is initially recognized or measured at fair value. A government grant is measured as the difference between the initial carrying amount of the loan and proceeds therefrom. A loan is subsequently measured in accordance with the applicable accounting policy.

When loans or similar assistance are provided by governments or related institutions, with an interest rate below the current applicable market rate, the effect of this favorable interest is regarded as an additional government grant.

The financing lines with the Brazilian Development Bank (BNDES), with interest rates not exceeding those prevailing in the market, are classified under the scope of IAS 20/CPC 7, and are recorded at fair value based on market rates. Adjustment arising from the comparison of the amount measured based on the rate agreed upon is accounted for as deferred revenue (Note 19).

u) Revenue recognition

Revenues substantially correspond to value of considerations received or receivable arising from the provision of telecommunications or communications services, the sale of goods, advertising and other revenue, and are stated net of taxes, discounts or returns (in case of sale of goods) thereon. Revenues and expenses are stated on the accrual basis of accounting.

Revenue is recognized when it is probable that future economic benefits will flow to the Company or its subsidiaries, when it can be reliably measured, costs incurred in the transaction can be measured, the risks and rewards have been substantially transferred to the buyer and when specific criteria have been met for each of the Company's activities.

Consolidated revenues of the Company comprise basically telecommunication services regarding voice, data and digital services, broadband, TV and additional telecommunication services that are offered to customers through fixed-price traffic packs (paid on a monthly basis) or based on customers' consumption, remuneration for network usage, advertising and sale of goods.

u.1) Recognition of revenues from telecommunication services

Revenues from telecommunication, data and digital services, broadband services provided are recorded on an accrual basis based on the amounts agreed upon. Local and long-distance calls are billed by the measurement process under legislation in force. The services billed on fixed monthly amounts are calculated and accounted for on a straight-line basis. Unbilled revenues from the last billing up to the balance sheet date are recognized in the month in which the service is provided.

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Revenues related to sale of public phone cards and pay-as-you-go credit for cellphones as well as the respective taxes are deferred and recognized in the income statement to the extent that the services are effectively rendered.

Revenues from equipment lease contracts classified as finance lease agreement (TData's Soluciona TI product) are recognized on installation of equipment whereupon effective transfer of risk takes place. Revenue is recognized at present value of future minimum payments provided for in the agreement.

Revenues from services are basically subject to the following indirect taxes: ICMS or ISS (as applicable), PIS and COFINS.

u.2) Recognition of revenue and cost from sales of goods

Revenues and cost of sales (mobile phones, simcards and accessories) are recorded when risks and rewards inherent in such goods are transferred to buyers.

Sales made in own stores are recognized upon sale to end consumer. Revenues and costs of sales made by accredited dealers are deferred and recognized in P&L when the device is activated, limited to 90 days from the sale date.

u.3) Customer loyalty program

The Company has a loyalty points program that enables customers to accumulate points when they pay bills regarding the usage of the services offered. The accumulated points may be exchanged for telephone sets or services, conditional upon obtaining a minimum balance of points by customer. The consideration received is allocated to the cost of sets or services at fair value. The fair value of points is determined by dividing the amount of discount granted by the number of points necessary for the redemption based on the

points program. The portion of revenue related to the fair value of the accumulated balance of points generated is deferred and recognized as revenue upon redemption of points.

The number of points to be accounted for is determined through statistical techniques that consider assumptions and historical data on expected redemption rates, expiration percentages and cancellation of points, among other factors. These estimates are subject to variations and uncertainties due to changes in the behavior of customer redemptions.

u.4) Membership fee and promotional campaigns

Participation fees paid for promotional campaigns by customers of the Company are deferred and recorded in P&L throughout the duration of such campaign.

u.5) Agreements combining more than one element

Commercial packages offered by the Company that combine different elements are analyzed to determine whether it is necessary to separate the different elements identified, adopting the recognition criterion that is most adequate to each situation. Total revenue generated by the package sale is distributed among its elements, based upon their respective fair values.

The fair value determination of each element then identified implies the need for complex estimates given the nature of the business. A possible change in fair values estimates could affect the distribution of revenues between components and consequently the deferred revenue.

u.6) Advertising

Revenues from advertising are recognized in income during the advertising period.

v) Financial income (expenses)

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These include interest, and monetary and exchange variations arising from short-term investments, derivative transactions, loans, financing, debentures, present value adjustments of transactions that generate monetary assets and liabilities and other financial transactions. These are recognized on an accrual basis when earned or incurred by the Company.

For all financial instruments measured at amortized cost and interest-yielding financial assets classified as available for sale, interest income or expense is recognized using the effective interest method, which exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability.

w) Post-retirement benefit plans

The Company and its subsidiaries individually sponsor pension funds of post-retirement benefits for active and retired employees, in addition to a multisponsor supplementary retirement plan and health care plan for former employees. Contributions are determined on an actuarial basis and recorded on an accrual basis. Liabilities relating to defined benefit plans are determined based on actuarial evaluations at each year end, in order to ensure that sufficient reserves have been set up for both current and future commitments.

Actuarial liabilities related to defined benefit plans were calculated using the projected unit credit method. Actuarial gains and losses are recognized immediately in equity (in other comprehensive income).

For plans with defined contribution characteristics, the obligation is limited to the contributions payable, which are recognized in the P&L in the respective accrual periods.

The asset or liability related to defined benefit plan to be recognized in financial statements corresponds to the present value of the obligation for the defined benefit (using a discount rate based on long-term

National Treasury Notes “NTNs”), less fair value of plan assets that will be used to settle the obligations. Plan assets are assets held by a privately-held supplementary pension plan entity. Plan assets are not available to the Company’s creditors or those of its subsidiaries and cannot be paid directly to the Company or its subsidiaries. The fair value is based on information on market prices and, in case of securities quoted, on purchase price disclosed. The value of any defined benefit asset then recognized is limited to the present value of any economic benefits available as a reduction in future plan contribution from the Company.

Actuarial costs recognized in the income statement are limited to the service cost and cost of interest on the defined benefit plan obligation. Any changes in the measurement of plan assets and obligations are initially recognized in other comprehensive income, and immediately reclassified to retained earnings in P&L.

The Company manages and individually sponsors a health care plan for retired employees and former employees with fixed contributions to the plan, in accordance with Law No. 9656/98 (which provides for private health care and health insurance plans). As provided for in articles 30 and 31 of said law, participants shall have the right to the health care plan in which they participated while they were active employees.

x) <u>Significant accounting judgments, estimates and assumptions</u>

The preparation of the financial statements requires management to make judgments, estimates and adopt assumptions supported by valuation bases used in accounting estimates. The accounting estimates involved in the preparation of these financial statements were based on objective and subjective factors, considering management’s judgment for determining the adequate amounts to be recorded in the financial statements.

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Settlement of transactions involving these estimates may result in amounts significantly different from those recorded in the financial statements due to the uncertainties inherent in their estimate process.

Significant assumptions concerning sources of uncertainty in future estimates and other significant sources of estimation uncertainty at the balance sheet date, involving a significant risk of causing a material adjustment to the carrying amount of assets and liabilities, are as follows:

x.1) Impairment of non-financial assets

An impairment loss exists when the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, which is the higher of fair value less cost to sell and value in use. The calculation of fair value less cost to sell is based on information available on transactions for sale of similar assets or market prices less additional costs to dispose of the asset. The calculation of value in use is based on the discounted cash flow model. The recoverable amount is sensitive to the discount rate used in the discounted cash flow method, as well as expected future cash receipts and growth rate used for extrapolation purposes.

The Company regularly analyzes the performance of the defined cash generating unit in order to identify any impairment of goodwill and its other assets. Determination of the recoverable amount of the cash generating unit to which goodwill is attributed includes use of assumptions and estimates and requires use of significant accounting judgment and criterion.

x.2) Post-retirement benefit plans

The cost of pension plans with defined benefits and other post-employment health care benefits and the present value of the pension obligation are determined using actuarial valuation methods. Actuarial valuation involves use of assumptions about discount rates, future salary increases, mortality rates and future increases in pension and annuity benefits. The obligation for defined benefits is highly sensitive to changes in these assumptions. All assumptions are reviewed on an annual basis.

The mortality rate is based on publicly available mortality tables in the country. Future salary increases and pension increases are based on expected future inflation rates for the country.

x.3) Fair value of financial instruments

When the fair value of financial assets and liabilities stated in the balance sheet cannot be obtained in active markets, it will be determined using valuation techniques, including the discounted cash flow method. Data for these methods is based on those adopted in the market, whenever possible. However, when this is not feasible, a certain level of judgment is required for fair value determination. Judgment includes consideration of the inputs used, such as liquidity risk, credit risk and volatility. Changes in the assumptions about these factors could affect the reported fair value of financial instruments.

x.4) Property, plant and equipment and finite-lived intangible assets

The accounting treatment of investment in fixed and intangible assets includes estimating useful life period for depreciation purposes and the fair value at the date of acquisition, particularly for assets acquired in business combinations.

Useful life determination requires estimates regarding the expected technological developments and alternative uses of assets. The hypotheses related to the technological aspect and its future development imply a significant level of analysis, considering the difficulties in forecasting time and nature of future technological changes.

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x.5) Revenue recognition – Customer Loyalty Program

The Company estimates the fair value of points attributed under the customer loyalty program by applying statistic techniques. Inputs for the model include assumptions about expected redemption rates, the mix of products that will be available for future redemption and customers' preference in relation to points use. Since issued points do not expire, these estimates are subject to significant uncertainties.

x.6) Agreements combining more than one element

The fair value determination of each element in a multiple element agreement requires complex estimates given the nature of the business. A possible change in fair value estimates could affect the distribution of revenues between components and consequently the deferred revenues.

x.7) Taxes

There are uncertainties regarding the interpretation of complex tax regulations and the amount and timing of future taxable profits. The Company and its subsidiaries set up provisions, based on reasonable estimates, for the possible consequences of audits by tax authorities in respective jurisdictions in which they operate. The amount of these provisions is based on various factors, such as previous tax audit experience and different interpretations of tax regulations by the taxable entity and by the relevant tax authority. Such differences in interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective domicile of the Company or those of its subsidiaries.

The Company and its subsidiaries evaluate the recoverability of deferred tax assets based on estimates of future profits. This recoverability ultimately depends on the ability of the Company or its subsidiaries to generate taxable profits over the period in which the deferred tax asset 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 subsidiaries, as a result of changes in tax laws or of unexpected future transactions that may impact tax balances.

x.8) Provisions for tax, labor, civil and regulatory proceedings

Provisions are recognized when the Company has a present obligation arising from a past event, settlement of which requires an outflow of resources rated as probable and when it can be reliably estimated. This obligation can be legal or constructive, derived from, among other factors, regulations, contracts, customary practices or public commitments that expose third parties to a valid expectation that the Company or its subsidiaries will assume certain responsibilities. The determination of the provision is based on the best estimate of the disbursement required to settle the corresponding obligation, considering the information available as of the closing date, including the opinion of independent experts, such as legal advisors.

x.9) Revenue recognition - revenue from unbilled services

The Company has billing systems for services with intermediate cut-off dates. Thus, at the end of each month there are revenues already received by the Company, but not effectively invoiced to its customers. These unbilled revenues are recorded based on estimates, which take into account historical consumption data, number of days elapsed since the last billing date, among others. Because historical data are used, these estimates are subject to significant uncertainties.

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y) Functional and reporting currency

The Company's functional and reporting currency is the Brazilian real. Transactions in foreign currency were translated at the exchange rate in force as of the date the transaction. Assets and liabilities denominated in foreign currencies are translated using the exchange rate at the balance sheet date. The exchange rate variations arising from transactions in foreign currencies are recognized in P&L as financial income or expenses. Gains and losses on the translation of foreign investments are recognized in the statement of comprehensive income.

z) Translation of transactions denominated in foreign currency

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency (real) at the exchange rate (fix rate) in force as of the transaction date and subsequently re-measured based on the fix rates effective that, at December 31, 2017, were US$1.00 = R$3.3080, €1.00 = R$3.9676, and at December 31, 2016, were US$1.00 = R$3.2591, €1.00 = R$3.4351. Gains and losses resulting from the translation of these assets and liabilities due to exchange rate variation between transaction date and period end are recognized in the income statement.

aa) Employee profit sharing

The Company and its subsidiaries have obligations arising from employment contracts, recognizing these provisions during the year. Provisions are recorded to recognize the expense regarding employee profit sharing. These provisions are calculated based on qualitative and quantitative goals set by management and accounted for in specific accounts according to their function in groups of: Cost of services, Selling expenses and General and administrative expenses.

ab) Share-based payments

The Company and its subsidiaries measure the cost of transactions settled with employees and officers based on shares issued by parent company (Telefónica), by reference to the fair value of the shares at the date at which they are granted, using the binomial valuation model. This fair value is charged to the income statement over the period until the vesting date.

ac) Treasury shares

Own equity instruments that are repurchased (treasury stock) are recognized at cost and deducted from equity. No gains or losses are recognized in P&L on purchase, sale, issue or cancellation of the Company's own equity instruments.

ad) Segment reporting

Business segments are defined as components of a company for which separate financial information is available and regularly assessed by the operational decision making professional in decisions on how to allocate funds to an individual segment and in the assessment of segment performance. Considering that: (i) all officers and managers' decisions are based on consolidated reports; (ii) the Company and subsidiaries' mission is to provide their customers with quality telecommunications services; and (iii) all decisions related to strategic planning, finance, purchases, short- and long-term investments are made consolidated on a consolidated basis, the Company and subsidiaries operate in a single operating segment, namely the provision of telecommunications services.

ae) Statement of cash flows and statement of value added

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The statement of cash flows was prepared in accordance with IAS 7/CPC 03 – Statement of Cash Flows using the indirect method, and reflects the changes in cash for the years reported.

The statement of value added (SVA) is shown as supplementary information, in compliance with Brazilian Corporation Law and was prepared in accordance with CPC09 – Statement of value added. The purpose of the statement of value added is to disclose the wealth generated by the Company during the year and the wealth distribution among its stakeholders.

4) CASH AND CASH EQUIVALENTS

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Cash and banks	114,556	189,445	117,799	198,369
Short-term investments	3,566,617	4,486,182	3,932,539	4,906,741
Total	**3,681,173**	**4,675,627**	**4,050,338**	**5,105,110**

Highly liquid short-term investments basically comprise Bank Deposit Certificates (CDB) and Repurchase Agreements kept at first-tier financial institutions, pegged to the Interbank Deposit Certificate (CDI) rate, with original maturities of up to three months, and with immaterial risk of change in value. Revenues generated by these investments are recorded as financial income.

5) TRADE ACCOUNTS RECEIVABLE, NET

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Billed amounts	6,642,523	6,077,768	6,753,621	6,939,909
Unbilled amounts	2,137,645	1,898,630	2,481,364	1,930,708
Interconnection amounts	835,085	1,333,595	859,819	1,345,471
Amounts from related parties (Note 28)	175,201	177,741	201,021	190,906
Gross accounts receivable	**9,790,454**	**9,487,734**	**10,295,825**	**10,406,994**
Estimated impairment losses	(1,209,369)	(1,004,512)	(1,433,471)	(1,399,895)
Total	**8,581,085**	**8,483,222**	**8,862,354**	**9,007,099**
Current	8,413,403	8,282,685	8,588,466	8,701,688
Noncurrent	167,682	200,537	273,888	305,411

Consolidated balances of noncurrent trade accounts receivable include:

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- R$122,651 at December 31, 2017 (R$143,265 at December 31, 2016), relating to the business model of resale of goods to legal entities, receivable within 24 months. At December 31, 2017, the impact of the present-value adjustment was R$16,011 (R$32,920 at December 31, 2016).

- R$45,031, at December 31, 2017 (R$57,272, at December 31, 2016), net of the present value adjustment relating to the portion of accounts receivable arising from negotiations on the bankruptcy process of companies from the OI group. At December 31, 2017, the impact of the present-value adjustment was R$15,535 (R$10,268 at December 31, 2016).

- R$106,206, at December 31, 2017, (R$104,874, at December 31, 2016), relating to “Soluciona TI”, traded by TData, which consists of lease of IT equipment to small and medium companies and receipt of fixed installments over the contractual term. Considering the contractual terms, this product was classified as finance lease. At December 31, 2017, the impact of the present-value adjustment was R$33,614 (R$3,005 at December 31, 2016).

The balances of current and noncurrent trade accounts receivable, relating to finance lease of “Soluciona TI” product, comprise the following effects:

	Consolidated	
	12/31/17	12/31/16
Nominal amount receivable	434,743	611,384
Deferred financial income	(33,614)	(3,005)
Present value of accounts receivable	**401,129**	**608,379**
Estimated impairment losses	(154,666)	(344,738)
Net amount receivable	**246,463**	**263,641**

Current	140,257	158,767
Noncurrent	106,206	104,874

At December 31, 2017, the aging list of gross trade accounts receivable relating to “Soluciona TI” product is as follows:

	Consolidated	
	Nominal amount receivable	Present value of accounts receivable
Falling due within one year	229,981	229,981
Falling due between one year and five years	204,762	171,148
Total	**434,743**	**401,129**

There are no unsecured residual values resulting in benefits to the lessor nor contingent payments recognized as revenue for the year.

The aging list of trade accounts receivable, net of estimated impairment losses, is as follows:

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	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Falling due	6,557,992	6,392,442	6,635,125	6,841,752
Overdue – 1 to 30 days	1,016,172	1,025,630	1,132,008	1,073,568
Overdue – 31 to 60 days	342,779	309,210	375,176	322,485
Overdue – 61 to 90 days	224,597	225,132	232,648	227,010
Overdue – 91 to 120 days	96,586	110,813	105,342	105,048
Overdue – over 120 days	342,959	419,995	382,055	437,236
Total	**8,581,085**	**8,483,222**	**8,862,354**	**9,007,099**

At December 31, 2017 and 2016, no customer represented more than 10% of trade accounts receivable, net.

Changes in the estimated impairment losses for accounts receivable are as follows:

	Company	Consolidated
Balance at 12/31/15	**(1,650,112)**	**(2,217,926)**
Supplement to estimated losses (Note 24)	(1,667,359)	(1,843,775)
Reversal of estimated losses (Note 24)	441,617	495,554
Write-off due to use	2,032,062	2,166,252
Merger (Note 1.c.2)		-

	(160,720)	
Balance at 12/31/16	**(1,004,512)**	**(1,399,895)**
Supplement to estimated losses (Note 24)	(1,870,438)	(1,994,769)
Reversal of estimated losses (Note 24)	465,353	513,754
Write-off due to use	1,200,228	1,456,158
Business combinations (Note 1.c.1)	-	(8,719)
Balance at 12/31/17	**(1,209,369)**	**(1,433,471)**

6) INVENTORIES

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Materials for resale (1)	302,235	335,281	325,850	377,465
Materials for consumption	55,448	75,086	57,740	77,732
Other inventories	7,822	7,892	7,822	7,892
Gross total	**365,505**	**418,259**	**391,412**	**463,089**
Estimated losses from impairment or obsolescence (2)	(40,794)	(50,108)	(42,657)	(52,676)
Total	**324,711**	**368,151**	**348,755**	**410,413**

(1) This includes, among others, mobile phones, simcards (chip) and IT equipment in stock.

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(2) Additions and reversals of estimated impairment losses and inventory obsolescence are included in cost of goods sold (Note 24).

7) DEFERRED TAXES AND TAXES RECOVERABLE

a) Taxes recoverable

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
State VAT (ICMS) (1)	2,438,272	2,317,739	2,450,856	2,329,159
Income and social contribution taxes recoverable (2)	401,259	829,160	505,535	830,549
Withholding taxes and contributions (3)	212,264	131,915	238,355	157,371
PIS and COFINS	66,335	125,273	85,098	148,759
Fistel, INSS, ISS and other taxes	8,232	22,775	27,431	38,236
Total	**3,126,362**	**3,426,862**	**3,307,275**	**3,504,074**
Current	2,386,258	2,952,622	2,563,990	3,027,230
Noncurrent	740,104	474,240	743,285	476,844

(1) This includes credits of ICMS arising from the acquisition of property and equipment (subject to offsetting in 48 months); requests for refund of ICMS, which was paid under invoices that were cancelled subsequently; for the rendering of services; tax substitution; and tax rate difference; among others. Noncurrent consolidated amounts include credits arising from the acquisition of property and equipment of R$423,588 and R$370,770 on December 31, 2017 and 2016, respectively.

(2) This refers to prepayments of income and social contribution taxes, which will be offset against federal taxes to be determined in the future.

(3) This refers to credits on withholding income tax (IRRF) on short-term investments, interest on equity and others, which are used as deduction in operations for the period and social contribution tax withheld at source on services provided to public agencies.

b) Deferred taxes

Deferred income and social contribution tax assets are computed considering expected generation of taxable profit, which were based on a technical feasibility study, approved by the Board of Directors.

Significant components of deferred income and social contribution taxes are as follows:

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				Company				
	Balances at 12/31/15	Income statement	Comprehensive income	Other	Merger (note 1 c.2)	Balances at 12/31/16	Income statement	Comprehens inco
Deferred tax assets (liabilities)								
Income and social contribution taxes on tax losses (1)	**-**	**1,376**	**-**	**-**	**-**	**1,376**	**587,374**	
Income and social contribution taxes on temporary differences (2)	**(155,951)**	**(716,769)**	**78,798**	**(1,516)**	**705,367**	**(90,071)**	**(1,264,191)**	**56,**
Provisions for legal, labor, tax civil and regulatory contingencies	1,681,016	257,288	-	-	282,751	2,221,055	34,032	
Trade accounts payable and other provisions	535,001	6,702	-	-	66,455	608,158	(19,864)	
Customer portfolio and trademarks	256,056	(62,660)	-	-	119,695	313,091	(58,674)	
Estimated losses on impairment of accounts receivable	369,174	(82,284)	-	-	54,645	341,535	69,652	
Estimated losses from modems and other P&E items	170,132	(10,561)	-	-	122,696	282,267	(82,833)	
Pension plans and other	26,164	1,780	80,459	-	-	108,403	10,498	55,

post-employment benefits								
Profit sharing	88,944	31,004	-	-	3,963	123,911	(23,268)	
Provision for loyalty program	32,604	(13,492)	-	-	-	19,112	(1,991)	
Accelerated accounting depreciation	10,865	13,168	-	-	-	24,033	(15,773)	
Estimated impairment losses on inventories	9,364	(11,757)	-	-	13,620	11,227	(107)	
Derivative transactions	47,911	2,891	(1,633)	-	10,523	59,692	(34,349)	8
Licenses	(1,204,226)	(216,330)	-	-	-	(1,420,556)	(216,330)	
Effects of goodwill generated in the merger of Vivo Part.	(809,600)	(54,720)	-	-	-	(864,320)	(5,461)	
Goodwill from Spanish and Navytree	(337,535)	-	-	-	-	(337,535)	-	
Goodwill from Vivo Part.	(837,918)	(167,202)	-	-	-	(1,005,120)	(167,203)	
Goodwill from GVT Part.	-	(522,228)	-	-	-	(522,228)	(696,305)	
Technological Innovation Law	(193,146)	52,206	-	-	-	(140,940)	43,407	
Income and social contribution taxes on other temporary differences (3)	(757)	59,426	(28)	(1,516)	31,019	88,144	(99,622)	(1
Total deferred tax assets (liabilities), noncurrent	**(155,951)**	**(715,393)**	**78,798**	**(1,516)**	**705,367**	**(88,695)**	**(676,817)**	**56,**
Deferred tax assets	**3,535,671**					**4,425,658**		
Deferred tax liabilities	**(3,691,622)**					**(4,514,353)**		
Deferred tax assets (liabilities), net	**(155,951)**					**(88,695)**		
Represented in the balance sheet as								

follows:		
Deferred tax assets	**-**	**-**
Deferred tax liabilities	**(155,951)**	**(88,695)**

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					Consolidated			
	Balances at 12/31/15	Income statement	Comprehensive income	Other	Balances at 12/31/16	Income statement	Comprehensive income	Bu comb (Not
<u>**Deferred tax assets (liabilities)**</u>								
Income and social contribution taxes on tax losses (1)	**26,519**	**(12,448)**	**-**	**-**	**14,071**	**710,411**	**-**	
Income and social contribution taxes on temporary differences (2)	**685,071**	**(748,969)**	**78,840**	**(1,516)**	**13,426**	**(1,251,816)**	**58,192**	
Provisions for legal, labor, tax civil and regulatory contingencies	1,954,236	276,100	-	-	2,230,336	68,399	-	
Trade accounts payable and other provisions	687,124	(10,001)	-	-	677,123	(25,706)	-	
Estimated losses on impairment of accounts receivable	447,018	(88,213)	-	-	358,805	76,155	-	
Customer portfolio and trademarks	343,107	(30,015)	-	-	313,092	(58,674)	-	
Estimated losses from modems and other P&E items	294,945	(10,268)	-	-	284,677	(83,736)	-	
Pension plans and other post-employment	26,285	1,633	80,501	-	108,419	8,630	57,485	

benefits								
Profit sharing	106,198	19,058	-	-	125,256	(15,210)	-	
Provision for loyalty program	32,604	(13,492)	-	-	19,112	(1,991)	-	
Accelerated accounting depreciation	10,865	13,168	-	-	24,033	(15,773)	-	
Estimated impairment losses on inventories	10,707	1,392	-	-	12,099	(347)	-	
Derivative transactions	59,408	2,358	(1,633)	-	60,133	(35,084)	822	
Licenses	(1,204,226)	(216,330)	-	-	(1,420,556)	(216,330)	-	
Effects of goodwill generated in the acquisition of Vivo Part.	(809,600)	(54,720)	-	-	(864,320)	(5,461)	-	
Goodwill from Spanish and Navytree	(337,535)	-	-	-	(337,535)	-	-	
Goodwill from Vivo Part.	(837,918)	(167,202)	-	-	(1,005,120)	(167,203)	-	
Goodwill from GVTPart.	-	(522,228)	-	-	(522,228)	(696,305)	-	
Technological Innovation Law	(193,146)	52,206	-	-	(140,940)	43,407	-	
Income and social contribution taxes on other temporary differences (3)	94,999	(2,415)	(28)	(1,516)	91,040	(126,587)	(115)	
Total deferred tax assets (liabilities), noncurrent	**711,590**	**(761,417)**	**78,840**	**(1,516)**	**27,497**	**(541,405)**	**58,192**	**1**
Deferred tax assets	**4,153,054**				**4,541,952**			
Deferred tax liabilities	**(3,441,464)**				**(4,514,455)**			
Deferred tax assets (liabilities), net	**711,590**				**27,497**			

Represented in the balance sheet as follows:

; Deferred tax assets	**711,590**	**27,497**
; Deferred tax liabilities	**-**	**-**

(1) This refers to the amounts recorded which, in accordance with Brazilian tax legislation, may be offset to the limit of 30% of the tax bases computed for the following years, with no expiry date. In 2017, there were increases of R$587,374 in the Company and R$779,862 in the consolidated, consisting of R$587,374 of the Company and R$192,488 of Terra Networks and POP.

(2) This refers to amounts that will be realized upon payment of provisions, effective impairment losses for trade accounts receivable, or realization of inventories, as well as upon reversal of other provisions.

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(3) These refer to deferred taxes arising from other temporary differences, such as deferred income, renewal of licenses burden, subsidy on the sale of mobile phones, among others.

At December 31, 2017, deferred tax credits (income and social contribution tax losses) were not recognized in indirect subsidiaries' (Innoweb anda TGLog) accounting records, in the amount of R$11,938 (R$2,993 at December 31, 2016), as it is not probable that future taxable profits shall be available for these subsidiaries to benefit from such tax credits.

Expected realization of deferred taxes, net, noncurrent.

The amounts are based on projections subject to change in the future.

Year	Company	Consolidated
2018	1,768,735	1,904,953
2019	543,722	685,775
2020	332,851	374,379
2021	426,700	442,867
2022	694,083	704,303
2023 em diante	(4,475,416)	(4,450,194)
Total	(709,325)	(337,917)

8) JUDICIAL DEPOSITS AND GARNISHMENTS

In some situations, in connection with a legal requirement or to suspension of tax liability, judicial deposits are made to secure the continuance of the claims under discussion. These judicial deposits may be required for claims where the likelihood of loss was analyzed by the Company and its subsidiaries, grounded on the opinion of its legal advisors as a probable, possible or remote loss.

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Judicial deposits				
Tax	4,074,517	3,698,966	4,230,917	3,758,787
Labor	864,022	1,040,635	885,338	1,051,430
Civil	1,203,297	1,107,929	1,205,807	1,109,001
Regulatory	200,627	276,604	200,627	276,604
Total	**6,342,463**	**6,124,134**	**6,522,689**	**6,195,822**
Garnishments	137,823	152,948	141,116	155,744
Total	**6,480,286**	**6,277,082**	**6,663,805**	**6,351,566**
Current	324,465	302,349	324,638	302,424
Noncurrent	6,155,821	5,974,733	6,339,167	6,049,142

On December 31, 2017, the Company and its subsidiaries had a number of tax-related judicial deposits in the consolidated amount of R$4,230,917 (R$3,758,787 at December 31, 2016). In Note 18, we provide further details on issues arising from the most significant judicial deposits.

The table below presents the composition of the balances as of December 31, 2107 and 2016 of the tax judicial deposits (segregated and summarized by tribute).

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	Consolidated	
	12/31/17	12/31/16
Contribution to Empresa Brasil de Comunicação (EBC)	1,238,068	1,053,867
Telecommunications Inspection Fund (FISTEL)	1,161,061	1,095,789
Corporate Income Tax (IRPJ) and Social Contribution Tax (CSLL)	518,474	449,988
Universal Telecommunication Services Fund (FUST)	484,649	456,977
Social Contribution Tax for Intervention in the Economic Order (CIDE)	270,612	176,557
State Value-Added Tax (ICMS)	273,264	212,652
Social Security, work accident insurance (SAT) and funds to third parties (INSS)	134,688	128,458
Withholding Income Tax (IRRF)	45,846	73,848
Contribution tax on gross revenue for Social Integration Program (PIS) and for Social Security Financing (COFINS)	37,965	35,570
Other taxes, charges and contributions	66,290	75,081
Total	**4,230,917**	**3,758,787**

A brief description of the main tax-related judicial deposits is as follows:

- Contribution to Empresa Brasil de Comunicação (EBC)

On behalf of its members, Sinditelebrasil (Union of Telephony, and Mobile and Personal Services) is challenging in court payment of the Contribution to Foster Public Radio Broadcasting to EBC, introduced by Law No. 11.652/2008. The Company and TData, as union members, made court deposits relating to that contribution.

- Telecommunications Inspection Fund (FISTEL)

The Company has legal proceedings involving the collection by ANATEL of the Installation Inspection Fee ("TFI") on the renewal of the validity of the license, as well as the exclusion of the calculation basis of the

Installation Inspection Fee ("TFI") and Inspection and Operation Fee ("TFF") of mobile stations that do not belong to it.

9) PREPAID EXPENSES

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Advertising and publicity	335,700	258,212	336,295	258,212
Insurance	36,672	39,008	36,941	39,558
Rental	29,713	19,276	29,713	19,276
Software and networks maintenance	7,422	10,204	12,375	12,283
Taxes, financial charges, personal and other	37,475	45,148	54,231	50,193
Total	**446,982**	**371,848**	**469,555**	**379,522**
Current	425,298	336,508	446,439	343,092
Noncurrent	21,684	35,340	23,116	36,430

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10) OTHER ASSETS

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Advances to employees and suppliers	53,103	81,325	58,456	83,634
Related-party receivables (Note 28)	557,211	311,633	166,733	250,679
Receivables from suppliers	114,015	96,065	114,015	99,166
Subsidy on handset sales	37,258	30,491	37,258	30,491
Surplus from post-employment benefit plans (Note 30)	9,616	8,838	9,833	9,041
Other amounts receivable	17,024	20,391	24,037	22,649
Total	**788,227**	**548,743**	**410,332**	**495,660**
Current	701,882	495,380	321,397	440,095
Noncurrent	86,345	53,363	88,935	55,565

11) INVESTMENTS

a) Information on investees

The Company holds equity interests in wholly-owned subsidiaries (subsidiaries) and jointly-owned subsidiaries. Below, we present the main information of the Company's investees.

TData: The Company's wholly-owned subsidiary, headquartered in Brazil, has the purpose of providing and operating value-added services (VAS); integrated business solutions in telecommunications and related activities; technical assistance and maintenance of telecommunications equipment and networks and project design.

TData is the parent company of TGLog (acquired on October 28, 2015 for R$15,811) and Terra Networks (acquired on July 3, 2017 for R$250,000).

GVTPart: A wholly-owned subsidiary of the Company up to March 31, 2016. GVTPart. was controlling shareholder of GVT and headquartered in Brazil, the business purpose of GVTPart is to hold interest in other domestic or foreign companies as a partner, shareholder or member. GVT provides landline telephone, data, multimedia communication and pay-tv services in the entire Brazilian territory. GVTPart. was merged into the Company on April 1, 2016 (Note 1c2).

POP: The Company's direct subsidiary on April 1, 2016 (Note 1c2), is engaged in the performance of activities related to information technology, internet and any other networks; hosting services and the commercial operation of websites and portals; handling, provision and storage of information and data; sale of software, hardware, telecommunication equipment and electronics; development, licensing and maintenance of information systems and routines; development of electronic commerce; creation and administration of own and/or third-party databases; sale of publicity and advertising and, banner vehicles; and holding interest in other companies as member or shareholder, and may also form consortia and/or other forms of association. Until March 31, 2016, POP was controlled by GVT (Note 1c2).

POP is the wholly-owned subsidiary of Innoweb Ltda ("Innoweb"), whose business purpose is to operate as an internet provider; performing information activities; all forms of telecommunications activities, including the transmission of voice, data and information; sale of telecommunications and electronic equipment and/or accessories; and holding interest in other companies as member or shareholder, and may also form consortia and/or other forms of association.

Aliança: Jointly-controlled subsidiary, headquartered in Amsterdam, Netherlands, with 50% interest held by the Company, this entity is engaged in the acquisition and management of subsidiaries, and holding interest in companies of the telecommunications industry.

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AIX: Jointly-controlled subsidiary headquartered in Brazil, with 50% interest held by the Company, this entity is engaged in holding interest in Consórcio Refibra, and in performing activities related to the direct and indirect operation of activities associated with the construction, completion and operation of underground networks for optical fiber ducts.

ACT: Jointly-controlled subsidiary headquartered in Brazil, with 50% interest held by the Company, this entity is engaged in holding interest in Consórcio Refibra, 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.

Below is a summary of significant financial data on the Company's investees:

	At 12/31/17					At 12/31/16				
	Consolidated wholly-owned subsidiaries		Jointly-controlled subsidiaries			Consolidated wholly-owned subsidiaries		Jointly-controlled subsidiaries		
	TData	POP	Aliança	Cia AIX	Cia ACT	TData	POP	Aliança	Cia AIX	Cia ACT
Equity interest	**100.00%**	**100.00%**	**50.00%**	**50.00%**	**50.00%**	**100.00%**	**100.00%**	**50.00%**	**50.00%**	**50.00%**
Summary of balance sheets:										
Current assets	2,928,721	33,566	167,540	22,431	17	1,414,039	27,407	145,121	20,337	15
	749,694	52,761	-	13,410	-	362,195	52,016	-	12,879	-

Noncurrent assets										
Total assets	**3,678,415**	**86,327**	**167,540**	**35,841**	**17**	**1,776,234**	**79,423**	**145,121**	**33,216**	**15**
Current liabilities	1,893,271	47,337	58	4,084	1	633,631	49,535	101	4,029	1
Non-current liabilities	185,794	24	-	4,811	-	63,139	-	-	5,415	-
Equity	1,599,350	38,966	167,482	26,946	16	1,079,464	29,888	145,020	23,772	14
Total liabilities and equity	**3,678,415**	**86,327**	**167,540**	**35,841**	**17**	**1,776,234**	**79,423**	**145,121**	**33,216**	**15**
Investment Book value	**1,599,350**	**38,966**	**83,741**	**13,473**	**8**	**1,079,464**	**29,888**	**72,510**	**11,886**	**7**

	2017					2016					
	Consolidated wholly-owned subsidiaries		Jointly-controlled subsidiaries			Consolidated wholly-owned subsidiaries			Jointly-controlled subsidiaries		
<u>**Summary of Income Statements:**</u>	TData	POP	Aliança	Cia AIX	Cia ACT	TData	POP (1)	GVTPart. (2)	Aliança	Cia AIX	C AC
Net operating income	4,023,145	29,512	-	45,622	82	2,538,270	32,233	1,531,692	-	42,840	
Operating costs and expenses	(2,311,211)	(16,049)	(43)	(43,448)	(80)	(1,448,225)	(20,142)	(1,300,347)	(155)	(41,760)	(7
Financial income (expenses), net	56,506	1,392	27	1,686	-	86,760	1,217	(41,146)	41	1,980	
Income and social contribution taxes	(475,614)	(5,777)	-	(686)	-	(404,171)	(6,010)	(57,958)	-	(464)	(
Net income (loss) for the year	**1,292,826**	**9,078**	**(16)**	**3,174**	**2**	**772,634**	**7,298**	**132,241**	**(114)**	**2,596**	
Equity pickup, according to interest held	**1,292,826**	**9,078**	**(8)**	**1,587**	**1**	**772,634**	**7,298**	**132,241**	**(57)**	**1,298**	

1) Includes the consolidated result of the POP for the period from 04/01 to 12/31/16.

(2) Includes the consolidated results of GVTPart. For the period from 01/01 to 03/31/16.

b) Changes in investments

	TData (1)	POP (1)	GVTPart. (1)	Aliança (2)	AIX (2)	ACT (2)	Goodwill (3)	Surplus value of net assets acquired attributed to the Company	Other investments (4)	**invest - Co**
Balances at 12/31/15	**1,056,305**	**-**	**7,674,444**	**89,799**	**10,099**	**4**	**13,049,199**	**2,461,583**	**1,259**	**24,3**
Equity pick-up	772,634	7,298	132,241	(57)	1,298	3	-	(67,641)	-	**8**
Merger (Note 1.c.2)	-	22,590	(7,806,685)	-	-	-	(12,837,141)	(2,393,942)	-	**(23,01**
Dividends and interest on equity	(749,395)	-	-	-	489	-	-	-	-	**(74**
Other comprehensive income	(80)	-	-	(17,232)	-	a -	-	-	83	**(1**
Balances at 12/31/16	**1,079,464**	**29,888**	**-**	**72,510**	**11,886**	**7**	**212,058**	**-**	**1,342**	**1,4**
Equity pick-up	1,292,826	9,078	-	(8)	1,587	1	-	-	-	**1,3**
Equity transactions (Note 1 c.1)	(59,029)	-	-	-	-	-	-	-	-	**(5**
Dividends and interest on equity	(707,794)	-	-	-	-	-	-	-	-	**(70**
Other comprehensive income	(6,117)	-	-	11,239	-	-	-	-	338	
Balances at 12/31/17	**1,599,350**	**38,966**	**-**	**83,741**	**13,473**	**8**	**212,058**	**-**	**1,680**	**1,9**

(1) Wholly-owned entities.

(2) Jointly-controlled subsidiaries.

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(3) Goodwill: (i) R$212,058 from partial spin-off of "Spanish and Figueira", which was reversed to the Company upon merger with Telefônica Data Brasil Holding S.A. (TDBH) in 2006; and (ii) R$12,837,141 originated from the acquisition of GVTPart. (Note 1 c3).

(4) Other investments (tax incentives and interest held in companies) are measured at fair value.

12) PROPERTY, PLANT AND EQUIPMENT

a) Breakdown and changes

				Company			
	Switching and transmission equipment	Terminal equipment / modems	Infrastructure	Land	Other P&E	Estimated losses (1)	Assets a facilities un construct
Annual depreciation rate (%)	**2.50 to 25.00**	**6.67 to 66.67**	**2.50 to 66.67**		**10.00 to 25.00**		
Balances and changes:							
Balance at 12/31/15	**14,476,070**	**1,530,793**	**3,371,532**	**313,105**	**711,085**	**(155,277)**	**1,771,7**
Additions	355,291	88,653	157,101	215	304,176	(19,858)	5,521,1
Write-offs, net (2)	(20,447)	(467)	(98,879)	(202)	(751)	21,708	(36,4
Net transfers	3,693,341	693,367	361,905	-	(38,238)	(3)	(4,776,7
Depreciation	(2,581,663)	(1,303,734)	(504,787)	-	(357,263)	-	

(Note 24)							
Merger (Note 1.c.2)	6,309,033	1,572,567	428,622	2,601	159,039	(331,956)	221,1
Balance at 12/31/16	**22,231,625**	**2,581,179**	**3,715,494**	**315,719**	**778,048**	**(485,386)**	**2,700,8**
Additions	42,997	141,132	91,160	550	238,989	(37,278)	6,062,6
Write-offs, net	(88,764)	(7,602)	(6,691)	(1,916)	(2,571)	162,224	(17,5
Net transfers	3,634,293	1,471,431	619,008	-	15,453	132,578	(5,891,9
Depreciation (Note 24)	(3,011,178)	(1,466,459)	(541,289)	-	(264,237)	-	
Balance at 12/31/17	**22,808,973**	**2,719,681**	**3,877,682**	**314,353**	**765,682**	**(227,862)**	**2,854,0**
At 12/31/16							
Cost	70,781,587	15,246,317	14,944,006	315,719	4,181,817	(485,386)	2,700,8
Accumulated depreciation	(48,549,962)	(12,665,138)	(11,228,512)	-	(3,403,769)	-	
Total	**22,231,625**	**2,581,179**	**3,715,494**	**315,719**	**778,048**	**(485,386)**	**2,700,8**
At 12/31/17							
Cost	74,092,109	16,797,604	15,628,384	314,353	4,404,945	(227,862)	2,854,0
Accumulated depreciation	(51,283,136)	(14,077,923)	(11,750,702)	-	(3,639,263)	-	
Total	**22,808,973**	**2,719,681**	**3,877,682**	**314,353**	**765,682**	**(227,862)**	**2,854,0**

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	Consolidated						
	Switching and transmission equipment	Terminal equipment / modems	Infrastructure	Land	Other P&E	Estimated losses (1)	Asse facilities constr
Annual depreciation rate (%)	**2.50 to 25.00**	**6.67 to 66.67**	**2.50 to 66.67**		**10.00 to 25.00**		
Balances and changes:							
Balance at 12/31/15	**20,935,963**	**3,146,109**	**3,655,951**	**315,705**	**1,066,452**	**(494,149)**	**1,85**
Additions	634,635	203,775	159,081	215	288,666	(19,962)	5,54
Write-offs, net (2)	(24,236)	(816)	(99,437)	(201)	3,059	28,539	(3
Net transfers	3,473,332	677,572	523,995	-	(159,702)	(3)	(4,625
Depreciation (Note 24)	(2,787,820)	(1,438,333)	(514,383)	-	(379,119)	-	
Balance at 12/31/16	**22,231,874**	**2,588,307**	**3,725,207**	**315,719**	**819,356**	**(485,575)**	**2,73**
Additions	42,999	141,132	91,160	550	259,620	(37,374)	6,08
Write-offs, net	(88,766)	(7,602)	(6,966)	(1,916)	(2,522)	162,319	(1
Net transfers	3,634,293	1,471,431	619,008	-	34,093	132,578	(5,91
Depreciation (Note 24)	(3,011,291)	(1,468,936)	(544,454)	-	(284,983)	-	
Business Combination (Note 1.c.1)	-	-	1,342	-	4,888	-	
	22,809,109						**2,88**

Balance at 12/31/17		**2,724,332**	**3,885,297**	**314,353**	**830,452**	**(228,052)**	
At 12.31.16							
Cost	70,789,534	15,294,619	15,023,890	315,719	4,308,718	(485,575)	2,73
Accumulated depreciation	(48,557,660)	(12,706,312)	(11,298,683)	-	(3,489,362)	-	
Total	**22,231,874**	**2,588,307**	**3,725,207**	**315,719**	**819,356**	**(485,575)**	**2,73**
At 12.31.17							
Cost	74,100,056	16,845,903	15,728,808	314,353	4,687,395	(228,052)	2,88
Accumulated depreciation	(51,290,947)	(14,121,571)	(11,843,511)	-	(3,856,943)	-	
Total	**22,809,109**	**2,724,332**	**3,885,297**	**314,353**	**830,452**	**(228,052)**	**2,88**

(1) The Company and its subsidiaries recognized estimated losses for potential obsolescence of materials used in property and equipment maintenance, based on levels of historical use and expected future use.

(2) Net write-offs regarding “Infrastructure and Assets and Facilities under Construction” for the year ended December 31, 2016, include the amount of R$99,210 regarding the disposal of 1,655 towers owned by the Company to Telxius Torres Brasil Ltda (former Towerco Latam do Brasil Ltda), a directly controlled Telefónica subsidiary.

b) <u>Depreciation rates</u>

In accordance with IAS 16 / CPC 27, the Company performed valuations of useful lives applied to its property, plant and equipment using the direct comparative method of market data. The results of these evaluations did not indicate the need for changes in useful lives in 2017.

In relation to 2016, these evaluations indicated the need for changes in useful lives and annual depreciation rates for some items of asset classes. This change in the accounting estimate, which was applied reduced the depreciation expense for the annual period ended December 31, 2016 by R$157,053.

c) Property and equipment items pledged in guarantee

At December 31, 2017, the Company had consolidated amounts of property and equipment items pledged in guarantee for lawsuits, amounting to R$176,591 (R$203,600 at December 31, 2016).

d) Reversible assets

The STFC service concession arrangement establishes that all assets owned by the Company and that are indispensable to the provision of the services described in the referred to arrangement are considered "reversible" (returnable to the concession authority). At December 31, 2017, estimated residual value of reversible assets was R$8,763,355 (R$8,813,916 at December 31, 2016), which comprised switching and transmission equipment and public use terminals, external network equipment, energy, system and operational support equipment.

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e) Finance lease

At December 31, 2017, classes of switching and transmission equipment, infrastructure and other assets included the net residual amounts of R$280,103 (R$298,604 as of December 31, 2016), in which the Company is a lessee of financial leasing operations.

13) INTANGIBLE ASSETS

a) Breakdown, changes and amortization rates

	Company						
	Indefinite useful life	Finite useful life					
	Goodwill	Software	Customer portfolio	Trademarks	Licenses	Other intangible assets	Es lo s
Annual amortization rate (%)		**20.00**	**11.76**	**5.13**	**3.60 to 6.67**	**20.00**	
Balances and changes:							
Balance at 12/31/15	**10,013,222**	**2,162,935**	**861,310**	**1,242,025**	**15,635,082**	**6,495**	
Additions (1)	-	615,462	-	-	185,450	11,815	
Write-offs, net	-	(3)	-	-	-	-	

Net transfers	-	617,232	-	-	-	(17,693)
Amortization (Note 24)	-	(922,275)	(507,102)	(107,149)	(922,564)	(6,287)
Merger (Note 1.c.2)	12,837,141	219,856	2,207,012	22,944	-	56,368
Balance at 12/31/16	**22,850,363**	**2,693,207**	**2,561,220**	**1,157,820**	**14,897,968**	**50,698**
Additions	-	260,777	-	-	-	207
Write-offs, net	-	(7,425)	-	-	-	-
Net transfers	-	701,545	-	-	-	(24,297)
Amortization (Note 24)	-	(943,704)	(582,357)	(84,205)	(928,362)	(5,660)
Balance at 12/31/17	**22,850,363**	**2,704,400**	**1,978,863**	**1,073,615**	**13,969,606**	**20,948**
At 12/31/16						
Cost	22,850,363	14,019,938	4,513,278	1,658,897	20,237,572	267,065
Accumulated amortization	-	(11,326,731)	(1,952,058)	(501,077)	(5,339,604)	(216,367)
Total	**22,850,363**	**2,693,207**	**2,561,220**	**1,157,820**	**14,897,968**	**50,698**
At 12/31/17						
Cost	22,850,363	14,966,763	4,513,278	1,658,897	20,237,572	238,193
Accumulated amortization	-	(12,262,363)	(2,534,415)	(585,282)	(6,267,966)	(217,245)
Total	**22,850,363**	**2,704,400**	**1,978,863**	**1,073,615**	**13,969,606**	**20,948**

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	Consolidated						
	Indefinite useful life	Finite useful life					
	Goodwill	Software	Customer portfolio	Trademarks	Licenses	Other intangible assets	E lo
Annual amortization rate (%)		**20.00 to 50.00**	**11.76 to 12.85**	**5.13 to 66.67**	**3.60 to 6.67**	**6.67 to 20.00**	
Balances and changes:							
Balance at 12/31/15	**23,062,421**	**2,385,723**	**3,154,501**	**1,274,803**	**15,635,082**	**18,190**	
Additions (1)	-	634,528	-	-	185,450	19,796	
Write-offs, net	-	24	-	-	-	(11)	
Net transfers	-	616,336	-	-	-	19,207	
Amortization (Note 24)	-	(942,090)	(593,281)	(116,983)	(922,564)	(6,480)	
Balance at 12/31/16	**23,062,421**	**2,694,521**	**2,561,220**	**1,157,820**	**14,897,968**	**50,702**	
Additions	-	276,390	-	-	-	207	
Write-offs, net	-	(7,427)	-	-	-	-	
Net transfers	-	701,545	-	-	-	(24,297)	
Amortization (Note 24)	-	(944,753)	(582,357)	(84,205)	(928,362)	(5,660)	
Business Combination (Note 1.c.1)	-	530	-	-	-	-	

Balance at 12/31/17	**23,062,421**	**2,720,806**	**1,978,863**	**1,073,615**	**13,969,606**	**20,952**
At 12/31/16						
Cost	23,062,421	14,062,127	4,513,278	1,658,897	20,237,572	267,074
Accumulated amortization	-	(11,367,606)	(1,952,058)	(501,077)	(5,339,604)	(216,372)
Total	**23,062,421**	**2,694,521**	**2,561,220**	**1,157,820**	**14,897,968**	**50,702**
At 12/31/17						
Cost	-	15,125,532	4,513,278	1,658,897	20,237,572	238,201
Accumulated amortization	23,062,421	(12,404,726)	(2,534,415)	(585,282)	(6,267,966)	(217,249)
Total	**23,062,421**	**2,720,806**	**1,978,863**	**1,073,615**	**13,969,606**	**20,952**

(1) On December 17, 2015, the Company was the winner in seven lots at a frequency of 2,500MHz, offering the amount of R$185,450. On July 21, 2016, through acts No. 2.483, No. 2.485 and No. 2.486, the Directing Council of ANATEL approved the use of these radio frequencies. The terms of authorization of these radio frequency bands were signed on July 26, 2016 and published in the DOU on August 26, 2016.

b) Goodwill breakdown

	Company	Consolidated
Ajato Telecomunicação Ltda.	149	149
Spanish e Figueira (merged with TDBH) (1)	-	212,058
Santo Genovese Participações Ltda. (2)	71,892	71,892
Telefônica Televisão Participações S.A. (3)	780,693	780,693
Vivo Participações S. A. (4)	9,160,488	9,160,488
GVT Participações S. A. (5)	12,837,141	12,837,141
Total	**22,850,363**	**23,062,421**

(1) Goodwill from partial spin-off of “Spanish and Figueira”, which was reversed to the Company upon merger of Telefônica Data Brasil Holding S.A. (TDBH) in 2006.

(2) Goodwill generated upon acquisition of equity control of Santo Genovese Participações (parent company of Atrium Telecomunicações Ltda.), in 2004.

(3) Goodwill generated upon acquisition of Telefônica Televisão Participações (formerly Navytree) merged in 2008.

(4) Goodwill generated upon acquisition/merger of Vivo Participações in 2011.

(5) Goodwill generated upon acquisition of GVT Participações in 2015 (Note 1.c3).

c) Goodwill impairment testing

The Company assessed recoverability of goodwill carrying amount based on the value in use and discounted cash flow method.

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The process for determination of the value in use involves the use of assumptions, judgments and estimates on cash flows, such as revenue, cost and expense growth rates, estimated future investments and working capital and discount rates. The assumptions about cash flow increase projections were based on management's estimates, market studies and macroeconomic projections. Future cash flows were discounted at the WACC (Weighted Average Cost of Capital) rate.

Consistent with the economic analysis techniques, the assessment of value in use is made for a period of five (5) years, and thereafter, considering the perpetuity of the assumptions based on the capacity of business continuity for an indefinite time. Management considered that the period of 5 years is adequate, based on its past experience in preparing cash flow projections. Such understanding is in line with paragraph 35 of IAS 36/ CPC 01 R1 – Impairment of Assets.

The growth rate used to extrapolate the projections beyond the 5 years period was 4.5% and 5.0% in 2017 and 2016, respectively. Estimated future cash flows were discounted at the pre tax rate of 13.58% in 2017 (14.75% in 2016), also at nominal amounts.

The inflation rate for the period analyzed in the projected cash flows was 4.0% in 2017 (4.5% in 2016).

Key assumptions were based on the Company's historical performance and reasonable macroeconomic assumptions grounded on financial market projections, documented and approved by the Company's management.

Based on annual impairment testing of the Company's intangible assets, prepared using projections considering the financial statements at December 31, 2017 and 2016, growth projections and operating results for the year ended December 31, 2017 and 2016, no impairment losses or evidence of losses were identified, since value in use is higher than net carrying amount as of the assessment date.

c.1) Key assumptions used in the calculation of value in use:

The value in use is mainly impacted by the following assumptions:

- Revenue Growth: is based on the observation of the historical behavior of each revenue line, as well as trends based on market analysis. The projected revenue differs between product lines and services with a tendency of growth in broadband services, pay TV and IT compared to voice services (fixed).

- Growth in operating margin: takes into account the historical margin estimate of price correction, as well as ongoing projects with the aim of greater cost efficiency.

- Capex volume: we considered the projects in progress aiming at the best efficiency of use of CapEx associated with the need to increase capacity and coverage in line with the growth in revenue provided under the long-term plan. The Capex volume may also be impacted by inflation and currency fluctuations.

- Discount rate: represents the assessment of risks in the current market. The calculation of the discount rate is based on the Company's specific circumstances and derived from the weighted average cost of capital (WACC). The WACC takes into account both debt and equity. The cost of equity is derived from the expected return on investment by Company investors. The cost of debt is based on loans with interest income that the Company is obliged to honor. The specific risk segment is incorporated by applying individual beta factors.

c.2) Sensitivity to changes in assumptions

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The Company carries out a sensitivity analysis of the impairment test by considering reasonable changes in the main assumptions used in such test.

The following maximum increases or decreases, expressed in percentage points (p.p.) were assumed for the years ended December 31, 2017 and 2016:

Changes in key assumptions	In percentage points (p.p)
Financial variables	
Discount rate	+/- 1.0
Perpetuity growth rates	+/- 0.5
Operating variables	
OIBDA Margin	+/- 2.0
Capex/Revenues Margin	+/- 1.0

The sensitivity analysis performed at year-end 2017 and 2016 indicates that there are no significant risks arising from possible changes in the financial and operating variables, considered individually. In other words, the Company considers that within the above (reasonably wide) limits, no losses would be recognized.

14) PERSONNEL, SOCIAL CHARGES AND BENEFITS

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Salaries and wages	37,070	54,525	40,171	55,476
Social charges and benefits	354,467	375,249	399,229	384,073
Profit sharing	247,501	282,134	273,384	285,887
Share-based payment plans (Note 29)	31,567	45,906	33,880	46,223
Total	**670,605**	**757,814**	**746,664**	**771,659**

Current	648,957	746,798	723,380	760,643
Noncurrent	21,648	11,016	23,284	11,016

15) TRADE ACCOUNTS PAYABLE

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Sundry suppliers (Opex, Capex, Services e Material)	6,380,614	6,270,535	6,683,503	6,617,240
Amounts payable (operators, cobilling)	183,250	314,959	187,976	314,958
Interconnection / interlink (1)	224,777	369,715	224,777	369,715
Related parties (Note 28)	1,772,203	656,093	350,844	381,240
Total	**8,560,844**	**7,611,302**	**7,447,100**	**7,683,153**
Current	8,560,844	7,539,395	7,447,100	7,611,246
Noncurrent	-	71,907	-	71,907

(1) As of December 31, 2016, the amount recorded as non-current related to the judicial proceeding filed against SMP operators claiming the reduction of the VU-M amount. On October 15, 2007, an injunction was obtained to provide a judicial deposit of the difference between VC1 calls and the amount effectively charged by SMP operators. In May 2017, the updated amount of R$71,956 was raised in favor of the operators involved, after an agreement between the parties.

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16) TAXES, CHARGES AND CONTRIBUTIONS

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Income and social contribution taxes payable	-	-	4,479	11,520
ICMS	1,106,507	1,187,244	1,149,137	1,226,172
PIS and COFINS	385,501	371,838	419,589	412,149
Fust and Funttel	93,869	92,828	93,869	92,828
ISS, CIDE and other taxes	102,327	67,420	113,689	77,193
Total	**1,688,204**	**1,719,330**	**1,780,763**	**1,819,862**
Current	1,669,741	1,698,334	1,731,315	1,770,731
Noncurrent	18,463	20,996	49,448	49,131

17) DIVIDENDS AND INTEREST ON EQUITY (IOE)

a) Dividends and interest on equity receivable

a.1) Breakdown:

At December 31, 2017, the Company had R$323,206 to be received from TData, related to mandatory minimum dividends of 2017.

a.2) Changes:

	Company	Consolidated
Balance at 12/31/15	**18,645**	**489**
Data's supplementary dividends for 2015 of TData	389,395	-
Interim dividends for 2016	360,003	3
Reversal of dividends approved by AIX	(489)	(489)
Receipt of dividends and interest on equity	(767,554)	(3)
Balance at 12/31/16	**-**	**-**
Data's supplementary dividends for 2016 of TData	384,588	-
Data's mandatory minimum dividend of 2017	323,206	-
Receipt of dividends and interest on equity of TData	(384,588)	-
Balance at 12/31/17	**323,206**	**-**

For the cash flow statement, interest on equity and dividends received from the subsidiary are allocated to “Investing Activities” group of accounts.

b) Dividends and interest on equity payable

b.1) Breakdown:

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	Company/Consolidated	
	12/31/17	12/31/16
Telefónica Latinoamérica Holding S.L.	505,750	454,583
Telefónica S.A.	609,003	547,390
SP Telecomunicações Participações Ltda	383,933	345,090
Telefónica Chile S.A.	1,070	962
Non-controlling interest	896,360	847,006
Total	**2,396,116**	**2,195,031**

b.2) Changes:

	Company/ Consolidated
Balance at 12/31/15	**2,209,362**
Supplementary dividends for 2015	1,287,223
Interim interest on equity (net of IRRF)	1,846,323
Unclaimed dividends and interest on equity	(189,471)
Payment of dividends and interest on equity	(2,966,384)
IRRF on shareholders exempt/immune from interest on equity	7,978
Balance at 12/31/16	**2,195,031**
Supplementary dividends for 2016	

	1,913,987
Interim interest on equity (net of IRRF)	2,054,143
Unclaimed dividends and interest on equity	(101,778)
Payment of dividends and interest on equity	(3,668,551)
IRRF on shareholders exempt/immune from interest on equity	3,284
Balance at 12/31/17	**2,396,116**

For the cash flow statement, interest on equity and dividends paid to shareholders are recognized in "Financing Activities".

Interest on equity and dividends not claimed by shareholders expire within three years from the initial payment date. Should dividends and interest on equity expire, these amounts are recorded in retained earnings for later distribution.

18) PROVISIONS AND CONTINGENCIES

The Company and its subsidiaries are parties to administrative and judicial proceedings and labor, tax and civil claims filed in different courts. The management of the Company and its subsidiaries, based on the opinion of its legal counsel, recognized provisions for proceedings for which an unfavorable outcome is considered probable.

Breakdown of changes in provisions for cases in which an unfavorable outcome is probable, in addition to contingent liabilities and provisions for decommissioning are as follows:

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	Company						
	Provisions for contingencies						
	Labor	Tax	Civil	Regulatory	Contingent liabilities (PPA) (1)	Provision for decommissioning (2)	Tota
Balances at 12/31/15	**1,140,492**	**2,684,924**	**965,730**	**595,028**	**286,983**	**298,751**	**5,971,908**
Additions (income) (Note 25)	588,104	126,438	674,733	123,532	-	-	1,512,807
Write-offs due to reversal (income) (Note 25)	(148,073)	(51,841)	(341,290)	(10,551)	(8,049)	(20,551)	(580,355)
Other additions	-	100,314	7,826	-	-	162,628	270,768
Write-offs due to payment	(394,473)	(146,628)	(526,853)	(2,561)	(11,240)	-	(1,081,755)
Monetary restatement	153,284	382,002	211,800	71,785	58,565	11,462	888,898
Merger (note 1 c.2)	35,236	14,597	46,284	51,701	555,486	89,541	792,845
Balances at 12/31/16	**1,374,570**	**3,109,806**	**1,038,230**	**828,934**	**881,745**	**541,831**	**7,775,116**
Additions (income) (Note 25)	804,537	215,999	745,656	271,124	-	-	2,037,316
Write-offs due to reversal (income) (Note 25)	(507,861)	(69,269)	(307,406)	(72,780)	(89,230)	-	(1,046,546)
Other additions (reversal)	-	100,252	(1,098)	-	-	20,765	119,919
Write-offs due to	(860,698)	(158,783)	(548,521)	(6,873)	-	-	(1,574,875)

payment							
Write-offs due to taxes (3)	-	(66,027)	-	-	-	-	(66,027)
Monetary restatement	143,771	342,922	120,574	83,387	53,281	12,129	756,064
Balances at 12/31/17	**954,319**	**3,474,900**	**1,047,435**	**1,103,792**	**845,796**	**574,725**	**8,000,967**
At 12/31/16							
Current	202,113	-	205,831	775,679	-	-	1,183,623
Noncurrent	1,172,457	3,109,806	832,399	53,255	881,745	541,831	6,591,493
At 12/31/17							
Current	239,229	-	201,673	994,009	-	-	1,434,911
Noncurrent	715,090	3,474,900	845,762	109,783	845,796	574,725	6,566,056

	Consolidated						
	Provisions for contingencies						
	Labor	Tax	Civil	Regulatory	Contingent liabilities (PPA) (1)	Provision for decommissioning (2)	Total
Balances at 12/31/15	**1,166,151**	**2,736,191**	**1,010,356**	**642,695**	**843,882**	**405,421**	**6,804,696**
Additions (income) (Note 25)	611,776	126,446	690,470	126,514	-	-	1,555,206
Write-offs due to reversal (income) (Note 25)	(153,758)	(53,616)	(343,016)	(10,552)	(9,088)	(32,924)	(602,954)
Other additions	958	100,314	7,897	-	-	162,628	271,797
Write-offs due to payment	(396,894)	(159,039)	(538,309)	(2,580)	(11,240)	-	(1,108,062)
Monetary restatement	154,724	379,385	211,959	72,857	58,191	11,462	888,578
Balances at 12/31/16	**1,382,957**	**3,129,681**	**1,039,357**	**828,934**	**881,745**	**546,587**	**7,809,261**
Additions (income) (Note 25)	809,754	226,125	748,620	271,124	-	-	2,055,623

Write-offs due to reversal (income) (Note 25)	(512,583)	(71,684)	(309,927)	(72,780)	(89,230)	-	(1,056,204)
Other additions (reversal)	(492)	93,596	207	-	-	20,765	114,076
Write-offs due to payment	(865,656)	(168,407)	(551,928)	(6,873)	-	-	(1,592,864)
Write-offs due to taxes (3)	-	(66,027)	-	-	-	-	(66,027)
Monetary restatement	147,334	348,393	123,487	83,387	53,281	12,129	768,011
Business combination (Note 1 c.1)	19,282	87,531	6,061	-	-	-	112,874
Balances at 12/31/17	**980,596**	**3,579,208**	**1,055,877**	**1,103,792**	**845,796**	**579,481**	**8,144,750**
At 12/31/16							
Current	202,113	-	205,831	775,679	-	-	1,183,623
Noncurrent	1,180,844	3,129,681	833,526	53,255	881,745	546,587	6,625,638
At 12/31/17							
Current	239,229	-	201,673	994,009	-	-	1,434,911
Noncurrent	741,367	3,579,208	854,204	109,783	845,796	579,481	6,709,839

(1) This refers to contingent liabilities arising from Purchase Price Allocation (PPA) generated on acquisition of the controlling interest of Vivo Participações in 2011 and GVTPart. in 2015.

(2) These refer to costs to be incurred to return the sites (locations for installation of base radio, equipment and real estate) to their respective owners in the same conditions as at the time of execution of the initial lease agreement.

(3) This refers to the amounts of tax on tax losses used to offset tax provisions arising from the Company's adherence to the Special Tax Regularization Program (PERT).

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a) Provisions and labor contingencies

	Amounts involved			
	Company		Consolidated	
Nature/Degree of Risk	12/31/17	12/31/16	12/31/17	12/31/16
Provisions - probable losses	954,319	1,374,570	980,596	1,382,957
Possible losses	210,211	275,483	261,876	293,146

Labor provisions and contingencies involve labor claims filed by former employees and outsourced employees (the latter alleging subsidiary or joint liability) claiming for, among other issues, overtime, salary equalization, post-retirement benefits, allowance for health hazard and risk premium, and matters relating to outsourcing.

The Company is also a defendant in labor claims filed by retired former employees who are covered by the Retired Employees Medical Assistance Plan ("PAMA"), who, among other issues, are demanding the cancellation of amendments to this plan. Most of these claims await a decision by the Regional Labor Court of São Paulo and the Superior Labor Court. Based on the opinion of its legal counsel and recent decisions of the courts, management considers the risk of loss in these cases as possible. No amount has been specified for these claims, since is not possible to estimate the cost to the Company in the event of loss.

In addition, the Company is party to Public Civil Actions filed by the Labor Public Prosecutor's Office, mainly in relation to the determination that the Company must cease the engagement of intermediaries to carry out its core activities. No amounts were allocated to the possible degree of risk in these Public Civil Actions in the above table, since at this stage of the proceedings it is not possible to estimate the cost to the Company in the event of loss.

b) Provisions and tax contingencies

	Amounts involved			
	Company		Consolidated	
Nature/Degree of Risk	12/31/17	12/31/16	12/31/17	12/31/16
Provisions - probable losses	683,849	3,109,806	3,579,208	3,129,681
Federal	420,128	343,353	502,153	343,353
State	231,667	226,571	231,998	226,571
Municipal	32,054	30,519	32,054	30,519
FUST, FISTEL and EBC	2,791,051	2,509,363	2,813,003	2,529,238
Possible losses	34,029,094	29,539,669	35,388,910	30,050,578
Federal	7,936,925	5,917,148	8,226,374	5,931,022
State	18,015,683	14,999,333	18,968,349	15,389,802
Municipal	542,084	852,926	548,014	853,244
FUST, FUNTTEL, FISTEL and EBC	7,534,402	7,770,262	7,646,173	7,876,510

b.1) Probable tax contingencies

Management and its legal counsel understand that losses are probable in the following federal, state, municipal and other tax proceedings (FUST, FISTEL and EBC) are described below:

Federal Taxes

The Company and/or its subsidiaries are parties to administrative and legal proceedings relating to: (i) claims resulting from the non-ratification of compensation and refund requests formulated; (ii) CIDE levied on the remittance of amounts abroad related to technical and administrative assistance and similar services, as well as royalties; (iii) IRRF on interest on equity; (iv) Social Investment Fund (Finsocial) offset amounts; and (v) additional charges to the PIS and COFINS tax base, as well as additional charges to

COFINS required by Law No. 9,718/98.

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At December 31, 2017, consolidated provisions totaled R$502,153 (R$343,353 at December 31, 2016).

State taxes

The Company and/or its subsidiaries are parties to administrative and judicial proceedings relating to: (i) disallowance of ICMS credits; (ii) telecommunications services not subject to ICMS; (iii) tax credit for challenges / disputes over telecommunication services not provided or wrongly charged (Agreement 39/01); (iv) rate difference of ICMS; (v) ICMS on rent of infrastructure necessary for internet (data) services; and (vi) outflows of goods with prices lower than those of acquisition.

At December 31, 2017, consolidated provisions totaled R$231,998 (R$226,571 at December 31, 2016).

Municipal taxes

The Company and/or its subsidiaries are parties to various municipal tax proceedings, at the judicial level, relating to: (i) Property tax (IPTU); (ii) Services tax (ISS) on equipment leasing services, non-core activities and supplementary activities; and (iii) withholding of ISS on contractors' services.

At December 31, 2017, consolidated provisions totaled R$32,054 (R$30,519 at December 31, 2016).

FUST, FISTEL and EBC

The Company and/or subsidiaries have administrative and judicial discussions related to: (i) the non-inclusion of interconnection expenses and industrial exploitation of a dedicated line in the calculation basis of FUST; (ii) exclusion of the calculation basis of the Installation Inspection Fee ("TFI") and Inspection and Operation Fee ("TFF") of the mobile stations that are not owned by it; and (iii) Contribution to the Promotion of Public Broadcasting (EBC).

At December 31, 2017, consolidated provisions totaled R$2,813,003 (R$2,529,238 at December 31, 2016).

b.2) Possible tax contingencies

Management and its legal counsel understand that losses are possible in the following federal, state, municipal and other tax proceedings (FUST, FUNTTEL, FISTEL and EBC) are described below:

Federal taxes

The Company and/or its subsidiaries are parties to various administrative and judicial proceedings, at the federal level, which are awaiting decisions in different court levels.

The most important of these proceedings are: (i) statements of dissatisfaction resulting from failure to approve requests for compensation submitted by the Company; (ii) INSS (social security contribution) (a) on compensation payment for salary losses arising from the "*Plano Verão*" and the "*Plano Bresser*"; (b) SAT, social security amounts owed to third parties (INCRA and SEBRAE) and (c) supply of meals to employees, withholding of 11% (assignment of workforce); (iii) IRRF and CIDE on the funds remitted abroad related to technical services and to administrative support and similar services, etc., and royalties; (iv) IRPJ and CSLL - disallowance of costs and sundry expenses not evidenced; (v) deduction of COFINS on swap operation losses; (vi) PIS and COFINS accrual basis versus cash basis; (vii) IRPJ FINOR, FINAN or FUNRES; (viii) IRPJ and CSLL, disallowance of expenses on goodwill of the corporate restructuring of Terra Networks and Vivo S.A., and for the takeovers of Navytree, TDBH, VivoPart. and GVTPart.; (ix) ex-tariff, cancellation of the benefits under CAMEX Resolution No. 6, increase in the import duty from 4% to 28%; (x) IPI levied on shipment of fixed access units from the Company's establishment; (xi) PIS and COFINS levied on value-added services and monthly subscription services; (xii) INSS on Stock Options - requirement of social security contributions on amounts paid to employees under the stock option plan; (xiii) IOF - required on loan transactions, intercompany loans and credit transactions; and (xiv) operating expenses allegedly non-deductible and related to estimated losses on the recoverable value of accounts receivable.

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At December 31, 2017, consolidated amounts involved totaled R$8,226,374 (R$5,931,022 at December 31, 2016).

State taxes

The Company and/or its subsidiaries are parties to various administrative and judicial proceedings, at the state level, which are awaiting decisions in different court levels.

Among these lawsuits, the following are highlighted: (i) provision of facility, utility and convenience services and rental of movable property; (ii) international calls (DDI); (iii) reversal of ICMS credit related to the acquisition of items of property, plant and equipment and payment of ICMS in interstate transfers of property, plant and equipment between branches; (iv) reversal of previously unused ICMS credits; (v) service provided outside São Paulo state with ICMS paid to São Paulo State; (vi) co-billing; (vii) tax substitution with a fictitious tax base (tax guideline); (viii) use of credits related to acquisition of electric power; (ix) secondary activities, value added and supplementary services; (x) tax credits related to opposition/challenges regarding telecommunications services not provided or mistakenly charged (Agreement 39/01); (xi) deferred collection of ICMS - interconnection (DETRAF - Traffic and Service Provision Document); (xii) credits derived from tax benefits granted by other states; (xiii) disallowance of tax incentives related to cultural projects; (xiv) transfers of assets among business units owned by the Company; (xv) communications service tax credits used in provision of services of the same nature; (xvi) card donation for prepaid service activation; (xvii) reversal of credit from return and free lease in connection with assignment of networks (used by the Company itself and exemption of public bodies); (xviii) DETRAF fine; (xix) ICMS on own consumption; (xx) ICMS on exemption of public bodies; (xxi) ICMS on amounts given by way of discounts; (xxii) new tax register bookkeeping without prior authorization by tax authorities; (xxiii) ICMS on monthly subscription; (xxiv) tax on unmeasured services; and (xxv) ICMS on advertising services.

At December 31, 2017, consolidated amounts involved totaled R$18,968,349 (R$15,389,802 at December 31, 2016).

Municipal taxes

The Company and/or its subsidiaries are parties to various administrative and judicial proceedings, at the municipal level, which are awaiting decisions in different court levels.

The most important of these proceedings are: (i) ISS on non-core activity, value-added and supplementary services; (ii) ISS withholding at source; (iii) IPTU; (iv) land use tax; (v) various municipal charges; (vi) charge for use of mobile network and lease of infrastructure; (vii) advertising services; (viii) services provided by third parties; (ix) advisory services in corporate management provided by Telefónica Latino América Holding; (x) ISS on call identification and mobile phone licensing services; (xi) ISS on full-time services, provisions, returns and cancelled tax receipts; and (xii) ISS on data processing and antivirus congeners.

At December 31, 2017, consolidated amounts involved totaled R$548,014 (R$853,244 at December 31, 2016).

FUST, FUNTTEL, FISTEL and EBC

Universal Telecommunications Services Fund ("FUST")

Writs of mandamus were filed seeking the right to not include revenues with interconnection and Industrial Use of Dedicated Line (EILD) in FUST tax base, according to Abridgment No. 7 of December 15, 2005, as it does not comply with the provisions contained in sole paragraph of article 6 of Law No. 9,998/00, which are awaiting a decision from Higher Courts.

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Various delinquency notices were issued by ANATEL in the administrative level to collect charges on interconnections, EILD and other revenues not earned from the provision of telecommunication services.

At December 31, 2017, consolidated amounts involved totaled R$4,316,571 (R$4,089,065 at December 31, 2016).

Fund for Technological Development of Telecommunications ("FUNTTEL")

Proceedings filed for recognition of the right not to include interconnection revenues and any others arising from the use of resources that are part of the networks in FUNTTEL calculation basis, as determined by Law 10,052/00 and Decree No. 3,737/01, thus avoiding the improper application of Article 4, paragraph 5, of Resolution 95/13.

Several notifications of debits drawn up by the Ministry of Communications in administrative actions for constitution of the tax credit related to the interconnection, network resources and other revenues that do not originate from the provision of telecommunication services.

At December 31, 2017, consolidated amounts involved totaled R$493,867 (R$1,190,637 at December 31, 2016).

Telecommunications Inspection Fund ("FISTEL")

Judicial actions for the collection of TFI on: (a) extensions of the term of validity of the licenses for use of telephone exchanges associated with the operation of the fixed switched telephone service; and (b) extensions of the period of validity of the right to use radiofrequency associated with the operation of the telephone service personal mobile service.

At December 31, 2017, consolidated amounts involved totaled R$2,556,443 (R$2,352,000 at December 31, 2016).

Contribution to Empresa Brasil de Comunicação (“EBC”)

The Union of Telephony and Cellular and Personal Mobile Service Companies ("Sinditelebrasil") judicially discusses, on behalf of the associates, the Contribution to the Promotion of Public Broadcasting to EBC, created by Law 11,652/08.

Several notifications of debit entry were drawn up by ANATEL at the administrative level for the constitution of the tax credit.

At December 31, 2017, consolidated amounts involved totaled R$279,292 (R$244,808 at December 31, 2016).

c) Provisions civil contingencies

	Amounts involved			
	Company		Consolidated	
Nature/Degree of Risk	12/31/17	12/31/16	12/31/17	12/31/16
Provisions - probable losses	1,047,435	1,038,230	1,055,877	1,039,357
Possible losses	2,840,894	2,573,459	2,858,796	2,574,836

c.1) Provisions for probable civil losses

Management and its legal counsel understand that losses are probable in the following civil proceedings:

• The Company and/or its subsidiaries are parties to proceedings involving rights to the supplementary amounts from shares calculated on network expansion plans since 1996 (supplement of share proceedings). These proceedings are at different stages: lower courts, court of justice and high court of

justice. At December 31, 2017, consolidated provisions totaled R$324,232 (R$256,276 at December 31, 2016).

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• The Company and/or its subsidiaries are parties to various civil proceedings related to consumers at the administrative and judicial level, relating to the non-provision of services and/or products sold. At December 31, 2017, consolidated provisions totaled R$296,169 (R$386,699 at December 31, 2016).

• The Company and/or its subsidiaries are parties to various civil proceedings of a non-consumer nature at administrative and judicial levels, all arising in the ordinary course of business. At December 31, 2017, consolidated provisions totaled R$435,476 (R$396,382 at December 31, 2016).

c.2) Civil contingencies assessed as possible losses

Management and its legal counsel understand that losses are possible in the following civil proceedings:

• Collective Action filed by SISTEL Participants' Association (ASTEL) in the state of São Paulo, in which SISTEL associates in the state of São Paulo challenge the changes made in the health insurance plan for retired employees ("PAMA") and claim for the reestablishment of the prior "status quo". This proceeding is still in the appeal phase, and awaits a decision on the Interlocutory Appeal filed by the Company against the decision on possible admission of the appeal to higher and supreme courts filed in connection with the Court of Appeals' decision, which changed the decision rendering the matter groundless. The amount cannot be estimated, and the claims cannot be settled due to their unenforceability because it entails the return to the prior plan conditions.

• Civil Class Actions filed by ASTEL, in the state of São Paulo, and by the Brazilian National Federation of Associations of Retirees, Pensioners and Pension Fund Members of the Telecommunications Industry (FENAPAS), both against SISTEL, the Company and other carriers, in order to annul the spin-off of the PBS private pension plan, alleging, in short, the "windup of the supplementary private pension plan of the SISTEL Foundation", which led to various specific mirror PBS plans, and corresponding allocation of funds from technical surplus and tax contingencies existing at the time of the spin-off. The amount cannot be

estimated, and the claims cannot be settled due to their unenforceability because this involves the return of the spun-off assets of SISTEL relating to telecommunication carriers of the former Telebrás System.

- The Company is party to other civil claims, at several levels, related to service rendering rights. Such claims have been filed by individual consumers, civil associations representing consumer rights or by the Bureau of Consumer Protection (PROCON), as well as by the Federal and State Public Prosecutor's Office. The Company is also party to other claims of several types related to the ordinary course of business. At December 31, 2017, the consolidated amount totaled R$2,827,071 (R$2,559,252 at December 31, 2016).

- TGLog (company controlled by TData) is a party to the civil enforcement action process in the 3rd Civil Court of Barueri - SP for the allegation of contractual noncompliance with the transportation of goods. At December 31, 2017, the amount was R$178 (R$1,377 at December 31, 2016).

- Terra Networks (company controlled by TData) is a party to: (i) supplier action related to the transmission of events; (ii) PROCON fine (annulment action); (iii) indemnification action related to the use of content; (iv) ECAD action on copyright collection; and (v) claim actions filed by former subscribers regarding unrecognized collection, collection of undue value and contractual noncompliance. At December 31, 2017, the amount was R$17,340.

- The Company has received notices regarding noncompliance with the Customer Service (SAC) Decree. The Company is currently party to various lawsuits (administrative and legal proceedings). At December 31, 2017 and at December 31, 2016, the amount was R$14,207.

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• Intelectual Property: Lune Projetos Especiais Telecomunicação Comércio e Ind. Ltda. (Lune), a Brazilian company, filed an action on November 20, 2001 against 23 wireless carriers claiming to own the patent for caller ID and the trademark "Bina". The purpose of that lawsuit was to interrupt provision of such service by carriers and to seek indemnification equivalent to the amount paid by consumers for using the service.

An unfavorable decision was handed down determining that the Company should refrain from selling mobile phones with Caller ID service ("Bina"), subject to a daily fine of R$10,000.00 (Ten thousand reais) in case of noncompliance. Furthermore, according to that decision, the Company must pay indemnification for royalties, to be calculated in settlement. Motions for Clarification were proposed by all parties and Lune's motions for clarification were accepted since an injunctive relief in this stage of the proceedings was deemed applicable. A bill of review appeal was filed in view of the current decision which granted a stay of execution suspending that unfavorable decision until final judgment of the review. A bill of review was filed in view of the sentence handed down on June 30, 2016, by the 4th Chamber of the Court of Justice of the Federal District, in order to annul the lower court sentence and remit the proceedings back to the lower court for a new examination. At the present time, we await the judgment of the regimental grievance filed against a decision prior to the judgment, which rejected the application of the former lawyers of Lune as assistants of the author. There is no way to determine the extent of potential liabilities with respect to this claim.

• The Company and other wireless carriers figure as defendants in several lawsuits filed by the Public Prosecutor's Office and consumer associations to challenge imposition of a period to use prepaid minutes. The plaintiffs allege that the prepaid minutes should not expire after a specific period. Conflicting decisions were handed down by courts on the matter, even though the Company understands that its criteria for the period determination comply with ANATEL standards.

d) Provisions and regulatory contingencies

Amounts involved

Nature/Degree of Risk	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Provisions - probable losses	1,103,792	828,934	1,103,792	828,934
Possible losses	5,065,907	5,018,205	5,065,907	5,018,205

d.1) Provisions for regulatory contingencies assessed as probable losses

The Company is party to administrative proceedings against ANATEL, filed based on an alleged failure to meet sector regulations, and to judicial proceedings to contest sanctions applied by ANATEL at the administrative level. At December 31, 2017, consolidated provisions totaled R$1,103,792 (R$828,934 at December 31, 2016).

d.2) Regulatory contingencies assessed as possible losses

According to the Company's management and legal counsel, the likelihood of loss of the following regulatory civil proceedings is possible:

- The Company is party to administrative proceedings filed by ANATEL alleging noncompliance with the obligations set forth in industry regulations, as well as legal claims which discuss the sanctions applied by ANATEL at the administrative level. At December 31, 2017, the consolidated amount was R$5,065,907 (R$5,018,205 at December 31, 2016).

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- Administrative and judicial proceedings discussing payment of a 2% charge on interconnection services revenue arising from the extension of right of use of SMP related radio frequencies. Under clause 1.7 of the authorization term that grants right of use of SMP related radio frequencies, the extension of right of use of such frequencies entails payment every two years, during the extension period (15 years) of a 2% charge calculated on net revenues from the service provider's Basic and Alternative Plans of the service company, determined in the year before that of payment.

However, ANATEL determined that in addition to revenues from Service Plans, the charge corresponding to 2% should also be levied on interconnection revenues and other operating revenues, which is not stipulated in clause 1.7 of referred Authorization Term.

Considering, based on the provisions of the Authorization Terms, that revenue from interconnection services should not be included in the calculation of the 2% charge for radiofrequency use right extension, the Company filed administrative and legal proceedings challenging these charges, based on ANATEL's position.

d.3) Term of Conduct Adjustment ("TAC")

The Board of Directors of ANATEL approved, on October 27, 2016, the Company's TAC. On September 27, 2017, this instrument was judged by the Brazilian Court of Audit ("TCU"), with the instruction of recommendations and determinations to ANATEL for the continuation of the analysis of the instrument.

d) Guarantees

The Company and its subsidiaries granted guarantees for tax, civil and labor proceedings, as follows:

	Consolidated					
	12/31/17			12/31/16		
	Property and equipment	Judicial deposits and garnishments	Letters of guarantee	Property and equipment	Judicial deposits and garnishments	Letters of guarantee
Civil, labor and tax	176,591	6,663,805	1,669,476	203,600	6,351,566	1,948,088
Total	**176,591**	**6,663,805**	**1,669,476**	**203,600**	**6,351,566**	**1,948,088**

At December 31, 2017, in addition to the guarantees presented above, the Company and its subsidiaries had amounts under short-term investment frozen by courts (except for loan-related investments) in the consolidated amount of R$69,764 (R$67,393 at December 31, 2016).

19) DEFERRED REVENUE

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Services and goods (1)	301,292	389,706	301,292	389,706
Disposal of PP&E (2)	165,162	227,397	165,162	227,397
Activation revenue (3)	7,477	44,117	7,959	44,914
Customer loyalty program (4)	50,354	56,210	50,354	56,210
Government grants (5)	115,379	133,300	115,379	133,300
Other (6)	81,466	89,544	83,052	90,112
Total	**721,130**	**940,274**	**723,198**	**941,639**
Current	370,493	428,488	372,561	429,853
Noncurrent	350,637	511,786	350,637	511,786

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(1) This refers mainly to the balances of revenues from recharging prepaid services, which are recognized in income as services are provided to customers. It includes the amount of the agreement the Company entered into for industrial use of its mobile network by a different SMP operator in Regions I, II and III of the general authorizations plan, which is intended solely for the rendering of SMP services by the operator for its customers.

(2) Includes the net balances of the residual values from sale of non-strategic towers and rooftops, which are transferred to income as the conditions for recognition are fulfilled.

(3) This refers to the deferred activation revenue (fixed) recognized in income over the estimated period in which a customer remains in the base.

(4) This refers to points earned under the Company's loyalty program, which enables customers to accumulate points by paying bills relating to use of services offered. The balance represents the Company's estimate of customers exchanging points for goods and / or services in the future.

(5) This refers to: i) government subsidy arising from funds obtained from BNDES credit lines to be used in the acquisition of domestic equipment, which have been amortized over the useful life cycle of the equipment; and ii) subsidies arising from projects related to state taxes, which are being amortized over the contractual period.

(6) Includes amounts of the reimbursement for costs for leaving radio frequency sub-bands 2,500MHz to 2,690MHz due to cancellation of the Multichannel Multipoint Distribution Service (MMDS).

20) LOANS, FINANCING AND DEBENTURES

a) <u>Breakdown</u>

	Company / Consolidated Information as of December 31, 2017				12/31/17			12/31/16	
	Currency	Annual interest rate	Maturity	Garantees	Current	Non-current	Total	Current	Non-cu
<u>Local currency</u>					**1,478,656**	**2,237,192**	**3,715,848**	**1,480,382**	**2,901**
Financial Institutions (a.1)					**820,468**	**1,456,624**	**2,277,092**	**711,848**	**2,158**
BNDES FINEM	URTJLP	TJLP+ 0 to 4.08%	7/15/2019	(1)	371,946	213,958	585,904	363,734	567
BNDES FINEM	URTJLP			(3)	-	-	-	29,319	
BNDES FINEM	URTJLP	TJLP+ 0 to 3.38%	8/15/2020	(3)	184,007	303,560	487,567	182,737	480
BNDES FINEM	R$	5.00%	11/15/2019	(3)	14,654	13,377	28,031	14,686	27
BNDES FINEM	URTJLP	TJLP+ 0 to 3.12%	1/15/2023	(3)	101,879	413,552	515,431	7,596	499
BNDES FINEM	R$	4.00% to 6.00%	1/15/2023	(3)	37,061	132,092	169,153	12,320	163
BNDES FINEM	R$	Selic Acum. D-2 + 2.32%	1/15/2023	(3)	70,426	305,952	376,378	1,408	340
BNDES PSI	R$	2.5% to 5.5%	1/15/2023	(2)	25,405	19,413	44,818	92,508	44
BNB	R$	7.06% to 10%	8/18/2022	(4)	15,090	54,720	69,810	7,540	34
Suppliers (a.2)	**R$**	**101.4% to 109.4% of CDI**	**12/31/2018**		607,152	-	607,152	722,591	
Finance lease (a.3)	**R$**	**IPCA and IGP-M**	**8/31/2033**		51,036	334,424	385,460	45,943	328
	R$	**Selic**				446,144			414

Contingent Consideration (a.4)					-		446,144	-	
<u>Foreign Currency</u>					**142,299**	**82,955**	**225,254**	**1,062,593**	**225**
Financial Institutions (a.1)					**142,299**	**82,955**	**225,254**	**1,062,593**	**225**
BNDES FINEM	UMBND	ECM + 2.38%	7/15/2019	(1)	142,299	82,955	225,254	136,850	225
Resolution 4131 - Scotiabank and Bank of America	US$				-	-	-	925,743	
Total					**1,620,955**	**2,320,147**	**3,941,102**	**2,542,975**	**3,126**

(1) Guarantee in receivables relating to 15% of the outstanding debt balance or four times the largest installment, whichever is higher.

(2) Pledge of financed assets.

(3) Assignment of receivables corresponding to 20% of outstanding debt balance or 1 time the last installment of sub-credit facility "A" (UMIPCA) plus 5 times the last installment of each of the other sub-credit facilities, whichever is greater.

(4) Bank guarantee provided by Banco Safra in an amount equivalent to 100% of the outstanding financing debt balance. Setting up a liquidity fund represented by financial investments in the amount equivalent to three installments of repayment referenced to the average post-grace period performance. Balances were R$11,722 and R$10,773 at December 31, 2017 and 2016, respectively.

a.1) <u>Loans and financing</u>

Some financing agreements with the BNDES described above, have lower interest rates than those prevailing on the market. These operations fall within the scope of IAS 20 / CPC 7 and thus the subsidies granted by BNDES were adjusted to present value deferred in accordance with the useful lives of the financed assets, resulting in a balance until December 31, 2017 as of R$32,155 (R$47,346 at December

31, 2016), note 19.

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a.2) Financing - Suppliers

Under bilateral agreements with suppliers, the Company obtained extension of the terms for payment of trade accounts payable at a cost based on fixed CDI rate for the corresponding periods, with the net cost equivalent to between 101.4% to 109.4% of CDI (108.4% of CDI as of December 31, 2016).

a.3) Finance lease

The Company has agreements classified as finance lease agreements in the condition of lessee relate to: (i) lease of towers and rooftops arising from sale and finance leaseback transactions; (ii) lease of Built to Suit ("BTS") sites to install antennas and other equipment and transmission facilities; (iii) lease of information technology equipment and; (iv) lease of infrastructure and transmission facilities associated with the power transmission network. The net carrying amount of the assets has remained unchanged until sale thereof, and a liability is recognized corresponding to the present value of mandatory minimum installments of the agreement.

The amounts recorded in property, plant and equipment are depreciated over the estimated useful lives of the assets or the lease term, whichever is shorter.

The balance of amounts payable relating to aforementioned transactions comprises the following effects:

	Company / Consolidated	
	12/31/17	12/31/16
Nominal value payable	787,147	831,479

Unrealized financial expenses	(401,687)	(457,051)
Present value payable	**385,460**	**374,428**
Current	51,036	45,943
Noncurrent	334,424	328,485

Aging list of finance lease payable at December 31, 2017 is as follows:

	Company / Consolidated	
	Nominal value payable	Present value payable
Up to 1 year	57,865	51,036
From 1 to 5 years	201,057	144,963
Over five years	528,225	189,461
Total	**787,147**	**385,460**

There are no unsecured residual values resulting in benefits to the lessor or contingent payments recognized as revenue at December 31, 2017 and 2016.

a.4) Contingent consideration

As part of the Purchase and Sale Agreement and Other Covenants executed by and between the Company and Vivendi to acquire all shares in GVTPart (Note 1c.3), a contingent consideration relating to the judicial deposit made by GVT for the monthly installments of deferred income tax and social contribution on goodwill amortization was agreed, arising from the corporate restructuring process completed by GVT in 2013. If these funds are realized (being reimbursed, refunded, or via netting), they will be returned to Vivendi, as long as they are obtained in a final unappeasable decision. Reimbursement will be made within 15 years and this amount is subject to monthly restatement at the SELIC rate.

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b) Debentures

Information on the debentures at December 31, 2017 and 2016:

							Company / Consolidated		
	Information as of December 31, 2017						12/31/17		
			Amounts						
Issue	Issue date	Maturity	Issued	Outstanding	Issue value	Remuneration p.a.	Current	Non-current	T
4th issue – Series 3	10/15/2009	10/15/2019	810,000	23,557	810,000	IPCA+4.00%	312	40,010	40,
1st issue – Minas Comunica	12/17/2007	7/5/2021	5,550	5,550	55,500	IPCA+0.50%	24,088	72,264	96,
3rd issue	9/10/2012	9/10/2017	200,000	200,000	2,000,000	100% of CDI + 0.75%	-	-	
4th issue	4/25/2013	4/25/2018	130,000	130,000	1,300,000	100% of CDI + 0.68%	1,317,513	-	1,317,
5th issue	2/8/2017	2/8/2022	200,000	200,000	2,000,000	108.25% of CDI	64,397	1,996,517	2,060,
6th issue	11/27/2017	11/27/2020	100,000	100,000	1,000,000	100% of CDI + 0.24%	6,176	999,462	1,005,
Total							**1,412,486**	**3,108,253**	**4,520,**

Transaction costs in connection with the 4th, 5th and 6th issues, totaling R$5,422 at December 31, 2017 (R$495 at December 31, 2016, 3th and 4th issues), were allocated as a reduction of liabilities as costs to be incurred and are recognized as financial expenses, according to the contractual terms of each issue.

c) Repayment schedule

At December 31, 2017, breakdown of noncurrent loans, financing, finance lease, debentures and contingent consideration by year of maturity is as follows:

	Company / Consolidated				
Year	Loans and financing	Debentures	Finance lease	Contingent Consideration	Total
2019	737,548	64,098	43,810	-	845,456
2020	353,587	1,024,088	37,140	-	1,414,815
2021	226,244	1,024,088	32,705	-	1,283,037
2022	204,427	995,979	31,308	-	1,231,714
2023 onwards	17,773	-	189,461	446,144	653,378
Total	**1,539,579**	**3,108,253**	**334,424**	**446,144**	**5,428,400**

d) Covenants

There are loans and financing with BNDES and debentures with specific covenants involving a penalty in the event of breach of contract. A breach of contract provided for in the agreements with the institutions listed above is characterized as noncompliance with covenants (analyzed on a quarterly, half-yearly or yearly basis), being a breach of a contractual clause, resulting in the early maturity of the contract.

At December 31, 2017 and 2016 all economic and financial indexes established in existing contracts have been achieved.

e) Changes

Changes in loans and financing, debentures, finance lease agreements and contingent considerations are as follows:

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	Company					
	Loans and financing	Debentures	Finance lease	Financing - Suppliers	Contingent Consideration	Total
Balance at 12/31/15	**3,190,529**	**3,544,714**	**271,530**	**1,113,244**	**377,721**	**8,497,738**
Additions	466,629	-	61,866	666,085	-	1,194,580
Government grants (Note 19)	(12,040)	-	-	-	-	(12,040)
Financial charges (Note 26)	385,240	486,178	62,242	49,933	37,012	1,020,605
Issue costs	-	495	-	-	-	495
Foreign exchange variation (Note 26)	(272,795)	-	-	-	-	(272,795)
Write-offs (payments)	(1,132,214)	(477,080)	(43,285)	(1,106,671)	-	(2,759,250)
Merger (Note 1 c.2)	1,532,666	-	22,075	-	-	1,554,741
Balance at 12/31/16	**4,158,015**	**3,554,307**	**374,428**	**722,591**	**414,733**	**9,224,074**
Additions	55,876	3,000,000	13,462	571,444	-	3,640,782
Government grants (Note 19)	(1,581)	-	-	-	-	(1,581)
Financial charges (Note 26)	300,153	485,295	45,265	70,603	31,411	932,727
Issue costs	-	(4,926)	-	-	-	(4,926)
Foreign exchange variation (Note 26)	15,846	-	-	-	-	15,846
Write-offs (payments)	(2,025,963)	(2,513,937)	(47,695)	(757,486)	-	(5,345,081)
Balance at 12/31/17	**2,502,346**	**4,520,739**	**385,460**	**607,152**	**446,144**	**8,461,841**

	Consolidated					
	Loans and financing	Debentures	Finance lease	Financing - Suppliers	Contingent Consideration	Total
Balance at 12.31.15	**4,773,489**	**3,544,714**	**296,684**	**1,228,682**	**377,721**	**10,221,290**
Additions	466,629	-	61,866	666,085	-	1,194,580
Government grants (Note 19)	(12,040)	-	-	-	-	(12,040)
Financial charges (Note 26)	424,867	486,178	63,003	50,038	37,012	1,061,098
Issue costs	-	495	-	-	-	495
Foreign exchange variation (Note 26)	(272,795)	-	-	-	-	(272,795)
Write-offs (payments)	(1,222,135)	(477,080)	(47,125)	(1,222,214)	-	(2,968,554)
Balance at 12.31.16	**4,158,015**	**3,554,307**	**374,428**	**722,591**	**414,733**	**9,224,074**
Additions	55,876	3,000,000	13,462	571,444	-	3,640,782
Government grants (Note 19)	(1,581)	-	-	-	-	(1,581)
Financial charges (Note 26)	300,153	485,295	45,265	70,603	31,411	932,727
Issue costs	-	(4,926)	-	-	-	(4,926)
Foreign exchange variation (Note 26)	15,846	-	-	-	-	15,846
Write-offs (payments)	(2,025,963)	(2,513,937)	(47,695)	(757,486)	-	(5,345,081)
Balance at 12.31.17	**2,502,346**	**4,520,739**	**385,460**	**607,152**	**446,144**	**8,461,841**

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The following is a summary of funding and payments made during the year ended December 31, 2017.

		Write-offs (payments)		
	Additions	Principal	Financial charges	Total
Loans and financing	**55,876**	**(1,781,261)**	**(244,702)**	**(2,025,963)**
BNDES	15,998	(825,256)	(213,752)	(1,039,008)
BNB	39,878	(11,808)	(4,073)	(15,881)
Resolution 4131 - Scotiabank and Bank of America	-	(944,197)	(26,877)	(971,074)
Debêntures	**3,000,000**	**(2,000,000)**	**(513,937)**	**(2,513,937)**
4th issue – Series 3	-	-	(1,522)	(1,522)
3rd issue	-	(2,000,000)	(246,817)	(2,246,817)
4th issue	-	-	(151,152)	(151,152)
5th issue	2,000,000	-	(114,446)	(114,446)
6th issue	1,000,000	-	-	-
Suppliers	571,444	(668,512)	(88,974)	(757,486)
Finance lease	13,462	(35,722)	(11,973)	**(47,695)**
Total	**3,640,782**	**(4,485,495)**	**(859,586)**	**(5,345,081)**

Loans and Financing

Banco do Nordeste ("BNB")

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

BNDES FINEM

Contract 14.2.1192.1: On December 30, 2014, a financing line of R$1,000,293 was contracted, with rates of: (i) TJLP + 0 to 3.12% p.a; (ii) 4% p.a; (iii) Selic + 2.32% p.a, total term of 8 years, with a grace period ending on January 15, 2018. After the grace period, interest and principal repayments will be paid in 60 monthly and successive installments; and (iv) 6% a.a. total term of 7 years, with a grace period ending on January 15, 2017. After the grace period, interest and principal repayments will be paid in 60 monthly and successive installments.
During 2017, three disbursements related to this agreement were made in the amount of R$15,998.

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

Debentures

5th Issue

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

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

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

6th Issue

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

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

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

21) OTHER LIABILITIES

	Company		Consolidated	
	12/31/17	12/31/16	12/31/17	12/31/16
Authorization licenses (1)	258,742	1,048,523	258,742	1,048,523

Liabilities with related parties (Note 28)	139,173	145,332	125,987	112,358
Payment for license renewal (2)	167,536	215,154	167,536	215,154
Third-party withholdings (3)	126,361	222,696	144,593	227,685
Surplus from post-employment benefit plans (Note 30)	522,498	327,670	531,938	327,670
Amounts to be refunded to subscribers	187,826	166,644	189,380	168,708
Other liabilities	70,108	90,815	72,893	92,447
Total	**1,472,244**	**2,216,834**	**1,491,069**	**2,192,545**
Current	700,251	1,641,926	718,468	1,640,757
Noncurrent	771,993	574,908	772,601	551,788

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

(2) This refers to the cost of renewing STFC and SMP licenses.

(3) This refers to payroll withholdings and taxes withheld from pay-outs of interest on equity and on provision of services.

22) EQUITY

a) Capital

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

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

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

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

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

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

At December 31, 2017

	Common Shares		**Preferred Shares**		**Grand Total**	
Shareholders	**Number**	**%**	**Number**	**%**	**Number**	**%**
Controlling Group	**540,033,264**	**94.47%**	**704,207,855**	**62.91%**	**1,244,241,119**	**73.58%**
Telefónica Latinoamérica Holding, S.L.	46,746,635	8.18%	360,532,578	32.21%	407,279,213	24.09%
Telefónica S.A.	198,207,608	34.67%	305,122,195	27.26%	503,329,803	29.76%

SP Telecomunicações Participações Ltda	294,158,155	51.46%	38,537,435	3.44%	332,695,590	19.67%
Telefónica Chile S.A.	920,866	0.16%	15,647	0.00%	936,513	0.06%
Other shareholders	**29,320,789**	**5.13%**	**415,131,868**	**37.09%**	**444,452,657**	**26.28%**
Treasury Shares	**2,290,164**	**0.40%**	**983**	**0.00%**	**2,291,147**	**0.14%**
Total shares	**571,644,217**	**100.00%**	**1,119,340,706**	**100.00%**	**1,690,984,923**	**100.00%**
Treasury Shares	(2,290,164)		(983)		(2,291,147)	
Total shares outstanding	**569,354,053**		**1,119,339,723**		**1,688,693,776**	

At December 31, 2016

	Common Shares		**Preferred Shares**		**Grand Total**	
Shareholders	**Number**	**%**	**Number**	**%**	**Number**	**%**
Controlling Group	**540,033,264**	**94.47%**	**704,207,855**	**62.91%**	**1,244,241,119**	**73.58%**
Telefónica Latinoamérica Holding, S.L.	46,746,635	8.18%	360,532,578	32.21%	407,279,213	24.09%
Telefónica S.A.	198,207,608	34.67%	305,122,195	27.26%	503,329,803	29.76%
SP Telecomunicações Participações Ltda	294,158,155	51.46%	38,537,435	3.44%	332,695,590	19.67%
Telefónica Chile S.A.	920,866	0.16%	15,647	0.00%	936,513	0.06%
Other shareholders	**29,320,789**	**5.13%**	**415,132,512**	**37.09%**	**444,453,301**	**26.28%**
Treasury Shares	**2,290,164**	**0.40%**	**339**	**0.00%**	**2,290,503**	**0.14%**
Total shares	**571,644,217**	**100.00%**	**1,119,340,706**	**100.00%**	**1,690,984,923**	**100.00%**
Treasury Shares	(2,290,164)		(339)		(2,290,503)	
Total shares outstanding	**569,354,053**		**1,119,340,367**		**1,688,694,420**	

b) Capital reserves

b.1) Special goodwill reserve

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

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b.2) Other capital reserves

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

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

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

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

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

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

(5) Regarding the effects of the acquisition of shares of non-controlling shareholders that, with the adoption of IFRS 10 / CPCs 35 and 36, would be recorded in equity when there is no change in the shareholding control.

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

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

b.3) Treasury shares

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

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

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	Shares			In thousands of reais
Treasury stock	Common shares	Preferred shares	Total	
At 12.31.15	**2,290,164**	**734**	**2,290,898**	**(87,805)**
Transfer of lawsuits concerning judicial proceedings (1)	-	(395)	(395)	15
At 12.31.16	**2,290,164**	**339**	**2,290,503**	**(87,790)**
Acquisition of shares in the financial market (2)	**-**	**706**	706	**(32)**
Transfer of lawsuits concerning judicial proceedings (1)	**-**	(62)	(62)	**2**
At 12.31.17	**2,290,164**	**983**	**2,291,147**	**(87,820)**

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

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

c) Income reserves

The amounts of the income reserves are distributed as follows:

	Legal reserve (1)	Expansion and Modernization Reserve (2)	Tax incentives (3)	Total
At 12.31.15	**1,703,643**	**700,000**	**6,928**	**2,410,571**

Reversal of reserves	-	(700,000)	-	(700,000)
Recording of reserves	204,262	550,000	10,141	764,403
At 12.31.16	**1,907,905**	**550,000**	**17,069**	**2,474,974**
Reversal of reserves	-	(550,000)	-	(550,000)
Recording of reserves	230,439	297,000	10,815	538,254
At 12.31.17	**2,138,344**	**297,000**	**27,884**	**2,463,228**

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

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

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

d) Dividend and interest on equity

d.1) Additional dividends proposed for 2016

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

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d.2) Remuneration to shareholders

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

	2017	2016
Net income for the year	4,608,790	4,085,242
Allocation to legal reserve	(230,439)	(204,262)
Total	**4,378,351**	**3,880,980**
(-) Tax incentives - not distributable	(10,815)	(10,141)
Adjusted net income	**4,367,536**	**3,870,839**
Dividend and IOE distributed for the year:	**2,416,639**	**2,172,145**
Interest on equity (gross)	2,416,639	2,172,145
Balance of unallocated net income	**1,950,897**	**1,698,694**
(+) Reversal special reserve for modernization and expansion	550,000	700,000
(+) Expired equity instruments	101,778	221,559
(+-) Actuarial gains (losses) recognized and effect of limitation of surplus plan assets, net of taxes and other changes	(113,811)	(156,266)
Income available to be distributed	**2,488,864**	**2,463,987**
Proposal for Distributions:		
Special reserve for modernization and expansion	297,000	550,000
Additional proposed dividends	2,191,864	1,913,987
Total	**2,488,864**	**2,463,987**
Mandatory minimum dividend - 25% of adjusted net income	**1,091,884**	**967,710**

The manner proposed by management for payment of dividends was:

For 2017: The remaining unallocated balance of net income for the year ended December 31, 2017, amounting to R$1,950,897, plus equity instruments lapsed in 2017 amounting to R$101,778 and reversal special reserve for expansion and modernization of 2016 amounting to R$550,000 and less other comprehensive income amounting to R$113,811, totaling R$2,488,864. The amount of R$297,000 was

classified as "Special Reserve for Expansion and Modernization" and R$2,191,864 was classified as additional proposed dividends in accordance with the management proposal for allocation of income for the year, submitted and approved at the General Shareholders' Meeting.

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

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

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

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

2017

Dates			Gross Amount			Net Value			Amount per Share (1)	
Approval	Credit	Beginning of Payment	Common	Preferred (2)	Total	Common	Preferred (2)	Total	Common	Preferred (2)
02/13/17	02/24/17	Until 12/31/18	56,916	123,084	180,000	48,379	104,621	153,000	0.084970	0.093467
03/20/17	03/31/17	Until 12/31/18	110,669	239,331	350,000	94,069	203,431	297,500	0.165220	0.181742
06/19/17	06/30/17	Until 12/31/18	30,039	64,961	95,000	25,533	55,217	80,750	0.044845	0.049330
09/18/17	09/29/17	Until 12/31/18	96,440	208,560	305,000	81,974	177,276	259,250	0.143978	0.158375
12/14/17	12/26/17	Until 12/31/18	470,072	1,016,567	1,486,639	399,561	864,082	1,263,643	0.701779	0.771957

Total					
764,136	**1,652,503**	**2,416,639**	**649,516**	**1,404,627**	**2,054,143**

2016

Dates			Gross Amount			Net Value			Amount per Sha (1)	
Approval	Credit	Beginning of Payment	Common	Preferred (2)	Total	Common	Preferred (2)	Total	Common	Prefe
02/19/16	02/29/16	08/22/17	63,239	136,761	200,000	53,753	116,247	170,000	0.094411	0.103
03/18/16	03/31/16	08/22/17	106,559	230,441	337,000	90,575	195,875	286,450	0.159083	0.174
04/18/16	04/29/16	08/22/17	69,563	150,437	220,000	59,129	127,871	187,000	0.103853	0.114
06/17/16	06/30/16	08/22/17	50,908	110,092	161,000	43,272	93,578	136,850	0.076001	0.083
09/19/16	09/30/16	08/22/17	205,528	444,472	650,000	174,699	377,801	552,500	0.306837	0.337
12/19/16	12/30/16	12/13/17	191,029	413,116	604,145	162,374	351,149	513,523	0.285191	0.313
Total			**686,826**	**1,485,319**	**2,172,145**	**583,802**	**1,262,521**	**1,846,323**		

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

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

d.3) Unclaimed dividends and interest on equity

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

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

e) Other comprehensive income

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

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

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

Changes in other comprehensive income are as follows:

	Consolidated			
	Financial instruments available for sale	Derivative transactions	Currency translation effects - foreign investments	Total
Balances at 12/31/15	**(8,936)**	**379**	**34,025**	**25,468**
Exchange variation	-	-	(17,232)	(17,232)
Gains from future contracts	-	42	-	42
Reclassification of gains cash flow hedge for capex	-	3,128	-	3,128
Gains on financial assets available for sale	55	-	-	55
Balances at 12/31/16	**(8,881)**	**3,549**	**16,793**	**11,461**
Exchange variation	-	-	11,239	11,239
Losses from future contracts	-	(1,595)	-	(1,595)
Gains on financial assets available for sale	223	-	-	223
Balances at 12/31/17	**(8,658)**	**1,954**	**28,032**	**21,328**

f) Company Share Repurchase Program

In a meeting held on June 9, 2017, the Company's Board of Directors, in accordance with article 17, item XV, of the Articles of Incorporation, approved the repurchase of common and preferred shares issued by the Company, under CVM Ruling No. 567, of September 17, 2015, for acquisition of common and preferred shares issued by the Company for subsequent cancellation, disposal or to be held in treasury, without

decreasing capital, to increase shareholder value through the efficient application of available cash resources and optimize the Company's capital allocation.

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

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

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

g) Earnings per share

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

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

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	Company	
	2017	2016
Net income for the year	4,608,790	4,085,242
Common shares	1,457,288	1,291,743
Preferred shares	3,151,502	2,793,499
Number of shares (thousands):	1,688,694	1,688,694
Weighted average number of outstanding common shares for the year	569,354	569,354
Weighted average number of outstanding preferred shares for the year	1,119,340	1,119,340
Basic and diluted earnings per share:		
Common shares	2.56	2.27
Preferred shares	2.82	2.50

23) NET OPERATING REVENUE

	Company		Consolidated	
	2017	2016	2017	2016
Gross operating revenue (1)	**61,886,869**	**59,633,012**	**66,243,174**	**65,006,728**
Deductions from gross operating revenue	**(22,543,141)**	**(21,007,617)**	**(23,036,342)**	**(22,498,269)**
Taxes	(15,575,815)	(14,583,996)	(16,058,584)	(15,388,784)

Discounts granted and return of goods	(6,967,326)	(6,423,621)	(6,977,758)	(7,109,485)
Net operating revenue	**39,343,728**	**38,625,395**	**43,206,832**	**42,508,459**

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

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

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

24) OPERATING COSTS AND EXPENSES

	Company						
	2017				2016		
	Cost of sales and services	Selling expenses	General and administrative expenses	Total	Cost of sales and services	Selling expenses	General a administrat expens
Personnel	(738,224)	(2,180,428)	(441,128)	(3,359,780)	(799,590)	(2,046,505)	(711,63
Third-party services	(4,802,834)	(6,368,599)	(1,191,495)	(12,362,928)	(4,521,863)	(6,070,348)	(1,198,5
Interconnection and network use	(1,440,968)	-	-	(1,440,968)	(1,889,632)	-	
Advertising and publicity	-	(984,301)	-	(984,301)	-	(1,014,120)	
Rental, insurance, condominium and connection means	(2,616,816)	(150,671)	(194,848)	(2,962,335)	(2,220,181)	(131,312)	(219,74
Taxes, charges and contributions	(1,758,227)	(37,918)	(33,458)	(1,829,603)	(1,805,685)	(4,699)	(86,48
Estimated impairment losses on	-	(1,405,085)	-	(1,405,085)	-	(1,225,742)	

accounts receivable							
Depreciation and amortization (1)	(5,937,372)	(1,433,260)	(455,552)	(7,826,184)	(5,429,820)	(1,312,818)	(423,53
Cost of goods sold	(1,785,811)	-	-	(1,785,811)	(1,997,405)	-	
Materials and other operating costs and expenses	(54,943)	(198,690)	(18,424)	(272,057)	(70,376)	(190,609)	(45,4
Total	**(19,135,195)**	**(12,758,952)**	**(2,334,905)**	**(34,229,052)**	**(18,734,552)**	**(11,996,153)**	**(2,685,3**

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	Consolidated						
	2017				2016		
	Cost of sales and services	Selling expenses	General and administrative expenses	Total	Cost of sales and services	Selling expenses	General a administrat expens
Personnel	(845,358)	(2,387,314)	(493,095)	(3,725,767)	(976,233)	(2,136,399)	(747,1
Third-party services	(5,591,284)	(6,423,523)	(1,232,379)	(13,247,186)	(5,705,098)	(6,151,012)	(1,254,1
Interconnection and network use	(1,440,968)	-	-	(1,440,968)	(1,924,148)	-	
Advertising and publicity	-	(1,015,414)	-	(1,015,414)	-	(1,065,882)	
Rental, insurance, condominium and connection means	(2,624,405)	(151,455)	(204,701)	(2,980,561)	(2,326,219)	(141,135)	(220,6
Taxes, charges and contributions	(1,792,764)	(39,050)	(34,779)	(1,866,593)	(1,861,237)	(5,933)	(92,3
Estimated impairment losses on accounts receivable	-	(1,481,015)	-	(1,481,015)	-	(1,348,221)	
Depreciation and amortization (1)	(5,963,153)	(1,433,297)	(457,284)	(7,853,734)	(5,821,620)	(1,408,866)	(423,9
Cost of goods sold	(1,955,890)	-	-	(1,955,890)	(2,118,940)	-	
Materials and other operating costs and expenses	(58,708)	(205,406)	(20,867)	(284,981)	(89,519)	(197,918)	(55,0
Total	**(20,272,530)**	**(13,136,474)**	**(2,443,105)**	**(35,852,109)**	**(20,823,014)**	**(12,455,366)**	**(2,793,3**

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

25) OTHER OPERATING INCOME (EXPENSES)

	Company		Consolidated	
	2017	2016	2017	2016
Recovered expenses and fines	349,985	482,596	355,415	504,877
Provisions for labor, tax and civil contingencies	(990,770)	(953,003)	(999,419)	(985,176)
Net gain (loss) on asset disposal/loss (1)	110,413	456,920	108,767	463,602
Other operating income (expenses) (2)	322,534	(58,442)	(187,249)	(51,977)
Total	**(207,838)**	**(71,929)**	**(722,486)**	**(68,674)**
Other operating income	782,932	939,516	464,182	968,479
Other operating expenses	(990,770)	(1,011,445)	(1,186,668)	(1,037,153)
Total	**(207,838)**	**(71,929)**	**(722,486)**	**(68,674)**

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

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

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

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

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26) FINANCIAL INCOME (EXPENSES)

	Company		Consolidated	
	2017	2016	2017	2016
Financial Income				
Interest income	592,577	648,011	655,474	719,399
Interest receivable (customers, taxes and other)	122,923	78,189	124,391	104,837
Gain on derivative transactions	369,987	994,801	373,971	994,801
Foreign exchange variations on loans and financing	113,203	487,747	113,203	487,747
Other revenues from foreign exchange and monetary variation	397,180	372,186	406,013	374,169
Other financial income	79,302	73,640	82,906	100,406
Total	**1,675,172**	**2,654,574**	**1,755,958**	**2,781,359**
Financial Expenses				
Loan, financing, debenture and finance lease charges	(932,727)	(1,020,605)	(932,727)	(1,061,098)
Foreign exchange variation on loans and financing	(129,049)	(214,952)	(129,049)	(214,952)
Loss on derivative transactions	(414,378)	(1,342,671)	(415,956)	(1,342,671)
Interest payable (financial institutions, provisions, trade accounts payable, taxes and other)	(133,831)	(270,136)	(136,425)	(278,175)
Other expenses with foreign exchange and monetary variation	(862,742)	(828,799)	(876,948)	(830,466)
IOF, Pis, Cofins and other financial expenses	(163,386)	(259,155)	(167,897)	(288,538)

Total	**(2,636,113)**	**(3,936,318)**	**(2,659,002)**	**(4,015,900)**

27) INCOME AND SOCIAL CONTRIBUTION TAXES

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

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

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	Company		Consolidated	
	2017	2016	2017	2016
Income before taxes	5,249,381	4,701,427	5,730,773	5,134,722
Income and social contribution tax expenses, at the tax rate of 34%	(1,784,790)	(1,598,485)	(1,948,463)	(1,745,805)
Permanent differences				
Equity pickup, net of effects from interest on equity received and surplus value of the assets purchased attributed to the Company (Note 11)	443,185	287,563	537	423
Unclaimed interest on equity	(21,843)	(11,432)	(21,843)	(11,432)
Temporary differences in subsidiaries	-	-	2,007	-
Non-deductible expenses, gifts, incentives	(86,946)	(82,089)	(94,413)	(88,916)
Deferred taxes recognized in subsidiaries on tax loss carryforwards, negative basis and temporary differences referring to prior years	-	-	132,080	-
Tax benefit related to interest on equity allocated	821,657	738,529	821,657	738,529
Other (additions) exclusions	(11,854)	49,729	(13,545)	57,721
Tax debits	**(640,591)**	**(616,185)**	**(1,121,983)**	**(1,049,480)**
Effective rate	12.2%	13.1%	19.6%	20.4%

Current income and social contribution taxes	36,226	99,208	(580,578)	(288,063)
Deferred income and social contribution taxes	(676,817)	(715,393)	(541,405)	(761,417)

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

28) BALANCES AND TRANSACTIONS WITH RELATED PARTIES

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

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

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

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

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

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

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

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

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

h) Marketing services provided by Terra Group companies;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The following table summarizes the consolidated balances with related parties:

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

Telefónica International Wholesale Services Espanha	j)	-	69,087	-	-	82,613	-
Telefônica Learning Services Brasil	a)	-	175	-	-	64	-
Telefónica Moviles Argentina	k)	-	7,194	-	-	6,288	-
Telefónica Moviles Del Chile	k)	-	539	387	-	10,207	337
Telefónica Moviles Del Espanha	k)	-	8,918	-	-	9,220	-
Telefônica Serviços Empresariais do Brasil	a) / d) / p)	-	2,938	2,355	-	2,518	2,410
Telefonica UK LTD.(O2 UK LTD)	k)	-	1,350	-	-	8,809	-
Telefónica USA	j)	-	6,248	-	-	3,550	-
Telfisa	q)	9,523	-	-	78,070	-	-
Telxius Cable Brasil	a) / d) / p)	-	28,981	819	-	11,513	2,678
Telxius Torres Brasil (1)	d) / l) / p) / x)	-	14,666	5,106	-	13,842	3,709
Terra Networks Chile, Terra Networks México, Terra Networks Perú e Terra Networks Operation	g) / h)	-	8,159	-	-	-	-
Terra Networks Brasil	a) / d) / l)	-	-	-	-	5,499	7,596
Other	a) / d) / g) / h) / k) / l) / p)	-	3,840	1,059	-	4,366	909
		9,523	**199,998**	**31,043**	**78,070**	**190,812**	**33,809**
Total		**9,523**	**201,021**	**166,733**	**78,070**	**190,906**	**250,679**
Current assets		**9,523**	**201,021**	**164,249**	**78,070**	**190,906**	**247,863**
Noncurrent assets		**-**	**-**	**2,484**	**-**	**-**	**2,816**

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

Telefônica Factoring do Brasil	l) / s)	-	146	-	6,154
Telefónica Global Technology	e) / l)	15,671	-	15,169	-
Telefônica Inteligência e Segurança Brasil	c) / l)	15,336	27	26,516	27
Telefónica International Wholesale Services Espanha	f)	44,240	8	50,121	8
Telefônica Learning Services Brasil	r)	37,931	-	16,328	-
Telefónica Moviles Argentina	k)	3,865	-	13,997	-
Telefónica Moviles Del Chile	k)	963	-	10,673	-
Telefónica Moviles Del Espanha	k)	3,589	-	4,671	-
Telefônica Serviços Empresariais do Brasil	d)	-	376	112	1,042
Telefonica UK LTD.(O2 UK LTD)	k)	89	-	3,868	-
Telefónica USA	f)	-	171	14,283	168
Telxius Cable Brasil	f)	44,037	2,068	52,210	2,068
Telxius Torres Brasil (1)	x) / l)	37,718	7,757	33,178	15,991
Terra Networks México, Terra Networks Perú e Terra Networks Operation	h)	7,633	-	-	-
Terra Networks Brasil	i)	-	-	3,360	1,209
Other	g) / h) / k) / l) / w)	9,379	29	14,555	29
		342,897	**11,037**	**378,895**	**27,066**
Total		**350,844**	**125,987**	**381,240**	**112,358**
Current liabilities		**350,844**	**124,749**	**381,240**	**110,449**
Noncurrent liabilities		**-**	**1,238**	**-**	**1,909**

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		Income statement					
		2017			2016		
Companies	Type of transaction	Operating revenues	Cost, despesas and other expenses (revenues) operating	Financial result	Operating revenues	Cost, despesas and other expenses (revenues) operating	Financial result
Parent Companies							
SP Telecomunicações Participações	d) / l)	-	268	-	-	67	-
Telefónica LatinoAmerica Holding	l)	-	36,523	11,030	-	87,526	4,348
Telefónica	l) / m) / n)	-	(331,684)	(996)	-	(319,708)	(9,727)
		-	**(294,893)**	**10,034**	**-**	**(232,115)**	**(5,379)**
Other Group companies							
Colombia Telecomunicaciones S.A. ESP	k)	349	(10)	604	217	(2,845)	(926)
Companhia AIX de Participações	a) / u)	36	(22,738)	-	67	(21,316)	-
Fundação Telefônica	a) / t)	-	(11,395)	-	-	(10,530)	-
Media Networks Brasil Soluções Digitais	a) / d) / f)	600	(57,176)	-	572	(3,451)	-
Media Networks Latina America SAC	b)	-	(33,133)	(516)	-	(17,133)	(50)
Pegaso PCS	k)	170	536	-	86	(5,991)	-
T. Learning Services Brasil	a) / r)	292	(54,782)	-	2	(47,544)	1,311
T.O2 Germany GMBH CO. OHG	k)	75	(1,409)	-	45	(4,527)	-
Telefónica Compras Electrónicas	v)	-	(29,062)	-	-	(42,889)	-
Telefônica Digital España	l) / o)	-	(81,893)	(2,600)	-	(44,872)	(1,262)
Telefônica Factoring do Brasil	a) / d) / l) / s)	69	828	61	41	200	-
	e) / l)	-	(36,395)	40	-	(28,933)	(756)

Telefónica Global Technology, S.A.U.							
Telefônica Inteligência e Segurança Brasil	a) / c) / d) / l)	706	(40,918)	-	1,041	(39,709)	389
Telefónica International Wholesale Services Espanha	f) / j)	56,728	(49,960)	(2,564)	72,520	(56,293)	(15,008)
Telefónica Moviles Argentina	k)	3,746	6,147	-	3,072	(9,112)	-
Telefónica Moviles Del Chile	k)	1,586	(2,196)	52	1,074	(1,096)	(80)
Telefónica Moviles Del Espanha	k)	1,048	(1,969)	-	(836)	(2,170)	-
Telefônica Serviços Empresariais do Brasil	a) / d) / p)	286	(989)	-	118	867	(43)
Telefonica UK LTD.(O2 UK LTD)	k)	1,163	(1,374)	-	5	(994)	-
Telefónica USA	f) / j)	2,392	(2,322)	(2,035)	2,998	(14,970)	(349)
Telxius Cable Brasil	a) / d) / f) / p)	15,044	(200,536)	787	17,624	(246,595)	244
Telxius Torres Brasil (1)	d) / l) / p) / x)	-	(107,373)	-	31	(72,460)	1,929
Terra Networks Chile, Terra Networks México, Terra Networks Perú e Terra Networks Operation	g) / h)	-	(9,782)	(120)	-	-	-
Terra Networks Brasil	a) / d) / l) / i)	2,485	(10,719)	-	16,483	(17,884)	1,194
Other	a) / d) / g) / h) / k) / l) / p) / w) / x)	3,537	(14,608)	41	1,683	(23,677)	1,216
		90,312	**(763,228)**	**(6,250)**	**116,843**	**(713,924)**	**(12,191)**
Total		**90,312**	**(1,058,121)**	**3,784**	**116,843**	**(946,039)**	**(17,570)**

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

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

The following table summarizes the aforementioned transaction:

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

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

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Impacts on the Statement of Income

Description	**DRE Group**	**R$ thousands**
Value of disposal of towers (except retention and financial lease)	Other operating revenues (expenses), net (Note 25)	575,580
Value of write-off of residual amount	Other operating revenues (expenses), net (Note 25)	(99,210)
Value of customer portfolio	Other operating revenues (expenses), net (Note 25)	40,899
Amount of PIS and Cofins charged on customer portfolio	Other operating revenues (expenses), net (Note 25)	(3,783)
Effect on operating income		**513,486**
Amount of IR and CS levied on towers of customer portfolio	Income and social contribution taxes (Note 27)	(174,585)
Net effect on transaction income	**Net effect on transaction income**	**338,901**

b) Management compensation

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

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

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

29) SHARE-BASED PAYMENT PLANS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

b) <u>Talent for the Future Share Plan ("TFSP")</u>

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

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

if their targets have been met.

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

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

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

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

c) Global Employee Share Plan ("GESP")

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

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

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

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

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

30) PENSION PLANS AND OTHER POST-EMPLOYMENT BENEFITS

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

Plan	Type	Entity	Sponsor
PBS-A	Defined benefit (DB)	Sistel	Telefônica Brasil, jointly with other telecoms resulting from privatization of the Sistema

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

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

- Post-Employment Health Benefits Plans

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

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

- Post-employment Social Security Plans

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

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

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

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

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

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

With the exception of the CTB deficit plans and the healthcare plan under Law No. 9656/98, generally all benefit plans that have fund constituted, present a surplus position. The economic benefit recorded in the Company's assets or that of its subsidiaries does not reflect the total surplus determined in these plans. The economic benefit stated under assets considers only the portion of the surplus which presents a real possibility of recovery. The means of plan surplus recovery is solely through reductions in future contributions and given that not all plans currently receive enough contributions for full recovery of surpluses, the economic benefit recorded under assets is limited to the total possible recovery amount in accordance with projected future contributions.

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

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

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

a) Post-retirement Health Plans

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

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

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

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

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

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

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

b) Post-Employment Pension Plans

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

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

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

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

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

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

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

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

b.2) CTB Plan

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

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

b.3) Telefônica DB Plan

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

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

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

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

b.4) Tcoprev Plan

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

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

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

b.5) VISÃO Plans

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

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

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

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

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

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

c.1) Reconciliation of assets and liabilities:

	Net liabilities (assets) at 12.31.17			Net liabilities (assets) at 12.31.16		
	Post-retirement pension plans	Post-retirement health plans	**Total**	Post-retirement pension plans	Post-retirement health plans	**Total**
Present value of DB plan obligations	1,861,651	1,050,576	**2,912,227**	1,763,866	767,642	**2,531,508**
Fair value of plan assets	2,585,679	726,060	**3,311,739**	2,703,593	667,993	**3,371,586**
Net liabilities (assets)	**(724,028)**	**324,516**	**(399,512)**	**(939,727)**	**99,649**	**(840,078)**
Asset limitation	791,177	130,440	**921,617**	993,754	164,953	**1,158,707**
Noncurrent assets	**(9,833)**	**-**	**(9,833)**	**(9,041)**	**-**	**(9,041)**

Current liabilities	**7,914**	**9,021**	**16,935**	**6,826**	**4,162**	**10,988**
Noncurrent liabilities	**69,068**	**445,935**	**515,003**	**56,242**	**260,440**	**316,682**

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

	2017			2016		
	Post-retirement pension plans	Post-retirement health plans	**Total**	Post-retirement pension plans	Post-retirement health plans	**Total**
Current service cost	3,044	7,606	**10,650**	2,811	2,761	**5,572**
Net interest on net actuarial assets/liabilities	5,258	29,325	**34,583**	5,278	2,986	**8,264**
Total	**8,302**	**36,931**	**45,233**	**8,089**	**5,747**	**13,836**

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

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

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

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	12.31.17			12.31.16		
	Post-retirement pension plans	Post-retirement health plans	**Total**	Post-retirement pension plans	Post-retirement health plans	**Total**
Net interest on net defined benefit liability (asset) at the beginning of the year	**54,026**	**264,603**	**318,629**	**46,907**	**29,712**	**76,619**
Business combinations	(12)	680	**668**	-	-	**-**
Expenses	8,302	36,931	**45,233**	8,089	5,747	**13,836**
Sponsor contributions	(10,680)	(3,041)	**(13,721)**	(8,562)	(31)	**(8,593)**
Amounts recognized in OCI	15,512	155,784	**171,296**	7,592	229,175	**236,767**
Net interest on net defined benefit liability (asset) at the end of the year	**67,148**	**454,957**	**522,105**	**54,026**	**264,603**	**318,629**
Actuarial assets per balance sheet	(9,833)	-	**(9,833)**	(9,041)	-	**(9,041)**
Actuarial liabilities per balance sheet	76,982	454,956	**531,938**	63,068	264,602	**327,670**

c.5) Changes in defined benefit liability

	12.31.17			12.31.16		
	Post-retirement pension plans	Post-retirement health plans	**Total**	Post-retirement pension plans	Post-retirement health plans	**Total**
Defined benefit liability at the	**1,763,866**	**767,642**	**2,531,508**	**1,503,966**	**402,927**	**1,906,893**

beginning of the year						
Liability assumed after acquisition of company	249	680	**929**	-	-	**-**
Current service costs	3,044	7,606	**10,650**	2,811	2,761	**5,572**
Interest on actuarial liabilities	181,208	82,488	**263,696**	179,496	48,420	**227,916**
Benefits paid	(168,856)	(30,777)	**(199,633)**	(156,056)	(24,229)	**(180,285)**
Member contributions paid	220	-	**220**	174	-	**174**
Actuarial losses (gains) adjusted by experience	(23,613)	128,469	**104,856**	78,373	298,403	**376,776**
Actuarial losses (gains) adjusted by demographic assumptions	(3,320)	(1,543)	**(4,863)**	-	(81,144)	**(81,144)**
Actuarial losses (gains) adjusted by financial assumptions	108,853	96,011	**204,864**	155,102	120,504	**275,606**
Defined benefit liability at the end of the year	**1,861,651**	**1,050,576**	**2,912,227**	**1,763,866**	**767,642**	**2,531,508**

c.6) Changes in the fair value of plan assets

	12.31.17			12.31.16		
	Post-retirement pension plans	Post-retirement health plans	**Total**	Post-retirement pension plans	Post-retirement health plans	**Total**
Fair value of plan assets at the beginning of the year	**2,703,593**	**667,993**	**3,371,586**	**2,178,182**	**529,485**	**2,707,667**

Asset acquired on acquisition of company	323	-	**323**	-	-	**-**
Benefits paid	(160,370)	(27,767)	**(188,137)**	(149,521)	(24,229)	**(173,750)**
Participants contributions paid	220	-	**220**	174	-	**174**
Sponsor contributions paid	2,195	31	**2,226**	2,027	31	**2,058**
Interest income on plan assets	283,090	71,061	**354,151**	264,761	65,015	**329,776**
Return on plan assets excluding interest income	(243,372)	14,742	**(228,630)**	407,970	97,691	**505,661**
Fair value of plan assets at the end of the year	**2,585,679**	**726,060**	**3,311,739**	**2,703,593**	**667,993**	**3,371,586**

c.7) Changes in assets limitation

	12.31.17			12.31.16		
	Post-retirement pension plans	Post-retirement health plans	**Total**	Post-retirement pension plans	Post-retirement health plans	**Total**
Asset Limitation at the beginning of the year	**993,754**	**164,953**	**1,158,707**	**721,123**	**156,270**	**877,393**
Interest on the asset limitation	107,140	17,898	**125,038**	90,543	19,580	**110,123**
Changes in the assets limitation, except interest	(309,779)	(52,411)	**(362,190)**	182,088	(10,897)	**171,191**
Effect generated by company acquisition	62	-	**62**	-	-	**-**

Asset Limitation at the end of the year	**791,177**	**130,440**	**921,617**	**993,754**	**164,953**	**1,158,707**

c.8) Results projected for 2018

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

c.9) Sponsoring company contributions projected for 2018

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

c.10) Average weighted duration of defined benefit liability

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

c.11) Actuarial assumptions

	12.31.17	
	Post-retirement pension plans	
Discount rate to present value of defined benefit liability	PBS-A and CTB: 9.8%	Visão: Telefônica BD and Tcoprev:
Future salary growth rate	PBS-A: N/A	Visão, CTB, Telefônica BD Tcoprev:
Medical expense growth rate		
Nominal annual		

adjustment rate of pension benefits		
Medical service eligibility age		
Estimated retirement age	years	PBS-A, CTB and Telefônica B Visão and Tcoprev: 60 y
Mortality table for nondisabled individuals	10%	PBS-A, CTB and Telefônica BD: AT-2000 Basic segregated by gender, down-rate Visão: AT-2000 Basic segregated by ge down-rated by
Mortality table for disabled individuals	40%	PBS-A, CTB and Telefônica BD: RP-2000 Disabled Female, down-rate Visão: N/A
Disability table	PBS-A, CTB, Telefônica BD and Tcoprev: Light-Forte	Visão: Light-Fraca, d rated by
Turnover	PBS-A, CTB, Telefônica BD and Tcoprev: N/A	Visão: Turn experience in VISÃO plans (2015 to 2

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

		12.31.16 Post-retirement pension plans	Post-retirement he
Discount rate to present value of defined benefit liability		Vivoprev and Visão: 10.9% PBS-A, CTB, Telefônica BD and Tcoprev: 10.8%	
Future salary growth rate	N/A	PBS-A: CTB, Telefônica BD, Prev and Visão: 6.2%	
Medical expense growth rate		N/A 4.5%	

Nominal annual adjustment rate of pension benefits			
Medical service eligibility age		N/A	PAMA and PCE: 5% when reachi of contribution; 3% each subseq retirement
			Law No. 9
Estimated retirement age	N/A years	PBS-A and CTB: Telefônica BD: 57 Prev and Visão: 60 years	years
Mortality table for nondisabled individuals	10%	PBS-A, CTB, Telefônica BD and Tcoprev: AT-2000 Basic segregated by gender, down-rated by Vivoprev and Visão: AT-2000 Basic segregated by gender, down-rated by 50%	AT-2000 Basic segregated by ge
Mortality table for disabled individuals	40%	PBS-A, CTB, Telefônica BD and PBS: RP-2000 Disabled Female, down-rated by Vivoprev and Visão: N/A	PAMA anc Male 9656/98: AT-2000 Basic segregat
Disability table	Disability	PBS-A, CTB and Telefônica BD: Mercer Prev and Visão: Light-Fraca, down rated by 30%	
Turnover	N/A	PBS-A, CTB and Telefônica BD: Prev and Visão: Turnover experience in VISÃO plans (2008 to 2011)	N/A Law No. 9656/98: Turnover e

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

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

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

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

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

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

c.13) Sensitivity analysis for actuarial assumptions

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

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

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

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

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

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c.14) Allocation of plan assets

	12.31.17		12.31.16	
	Post-retirement pension plans	Post-retirement health plans	Post-retirement pension plans	Post-retirement health plans
Investments with market value quoted in active market:				
Fixed income investments				
National Treasury Note (NTN)	1,998,931	670,516	1,769,606	553,515
Treasury Financial Letter	199,135	55,544	30,588	-
Repurchase operations	142,228	-	134,863	-
Debentures	13,209	-	12,843	-
Treasury Financial Letter (LFT)	4,567	-	229,793	114,478
FIDC shares / Others	3,694	-	6,449	-
National Treasury Notes (LTN)	2,165	-	1,895	-
Bank Deposit Certificates (CDB)	1,317	-	36,744	-
Variable income investments				
Investments in energy sector	57,781	-	246,400	-
Investments in food and beverage industry	32,337	-	45,054	-
Investments in aerospace sector	-	-	28,947	-
Investments in mining sector	1,197	-	2,581	-
Investments in other sectors (1)	7,124	-	9,207	-

Real estate investments	96,525	-	121,176	-
Loans to participants	18,346	-	23,562	-
Structured investments	3,753	-	224	-
Investments with market value not quoted in active market:				
Loans to participants	1,590	-	1,850	-
Structured investments	1,780	-	1,811	-
Total	**2,585,679**	**726,060**	**2,703,593**	**667,993**

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

c.15) Maturity of future benefit payments

	Post-retirement pension plans	Post-retirement health plans	**Total**
2018	162,546	38,839	**201,385**
2019	166,989	42,679	**209,668**
2020	171,275	47,023	**218,298**
2021	176,423	51,987	**228,410**
2022	180,505	57,309	**237,814**
2023 onwards	5,326,440	22,761,339	**28,087,779**
Total	**6,184,178**	**22,999,176**	**29,183,354**

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31) FINANCIAL INSTRUMENTS AND RISK AND CAPITAL MANAGEMENT

a) <u>Derivative transactions</u>

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

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

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

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

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

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

a.1) <u>Fair value of derivative financial instruments</u>

The valuation method used to calculate the fair value of financial liabilities (if applicable) and derivative financial instruments was the discounted cash flow method, based on expected settlements or realization of

liabilities and assets at market rates prevailing at the balance sheet date.

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

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

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

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

Foreign Currency	(411,208)	(181,469)	(4,235)	(71)
US$ (2)	(354,356)	(88,710)	(4,235)	(71)
LIBOR US$ (1)	(56,852)	(92,759)	-	-
Long position			**164,405**	**212,993**
Current			87,643	68,943
Non Current			76,762	144,050
Short position			**(20,651)**	**(184,616)**
Current			(5,239)	(183,212)
Non Current			(15,412)	(1,404)
Amounts receivable, net			**143,754**	**28,377**

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

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

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

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

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

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

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

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

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

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

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

a.2) Sensitivity analysis to the Company's risk variables

CVM Resolution 604/09 requires listed companies to comply with CPC 40 Financial Instruments: Disclosures (IFRS 7) by disclosing sensitivity analyses for each type of market risk that management understands to be significant when originated by financial instruments to which the entity is exposed at the end of each period, including all derivatives financial instrument transactions.

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

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

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

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Sensitivity analysis - net exposure

		Consolidated		
Transaction	Risk	Probable	25% depreciation	50% depreciation
Hedge (long position)	Derivatives (depreciation risk EUR)	(70,683)	(88,354)	(106,025)
Payables in EUR	Debt (appreciation risk EUR)	(42,808)	(53,510)	(64,212)
Receivables in EUR	Debt (depreciation risk EUR)	113,754	142,192	170,631
	Net Exposure	263	328	394
Hedge (short position)	Derivatives (depreciation risk US$)	(56,071)	(70,088)	(84,106)
Payables in US$	Debt (appreciation risk US$)	164,648	205,810	246,972
Receivables in US$	Debt (depreciation risk US$)	(108,567)	(135,709)	(162,851)
	Net Exposure	10	13	15
Hedge (long position)	Derivatives (risk of decrease in IPCA)	279,566	259,689	242,286
Debt in IPCA	Debt (risk of increase in IPCA)	(381,564)	(361,681)	(344,274)
	Net Exposure	(101,998)	(101,992)	(101,988)
Hedge (long position)	Derivatives (risk of decrease in IGP-DI)	42,538	42,575	42,612
Debt in IGP-DI	Debt (risk of increase in IGP-DI)	(140,859)	(140,859)	(140,859)
	Net Exposure			

		(98,321)	(98,284)	(98,247)
Hedge (long position)	Derivatives (risk of decrease in UMBND)	221,553	276,004	330,097
Debt in UMBND	Debt (risk of increase in UMBND)	(225,708)	(281,531)	(337,072)
	Net Exposure	(4,155)	(5,527)	(6,975)
Hedge (long position)	Derivatives (risk of decrease in TJLP)	418,496	414,263	410,144
Debt in TJLP	Debt (risk of increase in TJLP)	(1,586,846)	(1,582,396)	(1,578,066)
	Net Exposure	(1,168,350)	(1,168,133)	(1,167,922)
Hedge (CDI position)				
Hedge US$ and EUR (short and long position)	Derivatives (risk of decrease in CDI)	(130,892)	(146,692)	(162,471)
Hedge IPCA (short position)	Derivatives (risk of increase in CDI)	(279,566)	(259,689)	(242,286)
Hedge IGPM (short position)	Derivatives (risk of increase in CDI)	(42,538)	(42,575)	(42,612)
Hedge UMBND (short position)	Derivatives (risk of increase in CDI)	(221,553)	(276,004)	(330,097)
Hedge TJLP (short position)	Derivatives (risk of increase in CDI)	(418,496)	(414,263)	(410,144)
	Net Exposure	**(1,093,045)**	**(1,139,223)**	**(1,187,610)**
Total net exposure in each scenario		**(2,465,596)**	**(2,512,818)**	**(2,562,333)**
Net effect on changes in current fair value		**-**	**(47,222)**	**(96,737)**

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

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Sensitivity analysis assumptions

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

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

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

b) Fair value

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

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

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

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

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

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

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

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	Company					
		Fair value hierarchy	Book value		Fair value	
	Classification by category		12.31.17	12.31.16	12.31.17	12.31.16
Financial Assets						
Current						
Cash and cash equivalents (Note 4)	Amortized cost		3,681,173	4,675,627	3,681,173	4,675,627
Trade accounts receivable, net (Note 5)	Loans and receivables		8,413,403	8,282,685	8,413,403	8,282,685
Derivative transactions (Note 31)	Measured at fair value through profit or loss	Level 2	2,480	3,979	2,480	3,979
Derivative transactions (Note 31)	Hedges (economic)	Level 2	85,163	64,964	85,163	64,964
Noncurrent						
Short-term investments pledged as collateral	Amortized cost		81,472	78,153	81,472	78,153
Trade accounts receivable, net (Note 5)	Loans and receivables		167,682	200,537	167,682	200,537
Derivative transactions (Note 31)	Hedges (economic)	Level 2	76,762	144,050	76,762	144,050
Total financial assets			**12,508,135**	**13,449,995**	**12,508,135**	**13,449,995**

Financial Liabilities						
Current						
Trade accounts payable, net (Note 15)	Amortized cost		8,560,844	7,539,395	8,560,844	7,539,395
Loans, financing and finance lease (Note 20)	Amortized cost		1,316,034	1,256,147	1,463,609	1,363,539
Loans, financing and finance lease (Note 20)	Measured at fair value through profit or loss	Level 2	304,921	1,286,828	317,231	1,307,310
Debentures (Note 20)	Amortized cost		1,412,174	2,120,197	1,532,427	2,242,291
Debentures (Note 20)	Measured at fair value through profit or loss	Level 2	312	307	1,490	1,412
Derivative transactions (Note 31)	Measured at fair value through profit or loss	Level 2	4,372	4,111	4,372	4,111
Derivative transactions (Note 31)	Hedges (economic)	Level 2	735	179,101	735	179,101
Noncurrent						
Trade accounts payable, net (Note 15)	Amortized cost		-	71,907	-	71,907
Loans, financing and finance lease (Note 20)	Amortized cost		1,353,582	1,837,077	1,291,974	1,668,524
Loans, financing and finance lease (Note 20)	Measured at fair value through profit or loss	Level 2	520,421	874,982	505,422	822,818
Contingent consideration (Note 20)	Measured at fair value through profit or loss	Level 2	446,144	414,733	446,144	414,733
Debentures (Note 20)	Amortized cost		3,068,243	1,396,813	2,866,372	1,260,814
Debentures (Note 20)	Measured at fair value through profit or loss	Level 2	40,010	36,990	37,717	34,124
Derivative transactions	Hedges (economic)	Level 2	15,412	1,404	15,412	1,404

(Note 31)				
Total financial liabilities	**17,043,204**	**17,019,992**	**17,043,749**	**16,911,483**

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			Consolidated			
			Book value		Fair value	
	Classification by category	Fair value hierarchy	12.31.17	12.31.16	12.31.17	12.31.16
Financial Assets						
Current						
Cash and cash equivalents (Note 4)	Amortized cost		4,050,338	5,105,110	4,050,338	5,105,110
Trade accounts receivable, net (Note 5)	Loans and receivables		8,588,466	8,701,688	8,588,466	8,701,688
Derivative transactions (Note 31)	Measured at fair value through profit or loss	Level 2	2,480	3,979	2,480	3,979
Derivative transactions (Note 31)	Hedges (economic)	Level 2	85,163	64,964	85,163	64,964
Noncurrent						
Short-term investments pledged as collateral	Amortized cost		81,486	78,166	81,486	78,166
Trade accounts receivable, net (Note 5)	Loans and receivables		273,888	305,411	273,888	305,411
Derivative transactions (Note 31)	Hedges (economic)	Level 2	76,762	144,050	76,762	144,050
Total financial assets			**13,158,583**	**14,403,368**	**13,158,583**	**14,403,368**
Financial Liabilities						
Current						

Trade accounts payable (Note 15)	Amortized cost		7,447,100	7,611,246	7,447,100	7,611,246
Loans, financing and finance lease (Note 20)	Amortized cost		1,316,034	1,256,147	1,463,609	1,363,539
Loans, financing and finance lease (Note 20)	Measured at fair value through profit or loss	Level 2	304,921	1,286,828	317,231	1,307,310
Debentures (Note 20)	Amortized cost		1,412,174	2,120,197	1,532,427	2,242,291
Debentures (Note 20)	Measured at fair value through profit or loss	Level 2	312	307	1,490	1,412
Derivative transactions (Note 31)	Measured at fair value through profit or loss	Level 2	4,504	4,111	4,504	4,111
Derivative transactions (Note 31)	Hedges (economic)	Level 2	735	179,101	735	179,101
Noncurrent						
Trade accounts payable (Note 15)	Amortized cost		-	71,907	-	71,907
Loans, financing and finance lease (Note 20)	Amortized cost		1,353,582	1,837,077	1,291,974	1,668,524
Loans, financing and finance lease (Note 20)	Measured at fair value through profit or loss	Level 2	520,421	874,982	505,422	822,818
Debentures (Note 20)	Amortized cost		3,068,243	1,396,813	2,866,372	1,260,814
Debentures (Note 20)	Measured at fair value through profit or loss	Level 2	40,010	36,990	37,717	34,124
Contingent consideration (Note 20)	Measured at fair value through profit or loss	Level 2	446,144	414,733	446,144	414,733
Derivative transactions (Note 31)	Hedges (economic)	Level 2	15,412	1,404	15,412	1,404
			15,929,592	**17,091,843**	**15,930,137**	**16,983,334**

c) **Capital management**

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

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

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

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

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

d) Risk management policy

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

d.1) Currency Risk

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

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

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

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

d.2) Interest and Inflation Risk

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

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

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

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

d.3) Liquidity Risk

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

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

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

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

At 12.31.17	Less than one year	From 1 to 2 years	From 2 to 5 years	Over 5 years	Total
Trade accounts payable (Note 15)	7,447,100	-	-	-	7,447,100
Loans, financing and finance lease (Note 20)	1,620,955	780,904	885,411	207,688	3,494,958

Contingent consideration (Note 20)	-	-	-	446,144	446,144
Debentures (Note 20)	1,412,486	66,252	3,042,001	-	4,520,739
Derivative transactions (Note 31)	5,239	93	-	15,319	20,651
Total	**10,485,780**	**847,249**	**3,927,412**	**669,151**	**15,929,592**

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

d.4) Credit Risk

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

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

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

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

d.5) Social and Environmental Risks

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

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

d.6) Insurance Coverage

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

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

d.7) Other Risks

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

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

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

32) COMMITMENTS AND GUARANTEES (RENTALS)

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

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

	Company	Consolidated
Up to 1 year	2,282,506	2,285,148
From 1 to 5 years	7,435,159	7,442,212
Over five years	5,017,985	5,017,985
Total	**14,735,650**	**14,745,345**

33) ADDITIONAL INFORMATION ON CASH FLOWS

a) Reconciliation of cash flow financing activities

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

Company

Company		**Cash flows from financing activities**		**Cash flows from operating activities**	**Financing activities not involving cash and cash equivalents**				
	At 12/31/16	**Addtions**	**Write-offs (payments)**	**Write-offs (payments)**	**Financial charges and foreign exchange variation**	**Additions of financial lease and suppliers**	**Business combinations**	**Interim and unclaimed dividends and interest on equity**	**At 12/31/17**
Interim dividends and interest on equity	2,195,031	-	(3,668,551)	-	-	-	-	3,869,636	2,396,116
Loans and financing	4,880,606	55,876	(2,449,773)	(333,676)	385,021	571,444	-	-	3,109,498
Finance lease	374,428	-	(35,722)	(11,973)	45,265	13,462	-	-	385,460
Debentures	3,554,307	3,000,000	(2,000,000)	(513,937)	480,369	-	-	-	4,520,739
Derivative financial instruments	(28,377)	-	(162,334)	2,086	44,739	-	-	-	(143,886)
Contingent Consideration	414,733	-	-	-	31,411	-	-	-	446,144
Total	**11,390,728**	**3,055,876**	**(8,316,380)**	**(857,500)**	**986,805**	**584,906**	**-**	**3,869,636**	**10,714,071**

Consolidated

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Telefônica Brasil S.A.

NOTES TO FINANCIAL STATEMENTS
Years ended December 31, 2017 and 2016
(In thousands of reais, unless otherwise stated)

		Cash flows from financing activities		Cash flows from operating activities	Financing activities not involving cash and ca equivalents			
Consolidated	**At 12/31/16**	**Addtions**	**Write-offs (payments)**	**Write-offs (payments)**	**Financial charges and foreign exchange variation**	**Additions of financial lease and supplier financing**	**Business combinations**	**Inter a unclaim divider a interest equ**
Interim dividends and interest on equity	2,195,031	-	(3,668,551)	-	-	-	-	3,869,6
Loans and financing	4,880,606	55,876	(2,449,773)	(333,676)	385,021	571,444	-	
Finance lease	374,428	-	(35,722)	(11,973)	45,265	13,462	-	
Debentures	3,554,307	3,000,000	(2,000,000)	(513,937)	480,369	-	-	
Derivative financial instruments	(28,377)	-	(159,408)	2,086	42,334	-	(389)	
Contingent Consideration	414,733	-	-	-	31,411	-	-	
Total	**11,390,728**	**3,055,876**	**(8,313,454)**	**(857,500)**	**984,400**	**584,906**	**(389)**	**3,869,6**

b) <u>Financing transactions that do not involve cash</u>

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

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Telefônica Brasil S.A.

NOTES TO FINANCIAL STATEMENTS
Years ended December 31, 2017 and 2016
(In thousands of reais, unless otherwise stated)

TELEFÔNICA BRASIL S.A.

MANAGEMENT REPORT

Dear Shareholders,

In compliance with legal and statutory provisions, the management of Telefônica Brasil S.A. ("Telefônica Brasil" or "Company") hereby submits for your appreciation the Company's management report and separate and consolidated financial statements, together with the report issued by the independent auditors and the opinions of the board of directors, the fiscal council and the audit and control committee for the year ended December 31, 2017.

1. **Message from Management**

My mission when I took over at Telefônica Brasil was to speed up the digital transformation of Vivo, our retail brand in Brazil. After a little more than a year heading the company I can say that, in Brazil, Vivo has achieved somewhat more than we promised in 2016: we are spearheading the transformation of the telecom sector and we are well on the way to being the engine of change in digital technology that the country needs.

This digital transformation is already benefiting people on a number of fronts, such as in education, public administration and security, and I have no doubt that in the short term it will give a boost to economic growth and job creation.

Clearly, we have to remain at the forefront of this trend, which is primarily intended to offer our clients a unique experience while at the same time improving the profitability of the Company.

Therefore, we are making rapid progress in constructing what I believe to be the fundamental pillars of this transformation:

1. A state-of-the-art network infrastructure
2. A unique experience for the client
3. A complete and innovative portfolio of digital services
4. Giving clients control over their “digital life”

I must emphasize that putting these pillars in place has been a much easier task thanks to the trust that our investors, partners and staff have placed in the company. The proof that we are on the right track is that we once more posted very good results in 2017, in spite of the adverse macroeconomic situation.

Our revenues have grown steadily, with income from mobile broadband and fixed ultra-broadband more than 20% higher than in the previous year. The Company’s EBITDA margin, in turn, was up by around 2 percentage points, leading to a 7.3% rise in EBITDA, our best performance in real growth in recent years.

The digitalization of products, services and processes has been a major factor in leveraging the Company’s efficiency. For example, in 2017, complaints to our call center were down (-13%) while at the same time we increased our penetration of digital accounts (+23 p.p.). Our digital channels also showed an increase in virtual top-ups (+28%) and in single users (+43%).

With increased profitability and optimum allocation of investments, we generated 20% more free cash flow than in 2016, giving a total of R$5.7 billion for the year, and this allowed us to propose to our shareholders a 13% increase in dividends to be paid in 2018. These are factors that allow us to advance sustainably and consistently, investing in the growth of the business and remunerating our shareholders, while at the same time maintaining a sound and robust capital structure.

State-of-the-art network infrastructure

We seek to offer our clients top quality connectivity, so that they can make the best use of digital resources, mainly by consistently investing in fiber optics and the fourth generation mobile network. During the last year, we have expanded our 4G coverage even more, adding 2,084 more cities to the network we cover with this technology. This growth is the largest ever achieved by an operator in Brazil in a single year. We ended 2017 with 4G services to 2,600 municipalities, covering the equivalent of 84.5% of the population of Brazil.

The gradual release of the 700MHz frequency, previously occupied by analog television, has made a significant contribution to the expansion of 4G and also to an increase in the coverage of 4G+ (which is up to twice as fast as 4G), by adding frequencies. We are the first operator to offer a 4G+ service in all Brazil's state capitals, and it is now available in 118 cities.

Our fiber optics cover 215 municipalities and we have been the first to take ultra high-speed internet to people's homes, through the FTTH (Fiber-to-the-Home) technology. In the last year, 16 new cities received FTTH coverage, bringing the total with this technology to 87.

Even with the lower level of investment in the telecom sector as a whole, we have maintained an average of R$8 billion of investment per year during the last two years. For the period from 2017 to 2019 we have defined an investment plan for a total of around R$24 billion in Brazil, mainly in network expansion. This means better quality and more connectivity for Brazil's people.

A unique experience for our clients

We took another step forward in 2017 towards transforming the experience of our clients and making the company more agile, more convergent and more digital. Our Vivo Next project has given our staff access to a new system for selling post-paid, Hybrid and Vivo Mobile Internet products to the clients in our legacy systems. This means that our clients are now being billed and serviced through a single platform. This is a further stage in a project for integrating billing and CRM (Customer Relationship Management) platforms, so that we can offer standard, convergent service at every point of contact with the client and to allow us to digitalize and simplify our procedures and services.

We are committed to promoting digital channels so that we can provide the unique multichannel service that our clients require. One example is the *Meu Vivo* app. To give an idea of the importance of this app, it was downloaded more than 24 million times in 2017, with 13 million single users per month. Vivi, in turn is an online service boot, which can respond to an average of a million queries per month with 94% efficiency (based on actual feedback from clients) and using cognitive intelligence techniques. We have also increased the number of clients we serve through the social networks, with contacts rising to more than 300 thousand a month. More than 50% of our client service is now through these channels.

In our stores, we are following best domestic and international practices to offer an even better experience for visitors. We use segmentation criteria to ensure that each store is as relevant as possible for the public it serves, taking into account the characteristics of the region and the client. All our models are designed to increase the level of sampling and experimentation. Clients are connected on our premises, in a flexible

and technological environment with our staff there to help. We recently launched the co-working concept, first in our store in the JK Shopping Mall in São Paulo, and it will be extended to other units of the same standard: we offer visitors a place to access the internet, work or simply take advantage of what the store has to offer.

A complete and innovative portfolio of digital services

We are recognized for the quality of our network, and we know that this gives us an edge. To make our clients' digital lives easier, we have introduced numerous service options going far beyond mere connectivity, through new digital offers. Highlights of the year's novelties include GoRead, an app with access to more than 170 titles published by Editora Abril; NBA, which allows people to watch games on their cell phones and access exclusive content about the league; and Vivo Meditação, which has more than a thousand meditations and exclusive lessons, created and recorded especially for the app.

We believe in the collaborative economy, and for the first time in the market we are offering clients the possibility of sharing data plans, free of charge.

Corporate clients, for their part, see our portfolio as a complete platform for speeding up the digitalization of their businesses. We are making innovations on every front. For small and medium companies we offer the experience we have accumulated in information security, which we already offer to large companies, and in this way we have increased the number of clients with this type of service threefold.

We have extended our offer of cloud computing services and reinforced partnerships with global market players. For the Internet of Things (IoT), we have inaugurated a laboratory for studies on new communication techniques, thus increasing the rate of expansion of IoT in Brazil. This is based on the most advanced technologies, such as 4G, to ensure longer-lived solutions. We are also focusing on increasing connectivity to offer end-to-end solutions including devices, new platforms and intelligence using Big Data. Today, in terms of connections to the Internet of Things, Vivo is the market leader with a 40% market share through M2M (Machine-to-Machine) operations.

I should also mention the launch of Vivo Eficiência Energética, a solution offering companies operational improvements, such as control over the principal points of energy consumption, leading to more predictable electricity bills and better cost management.

Control over "digital life"

We want to offer our clients the tools they need to have full control over their data and to make it possible for them to lead increasingly digital lives with security. To give some examples, in the near future a client of ours will be able to click on an app to know how much of his data package has been used, the price of a call, the balance of a prepaid account and the month's charges to date. We encourage people to use our services properly and responsibly.

The Telefónica Group has also created a landmark project involving artificial intelligence, which in Brazil we will build into our virtual attendant Vivi. Based on the principle of client confidentiality, users will have security, transparency and control of their information.

This project is named Aura, and it will be a complete virtual assistant, answering clients' questions about things involving the internet, cell phones, pay TV and any of the services, which Vivo offers in Brazil. This is sure to give us more satisfied clients, thanks to the quality and speed with which we will be able to offer clear answers to their queries.

Today we are building the Vivo of tomorrow

The four fronts I have mentioned here are part of a major commitment that we have undertaken to our staff: to follow our DNA textbook which requires us to be a Reliable, Efficient, Simple and Delightful brand. Therefore, we have created a program, which is already changing the way we service our clients and relate to them, based on the characteristics that have made Vivo unique in the marketplace. I have no doubt that we shall be a benchmark for our clients over the years ahead.

Another important backdrop is the internal culture change involving our staff, as our organization undergoes this digital transformation. We have, for example, reinforced the #DeX project, which involves a complete change in the way multidisciplinary teams from different department of the company work together: they are now organized in digital squads, using methods such as Agile and Design Thinking as a basis. This project has been in existence for a year and a half, and now some 200 Vivo employees are members of the Squads, which in turn can provide more than 140 different functions through the various digital service channels. People are the basis of our strategy. Attracting and retaining the best talents in key areas of the Company will allow us to achieve our digital transformation successfully.

And in 2017, through our institutional campaigns – which accompanied a change in our brand positioning ("*Viva Tudo*") –, we invited our clients (as well as our partners and our staff) to rethink their habits and "*Viver Menos do Mesmo*" ("Live less of the same"). With the film #Repense, we ended 2017 once more in the leading role in discussions on matters that go beyond connection services and technology.

Responsible and sustainable management

In 2017, we raised our compliance rules to new levels, to ensure that we meet all the requirements of the regulations and standards that apply to us. Proof of this change was the recognition of Telefônica Brasil as one of the 15 most highly rated companies in the NGO Transparency International's publication "The 100 Top Companies and 10 Top Banks in Brazil". In rating the 100 companies, the study took into account three aspects of each of the companies analyzed: adoption of anticorruption practices, clarity of the organizational structure and transparency of published financial statements.

We also introduced #VivoDeAcordo, an online training program to make all our staff more familiar with these all-important issues.

Once more we are included in B3's Corporate Sustainability Index (ISE 2018) portfolio, an important achievement in consolidating our position of excellence in sustainable management, which shows how we have steadily been adopting the best corporate governance and social and environmental responsibility practices, generating increasing value for our shareholders and investors.

Innovation is one of the pillars of the sustainability of our business, and this is the role of Telefónica Open Future, a support program for entrepreneurs, that allows us to absorb new ideas, projects and solutions coming from digital startups and turn them into services. One of the highlights of Open Future is Wayra, the country's first corporate accelerator, which in 2017 commemorated five years of operations in Brazil. The model is now mature, and to date Wayra has invested more than R$10 million in 64 startups, with major support from the risk investment market.

And we create value for society. Through the Telefônica Vivo Foundation, we invest in initiatives for innovation in education, social entrepreneurship and citizenship. Foundation projects benefited 1.2 million children, young people and teachers in 2017. During the year, the Telefônica Vivo Foundation launched initiatives such as *Aula Digital* ("Digital Lesson"), which is intended to improve the opportunities for children in areas of vulnerability, using technology and new teaching and learning methods to bring these new ideas into the schools.

We want more in 2018

We are happy with what we have achieved in 2017, but there is still a long way to go. We want to do more in 2018, and we can do more. We will introduce even higher standards for the way we work and create more value for our employees. We will increase our B2B business, extend the FTTH network more rapidly and maintain our lead in mobile operations by speeding up the introduction of 4G technology.

It will not be long before the word "digital" ceases to have meaning, because everything will be digital. And there is no turning back. So we will continue to digitalize as fast as we can. But if the whole population is to benefit, we have to resolve two dilemmas which require immediate attention: the current legal framework, which regards fixed voice services as the only essential, when people value them less each day. In other words, the telecom operators are meeting the legal requirements of a concession model that is already outdated.

IPEA figures, for example, show that only 369 municipalities have broadband faster than 10 Mbps on average. In 67% of Brazil's cities the available infrastructure can handle speeds of 2 to 10 Mbps, and in 26% the maximum connection speed does not go above 2 Mbps. Some 11.6 million Brazilian households would use the service, but it is simply not available to them. The legal framework needs to be changed to provide a balance of requirements and so as to ensure that broadband is available universally. We support the creation of public policy for the installation of high-speed broadband services, which without doubt will have a major social and economic impact in cities where there is both a large population and a demand. This will ensure that operators invest in broadband and extend access to fast connections in less competitive regions. Otherwise, there will continue to be two separate Brazils: one of them connected, in line with international standards, and the other unconnected and far below the average.

We believe that broadband is of fundamental importance for the country's economic and social development, and we are committed to building a digital Brazil. We shall do this with the help of our partners and our staff; and above all we shall do it sustainably, creating value for our shareholders. My thanks to all of you!

Eduardo Navarro

CEO of Telefônica Brasil

2. **Telecommunications Sector Economic Scenario**

2.1. Economic Scenario

The Brazilian economy faced ups and downs in 2017, although the economic activity has given more consistent signs of recovery. The international scenario also helped, since, globally, there was greater economic growth without inflation pressure, enabling stabilization of the monetary policy in developed countries. This situation contributed to keeping global liquidity at high levels, which benefited the emerging economies and maintained risk premium at low levels. In Brazil, there were advances due to economic measures, amidst the uncertainty in the political sphere. Among these measures, we highlight the creation of the limit for government spending, the labor reform, the reduction in inflation targets, the microeconomic reforms intended to reduce Brazil Cost, and the credit reforms, which included the creation of the TLP (*Taxa de Longo Prazo*, or Long-term Interest Rate) in order to reduce subsidized credit. The success of the monetary policy in fighting inflation pressures, which enabled return of inflation expectations back to the targets, opened a space for a sustainable cycle of reduction in the basic interest rate, which fell practically by half in 2017 (from 13.75% to 7.00%). On the other hand, the political turmoil due to denounces in the

scope of Operation Carwash delayed the voting of some reforms such as social security, which was postponed for 2018. Consequently, increased uncertainty in the tax scenario continues to be quite challenging, which, in turn, boosted the volatility and depreciation of some financial assets.

In the tax scenario, the 12-month public sector primary deficit fell to 1.7% of GDP, against 2.5% in 2016, as a result of the effects of the recovery of economic activity on public revenues as from the second half, and reduction in expenses, particularly, non-mandatory expenses, which are more flexible. The result exceeded the target established for the year (2.4%). Despite that, the negative result led to an increase in gross debt from 69.9% of GDP in 2016 to 74% in 2017, while the public sector’s nominal deficit grew from -7.6% of GDP to -7.8% on the same basis of comparison due to increased debt stock.

Inflation retreated significantly on both wholesale and retail indices, driven mainly by the shock of favorable supply on food prices and the effects of the recession on market prices, amidst anchored expectations. The General Price Index – Internal Availability (IGP-DI) calculated by Fundação Getúlio Vargas fell 0.42% in 2017 after a 7.2% rise in 2016 and reflected lower market prices polled by the Wholesale Price Index (IPA-DI), which dropped 2.5% in 2017 after rising 7.7% in 2016 and the slowdown of the Consumer Price Index (CPI), which rose 3.2% in 2017 against 6.2 in 2016. The Extended Consumer Price Index (IPCA) calculated by the IBGE and used by the Brazilian Central Bank as a benchmark for its inflation targeting system, rose 2.95% in 2017, or 3.35 percentage points less than in 2016 (6.3%), staying below the lower limit of the inflation target (4.5, within a tolerance range of 3% to 6%).

In this favorable inflation scenario, the Monetary Policy Committee (Copom) cut the basic rate from 13.75% in the end of 2016 to 7.0% in the end of 2017. Net of the inflation rate in the year the actual real interest fell to 4% against 7% in the previous year.

The prevalence of a relatively unstable political environment, despite the partial progress made on the reforms required to return to growth, combined with a gradual stabilization of the monetary policy in developed countries, resulted in the devaluation of Brazil's currency against the US dollar, which increased to R$/US$3.31 by the end of 2017 (from R$3.26 by the end of 2016), which is equivalent to a slight devaluation of 1.5% of the Brazilian currency against the level recorded in the end of the previous year. Despite this, the year's average exchange rate of R$/US$3.19 was 8.4% lower than in the previous year.

Foreign trade figures were quite favorable in 2017. Brazil posted a US$67 billion trade surplus in 2017 (against US$47.7 billion in 2016), as a result of the increase in exports against imports, which varied 17.6% and 9.6%, respectively. This account helped reduce the current account deficit to 0.5% of Brazil's GDP in 2017, from 1.3% by the end of 2016, and its international reserves ended the year at US$382 billion against U$372.2 billion in the end of the previous year.

The economic activity started to recover in 2017, after two years of recession, reflecting the return of confidence in greater political stability and advance of structural reforms; the incentives of the monetary policy; the recovery of purchasing power due to a sharp fall of inflation; and the favorable external scenario. With regard to supply, the main factors that boosted growth were consumption, favored by the increase in actual income and lower inflation rates; and exports, reflecting the increase in global growth. In this context, investments gave the first signs of recovery in the third quarter, after more than three years of downturn. According to estimates, GDP increased approximately 1% in 2017[1], after falling 3.5% in 2016.

2.2. Competitive Scenario

The year 2017 showed signs of macroeconomic recovery, but the telecommunications market still felt the effects of retraction in previous years. The behaviors observed between operators and consumers were intensified amid this scenario.

In the landline market, the expansion of Broadband continued to show strong results. There is a clear search for higher speed access, as shown by the growth observed in UBB (speeds greater than 34Mbps), against a lower growth, and even retraction, of lower speed accesses. In the mobile market, the increased need for data guided the sector's trends. Commercial offers focused on the increase in data volumes supplied, highlighting them in advertisements. Combined with this offer, the increased availability of Value-Added Services and access to mobile applications also consolidate the trend for Internet access

through mobile devices.

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[1] Market estimate, according to the Focus survey.

Added to this combination of factors is the operators' search for digitalization. e-Care, which comprises virtual forms of interaction and care with subscribers, clearly benefits the telecommunications companies both for boosting enchantment and loyalty of customers, who are more and more used to the omnichannel environment, and for reducing costs. Simultaneously, we see growing concerns regarding the expansion of the network in terms of coverage and quality. In 2017, 4G coverage reached more than double the cities served, taking higher speeds to over 90% of Brazil's population.

Telefónica Brasil maintained its track record of delivering significant results throughout the year. The consistent growth in all financial lines reinforced the message of a sustainable company, established to compete in the dynamic telecommunications market. In the mobile business, the mix of post-paid customers continued to migrate to plans with greater ARPU, consolidating the vocation of Telefônica Brasil to capture high-value customers, given its distinguished quality and capacity to deliver innovative solutions. In the fixed business, we delivered FTTH to 16 new cities that presented commercial performance above the expectations. Accordingly, we were able to provide greater quality and higher speed to new customers in products deemed as "premium" in the global telecommunications market (fiber optic and IPTV).

2.3. Regulatory Environment

With regard to the Ministry of Science, Technology, Innovation and Communications (MCTIC), we highlight the organization of important public consultations for the sector. These included the Brazilian Strategy for Digital Transformation and the consultation on the Telecommunications Public Policies Decree, which took place simultaneously to the development and release of the National Plan for the Internet of Things.

See below the key regulatory topics included in the agenda of Telefônica Brasil, ANATEL (National Telecommunications Agency) and the Federal Government.

Court-supervised reorganization of Oi

A key topic involving ANATEL was the court-supervised reorganization of Oi, which required constant actions by our technical body, our Directors and the Specialized Attorneys' Office. In spite of the approval of the court-supervised reorganization by the Shareholders' Meeting held on December 20, this topic will continue to require significant attention from the board of ANATEL in 2018, particularly with regard to (i) the treatment ANATEL's credits associated with Oi's fines; and (ii) a potential intervention, or even annulment of the concession in case of deterioration of operations.

Despite being attentive to the issue, Telefônica Brasil has limited capacity to interfere in its outcome. Regarding the credits hold against Oi, Telefônica Brasil adopted the measures required to assure the best treatment possible, also by voting in favor of the reorganization plan presented in the meeting with creditors; acting together with the administrator of the reorganization; and participating in the lawsuit in progress in Rio de Janeiro.

Conduct Adjustment Term (TAC)

In September 2017, after several months analyzing the issue, the Federal Court of Auditors (TCU) unanimously approved the signing of the TAC negotiated between ANATEL and Telefônica Brasil, under the condition that, before signing the instrument, the agency must fulfill certain conditions and recommendations imposed. In the past months, ANATEL's technical area analyzed the adjustments required, having submitted the new version of the Term for approval by the board. The document will be sent to the TCU, which will make a summary analysis of the amendments made and allow the commitment to come into force.

New Regulatory Framework for Telecommunications

Bill of Law (PL) 79, which deals with the Regulatory Framework for Telecommunications, has not been approved yet. The document was sent by the Senate for presidential sanction in the end of 2016.

In early February, STF justice Luís Roberto Barroso granted an injunction filed by a group of senators aiming at avoiding sanctioning of the bill of law by the President of the Republic, and rather, his retuning of the document to the Federal Senate to be analyzed again.

On August 24, the president of the Senate, Eunício Oliveira, said, during a meeting with MCTIC, ANATEL, service providers, the industry and entities of the telecommunications sector, that the project would not be voted without a decision by the STF about the Injunction that prevented submission of the matter for sanction. On October 5, STF justice Alexandre de Moraes determined the immediate analysis by the Senate of the appeals filed by the opposition so that the bill of law could be analyzed by the Plenary Session.

Despite this decision, in the last months of 2017 the project was still pending a discussion at the Federal Senate.

Revised Concession Agreement and PGMU (General Universalization Targets Plan)

After successive postponements of the five-year revision of Concession Agreements, the instruments revised were not signed in 2017. Questions were raised about the addition of a new clause that valued the estimated balance from the planned reduction in universalization targets in favor of the Federal Government, in the amount of R$3.5 billion (including all concession operators). For the companies, the time was too short to discuss this proposal, also because it included amounts that did not represent a consensus.

So, despite all discussions, the Government has not yet published the Presidential Decree that revises the PGMU which, based on the Public Consultations already held, provides an exemption to concession operators by recognizing that the provision of STFC (Switched Fixed Telephony Services) has lost its social importance, and the maintenance of obligations in connection with collective (TUP – Public Phones) and individual access, as it was in the past, is no longer warranted.

General Concessions Plan (PGO)

In January, ANATEL opened a public consultation about the General Concessions Plan (PGO), but in the absence of a decision about PLC 79/2016 by the Senate, the deadline for sending contributions was postponed to June 10, 2017. According to Telefônica Brasil, the PGO must be updated primarily in order to create a new cycle of investments in telecommunications in Brazil that would focus on the expansion of updated networks that may enable access to broadband connections in ultra-high speed. The company said that many resources allocated to the fulfillment of concession obligations ceased to make sense in a world where fixed telephony has lost its importance.

Telefônica Brasil highlighted that the process of revising concession agreements and universalization targets must be completed urgently, and that the balances involved must be duly ascertained and used in the context of the new telecommunications model. We have also reinforced that it is important that the PGO be published together with all regulations that may require revision, ensuring concession companies the possibility to analyze the conditions set forth in the new agreements and how migration will take place.

Fixed Broadband Data Franchises

The term for delivery of the “collection of subsidies” (an open and informal procedure used for collecting subsidies) for fixed broadband data allowance, which is conducted by ANATEL, ended on April 30. According to Telefônica Brasil, since the capacity to offer data resources is finite, this should be equally treated as a finite resource, similar to water and gas. Additionally, the unpredictability of future traffic, the exponential growth of demand, and the progressive reduction in the profit margins of the service may diminish the investment capacity of providers and make the broadband market economically unfeasible.

On March 15, Federal Senate Bill of Law 174/2016 proposing prohibition of a limited consumption allowance for fixed broadband internet plans was approved by the Plenary Session of the Senate and submitted to the House of Representatives, where it was named PLC 7182/2017. On May 30, the Consumer Protection Commission approved the bill, which was then submitted for analysis by the Science and Technology, Communication and Information Technology Commission (CCTCI).

General Competition Targets Plan (PGMC) and related rules

The contributions for the Public Consultation regarding the new General Competition Targets Plan (PGMC) were accepted until March 22. The contribution given by Telefônica Brasil focused on measures involving investments, particularly, regarding companies that hold telecommunications infrastructure, which often have to make high additional investments to share infrastructure, withdrawing the incentives in new infrastructure investments and more attractive services. In terms of competitiveness, we highlighted the revision of the asymmetric rules implemented for each category created, in accordance with the competition level, and suggested improvement in the criteria adopted. We also defended shorter terms for revision of PGMC due to the fast changes in the sector and suggested that ANATEL request information on wholesale markets to all participating companies in order to make a more realistic analysis of significant market power. Finally, we suggested the exclusion of the relevant High Capacity and Fixed Networks Interconnection markets.

The contributions for the public consultation about the General Interconnection Regulations (RGI) were also accepted until March 22. The main points defended by Telefônica Brasil suggested that, in the scope of investments, technological updates must be grounded on detailed economic impact surveys, in view of the country’s current economic difficulties and the clear pressure on the revenues of telecommunications services providers. Also, we highlighted that the requirement to share such technology with other operators, without any guarantee of return on the investment, may have an adverse impact on the sector.

Spectrum Allocation

On July 4, ANATEL board approved the 2017 Plan for Assignment, Destination and Distribution of Radiofrequency Bands in Brazil, which consolidates and informs the principal rules for use of the band-to-band spectrum and presents the agency’s latest decisions about the management of frequencies.

On November 7, ANATEL published Resolution 688, which establishes that, within two years, 100 MHz located between the frequencies of 2,300 MHz and 2,400 MHz will be occupied, primarily, by the Personal Mobile Service (“SMP”). With this new allocation, Brazil’s mobile telephony will count on a 997 MHz band.

Public Price for Rights to Use Radiofrequency (PPDUR)

The public consultation regarding revision of the calculation of the Public Price for Rights to Use Radiofrequency (PPDUR) was completed in May. The revision of these regulations brings new methods for calculating the price paid for radiofrequencies.

Phase out of Analogue TV and Release of 700 MHz

Phasing out of the analogue TV signal is an essential action for activating the LTE (Long Term Evolution).) in 700 MHz. Migration from the analogue TV signal to the digital signal, which enables releasing the 700 MHz band for use by the SMP, is being implemented by GIRED (Group for Implementation of TV and RTV Channels Distribution and Digitalization Process), according to the schedule established by the MCTIC. The first city where the analogue signal was switched off was Rio Verde (State of Goiás) in February 2016, followed by Brasília (Federal District) on November 17, 2016.

In 2017, the signal was switched off in the municipalities of 8 Brazilian states. In the capital cities, the signal was switched off in March, in São Paulo (São Paulo); in June, in Goiânia (Goiás); in July, in Recife (Pernambuco); in September, in Salvador (Bahia) and Fortaleza (Ceará); in October, in Vitória (Espírito Santo); and in November, in Belo Horizonte (Minas Gerais) and Rio de Janeiro (Rio de Janeiro).

According to MCTIC, 3,489 municipalities have already been cleared for activation of the LTE in the 700 MHz band. In 2018, the signal will be switched off planned for the capital cities of Curitiba (Paraná), Florianópolis (Santa Catarina) and Porto Alegre (Rio Grande do Sul), in January; São Luís (Maranhão), in March; Belém (Pará), João Pessoa (Paraíba), Maceió (Alagoas), Manaus (Amazonas), Teresina (Piauí) and Aracaju (Sergipe), in May; and Boa Vista (Roraima), Campo Grande (Mato Grosso do Sul), Cuiabá (Mato Grosso), Macapá (Amapá), Palmas (Tocantins), Porto Velho (Rondônia) and Rio Branco (Acre), in November.

Thus, by the end of 2018, the analogue signal will have been switched off in all capital cities and, by mid 2019, all Brazilian municipalities will be ready to receive the LTE in the 700 MHz band.

National Plan for the Internet of Things (IoT)

The National Plan for the Internet of Things (IoT) was prepared in 2017 based on a survey ordered by the National Economic and Social Development Bank (BNDES) and the MCTIC to the consortium set up by McKinsey consulting company, CPqD, and Pereira Neto Macedo Advogados law firm.

The study was divided in three phases: i) diagnosis and Brazil's aspiration regarding IoT; ii) definition of priority sectors for investment; and iii) preparation of actions intended to accelerate implementation of the IoT market in the country. Accordingly, the preparation of the survey included public consultations that sought to discuss the guidelines to be adopted by the plan, and the publication of a series of technical reports – as a result of the study – which included, among others, the benchmark for public policies, the map of technological offer and supply, and the report on the country's regulatory environment.

The National Plan was officially launched in October, during the 2017 Futurecom. The details of each priority verticals of the 2017-2022 action plan (smart cities, rural, health and industry) were disclosed during the event. Topics such as regulations were also discussed, including the regulatory review, which is part of

ANATEL's Regulatory Agenda for the second half of 2018.

The vision established in the National Plan for IoT in Brazil is focused on increasing competitiveness of the economy; strengthening productive chains and improving people's quality of life, with objective actions defined for each vertical.

With regard to Cities, the plan intends to encourage the use of technology to solve problems such as mobility, public safety, energy efficiency and sanitation. In the health area, IoT solutions will be stimulated to improve the treatment of chronic diseases, control of epidemics and infectious and contagious diseases, and efficiency in management of health units and hospitals. With regard to the rural vertical, projects to promote the efficient use of natural resources and inputs, efficient use of machines, and monitoring of biologic assets will be encouraged. In the industrial vertical, IoT can be used to increase the efficiency and flexibility of industrial processes, develop new equipment, and promote integration and cooperation throughout the productive chain.

Video on Demand (VOD)

The contributions regarding the public consultation on "Video on Demand" (VOD) were accepted until March 29. The National Film Agency (Ancine) proposed a debate about the rules of the offer of on-demand audiovisual content in the domestic market. The scope of the document includes the definition and objectives intended by the regulations, based on four topics: guarantee of legal certainty to VOD providers; independence of economic agents that operate in different segments of the audiovisual market; search for increasing the diversity of the offer of audiovisual content; and prospects for development of services, of Brazil's audiovisual production, and of the audiovisual economy in the country.

The National Association of Telephony and Cellular and Personal Mobile Service Companies defended that, within the legislative scope, the adoption of tax and regulatory obligations for Audiovisual Communication On Demand (CAvD) should be the subject matter of a bill of law to be discussed at the National Congress. The entity also questioned the high tax burden already levied on providers of the telecommunications sector in Brazil and defended that Ancine should give priority to values such as free initiative, freedom of expression and independence, so as to enable a favorable environment for development in the sector.

Public Consultation: Brazilian Digital Transformation Strategy (EBTD)

The public consultation on the Brazilian Digital Transformation Strategy was launched on August 1st and received contributions until September 20. The strategy was developed by an interministerial workgroup that carried out a diagnosis and, based on the survey, prepared a strategy for the digital transformation of the Brazilian society. To that end, the strategy proposed specific actions that are divided in 7 topics. Based on a list of suggested initiatives, the public consultation asked the participants to indicate 3 strategic actions in each topic, as well as supplementary actions and possible challenges regarding the implementation of the strategy. The contributions given by Telefônica Brasil were as follows:

- Infrastructure and Access to TICS – Tax Exemptions and review of FUST legislation in order to enable its application for expansion of access to broadband; approval of PLC 79/2016 and availability of spectrum for development of 5G;
- Research, Development and Innovation – Joint calls for international cooperation and greater interaction between the public and private sectors and the academy;
- Trust on the Digital Environment – Publication of a specific law on personal data, and consolidation of a legal framework regarding cyber security;
- Education and professional Qualification – Increased speed of access at public schools, and synergy among different national plans;
- International Dimension – Active promotion of the international regulations in force and of technology transfer programs;
- Transformation of the Economy – Strengthening of the ecosystem for development of the data market, international interoperability and adoption of cloud computing in public administration sectors;
- Transformation of the Government – Improvement of the network infrastructure and databases of public administration, and development of e-Government initiatives.

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Internet Management Committee (CGI.br)

On August 8th, the MCTIC launched a public consultation to assess the need for changing the governance and composition of the Internet Management Committee (CGI.br). The consultation was open until September 8, and Telefônica Brasil presented its manifestation, which basically sought to (i) implement measures to improve transparency; (ii) establish new governance practices (including issues relating to reelection and term of office); and (iii) change the composition of the committee aiming at improving the balance among stakeholders, including increase in the number of private sector representatives.

Public Telecommunications Policies Decree

On October 18, the MCTIC launched a public consultation on the Public Telecommunications Policies Decree. The consultation was closed on November 17. The new decree proposes a revision of the regulatory framework for the sector by updating the legislation through replacement of three previous decrees: Decree 4.733/2003, Decree 7.175/2010 (which established the National Broadband Plan), and Decree 8.776/2016 ("Brasil Inteligente" Plan). The main aspects of Telefônica Brasil's contribution are as follows:

- Incentives to investments in projects for expansion of telecommunications networks;
- Guarantee of the economic feasibility of telecommunications services;
- Promotion of research and development of technological solutions for compliance with public telecommunications policies;
- Maintenance of the authority of MCTIC and ANATEL, as provided for in the current legislation, avoiding the interference of the Ministry in the actions taken by the agency and safeguarding its independent character;
- Promotion of an efficient management of the radiofrequency spectrum;
- Promotion of a regulatory environment with simplified norms, based on minimum governmental intervention and incentives to long-term investments, with balanced obligations and rights;
- Compliance of the conditions provided for in the General Competition Targets Plan (PGMC) regarding the sharing of transport networks and metropolitan networks implemented based on the investment commitments established by ANATEL as a result of the Conduct Adjustment Terms;
- Coordination, by the MCTIC, of the implementation of the National Plan for the Internet of Things, aiming at developing smart cities, health, agriculture and industry, as per the guidelines of the national plan; and
- Exclusion of the article regarding the activities performed by Telecomunicações Brasileiras S.A. - TELEBRÁS, proposing that this mixed-capital company receive the same treatment as market operators, without any privileges or exclusiveness in the provision of services.

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2.4. Commercial Strategy

Just as in the previous years, we faced strong competition in Brazil's telecommunications market. According to ANATEL, the number of accesses has dropped significantly, particularly in the mobile segment. Therefore, the competitive environment has remained active in the search for new customers and maintenance of customer bases.

Given this scenario, in 2017 the Company carried out a commercial strategy focused on high value customers, seeking to expand its leadership in the market share of these segments, and consistently increase the ARPU in key markets.

With the challenge to maintain revenue growth amid a market in decline, particularly regarding traditional services (voice and low-speed broadband), high-value segments, such as ultra-broadband, post-paid plans and mobile data, played a key role and recorded a good performance. Customers are requesting more quality and more availability of data, which requires constant investments in development, update, expansion and continuous improvement in the quality of services and customer experience.

The mobile business maintained good expansion in revenues, boosted by the growth in the post-paid segment and greater contribution from data. The Company recorded growth in market share, with a focus on a high-value customer mix, supported by strong commercial activities. With the launch of the new mobile portfolio with unique and innovative settings, we managed to stand apart from competition and improve the segment's monetization.

Among the main commercial actions in 2017, we highlight the innovations of the post-paid mobile portfolio offered through Family Plans. The new applications enable customers to make a better use of the data franchise through plans that add benefits to be used in applications and essential services, fostering greater loyalty from mobile segment's customers.

A novelty in the Brazilian market, the company launched a functionality that enables users of "Vivo Turbo" and "Hybrid" pre-paid plans to share, at no cost, their mobile internet packages with other customers with the same plans through, whether through the application or through "Meu Vivo" website. The action helped users make a better use of data through an innovative tool that was publicized in a campaign featured by Brazilian singer Ivete Sangalo and famous youtubers.

The Company also launched "Vivo Turbo Bis," which enables customers to transfer accumulated unused internet balances to the following month, after the end of the current allowance.

Hybrid plans were revised in 2017, with the launch of new offers an increase of up to 50% in data packages. The plans also include exclusive application contents, such as NBA, Kantoo and GoRead.

Maintaining absolute leadership in the market share of the post-paid segment[2], in 2017 the company introduced four novelties for "Vivo Família" plans: internet bonus for exclusive use in video and music applications (Spotify, Youtube, Vivo Música, Netflix and NBA); access to essential applications without using plan data (Cabify, Easy Táxi); inclusion of digital services, such as Studio+ and NBA (entertainment), Vivo Sync and Vivo Família Online (safety), Vivo Educa (education) and Vivo PlayKids (for children). Finally, some eligible Vivo Família plans enable customers to receive seven daily allowances in Vivo Travel and another 100 minutes of long-distance calls while travelling abroad. The communication regarding Family plans was focused on new family compositions under the slogan: "Living less of the same."

Vivo's 4G technology maintained its recognized quality in 2017, with strong expansion in its coverage, reaching more than 2,300 municipalities. The company continued to be a leader in the market share of 4G technology[3]. In line with the digital transformation strategy, in December we announced the 4G+ (LTE-Advanced) coverage for all Brazilian capitals, totaling 118 municipalities. The voice on LTE (VoLTE) service was also activated in Rio Verde (Goiás) and Brasília (Federal District), allowing the use of voice in 4G mobile telephony networks.

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[2] Source: Anatel – December 2017.

On the mobile front, the following actions and initiatives, among others, aimed at expanding differentiation, in line with the “more for more” strategy: partnership with Movile (education application with more than 50 video courses), NBA (distribution of content through mobile phones with live games and virtual reality), Vivo Recado Premium application (automatic transcription of voice from the inbox to text), GoRead (digital magazines in partnership with Grupo Abril), Vivo Meditação application (guided by monk Satyanatha), and Vivo Transfer (free application for transferring data from one cell phone to another). We highlight other actions, such as the LG G6 smartphone test drive at Vivo’s physical stores, and the partnership with the store iPlace for sale of iPhones with Vivo post-paid and Hybrid plans.

With regard to the landline business, the year 2017 saw strong expansion in broadband, partially offsetting the trend for maturity of voice. Once again, strong commercial activities and the improved mix of broadband and paid TV accesses boosted the average revenue per user (ARPU).

The year ended with the expansion of the fiber optic network to another 16 municipalities. According to ANATEL, Telefônica Brasil recorded 1.3 million broadband accesses through fiber (FTTH), a 45% growth against the previous year. In the State of São Paulo, we surpassed our rivals in the number of net additions through fiber, with over 300 thousand new access in the year.

In Brazil, the Company recorded an expressive performance in terms of growth in accesses with speeds above 34 Mbps. There was a 29% increase compared to the previous year, reflecting the Company’s efforts towards growing the customer base and migrating customers to higher speeds. We also highlight the effect on the growth of the average speed of accesses of residential customers, which increased by 22% in this period.

With the “Living less of the same” advertising campaign, the Company marked the evolution of the “Viva Tudo” positioning by inviting people to experience new possibilities with Vivo Fibra’s ultra-high speed (from 50 Mbps to 300 Mbps). The Company also expanded its fiber-optic TV services (IPTV) to another 3 cities: Curitiba, Rio de Janeiro and Niterói.

As a benchmark in the segment of online games, the Company introduced important novelties in 2017: the launch of Vivo Games4U, a service that gathers the world’s best games, with over 300 games; the announcement of the sponsorship of the eSports team; Vivo Keyd; and, finally, the new season of the documentary “Game Changers.”

The convergence actions continued throughout the year with commercial campaigns promoting fixed broadband offers that included minutes in mobile service calls and data bonuses for mobile internet.

In a year marked by digital transformation, the initiatives on the continuous improvement of the customer’s experience were evidenced by significative advances in digital services. The volume of virtual services in the last months of the year surpassed 1 million per month through the web and mobile site, “Meu Vivo” application, Facebook Messenger, and other digital channels. These digital interactions show the Company’s engagement with its strategy to promote more quality with differentiation and continuous improvement.

Our Brand

In 2017, the Vivo brand built on its “Viva Tudo” positioning with a new look on technology, through a more aggressive brand opinion. Based on the “Less of the same” concept, we invited our customers to leave their ideological bubbles and reflect about the new possibilities afforded by connection. We encouraged people to experience less their pre-established standards and concepts and to open up for new things. Accordingly, the brand tried to get closer to people by participating in discussions that have been guiding our society, such as gender, age or family composition stereotypes.

Once again, the year was marked by a series of recognitions and awards that shows our brand's strength and soundness. Vivo continues to rank among Brazil's most valuable brands, maintaining the 9th place in the ranking published by the consultancy firm Interbrand with its estimated valuation of R$2.356 billion. For the tenth consecutive year, Vivo was elected Top of Mind brand in the mobile phone and broadband categories by the reputable survey conducted by the *Folha de São Paulo* newspaper.

Our commitment to customers has also been recognized. Vivo was elected the brand that most respects consumers by *Consumidor Moderno* magazine in the "fixed telephony operator" and "mobile telephony operator" categories. An award made by *Seleções* magazine in partnership with Datafolha elected Vivo as Brazil's most reliable telephone operator for the 14th time, with five points over 2016.

The Company was also highlighted in the market's top rankings. Telefônica Brasil was appointed as the best IT & Telecom company by *Valor 100* yearbook, published by *Valor Econômico* newspaper, and led the ranking *As Melhores da Dinheiro 2017*, published by *Dinheiro* magazine, in the Social Responsibility category. For the third consecutive year, we ranked first in the Telecom category of the *Empresas Mais* survey published by *Estadão* newspaper. We were also awarded the 2017 *Empresas Notáveis* Prize developed by *Grupo Padrão/Consumidor Moderno*, in the "Mobile Convergence" category. TData, which is the technology arm of Telefônica Brasil, was appointed as the best company in the Telecommunications industry in the "Best & Biggest" award held by *Exame* magazine.

Communication Plans and Campaigns

Throughout the year, we faced the challenge to present the evolution of our "Viva Tudo" brand positioning in integration with the communication of our services, based on the slogan "Live less of the same."

This concept was launched in May this year, during the new Vivo Fibra broadband campaign. We showed several films that reinforced the brand's belief in the power of connection to transform the lives of people and make them search for new discoveries.

We have also adopted a differentiated approach to communicating this service through digital means. We started the year continuing the series of three short films called "Great Broadband Dramas," which featured the functionalities of Vivo Fibra Broadband in a funny way. Their language revisited classic old-school horror movies; their high-point is always one of our technicians arriving to install Vivo Fibra. This campaign followed a "brandformance" strategy, which connects the processes of generation of awareness, consideration and performance into a multiplatform delivery.

Later on, we launched *A Revolta dos Conteúdos* [The Rebellion of Content] online campaign, a series of three films that showed Vivo Fibra's superiority in a didactic, mobilizing manner with a touch of humor. The films aired from June to December were based on the insight that consumers without quality broadband are complacent. The purpose is to make them act and mobilize them to change to *Vivo Fibra*. Using the concept "Don't get frozen; change to Vivo Fibra," we demonstrated the contents more commonly consumed through broadband, such as shows, games and films, rebelling against the low-quality of the user's connection, which kept on freezing".

To complement this approach, we count on a continuous online performance campaign, which is addressed to audiences that are more likely to buy the service. This line objectively reinforces the advantages of Vivo Fibra broadband, and leads users directly to the sales channels.

We also directed efforts to communicate the strong expansion of Vivo Fibra services, which reached 16 new cities in 2017. With an objective message, and focusing on the offer, we used several means, such as free-to-air TV, cinema, OOH (Out Of Home), outdoor media, printed media, radio, and tactical means with impact, such as pizza boxes and partnerships with local fitness centers.

With regard to Vivo TV services, our communication challenge was to position them as TV services with varied contents and counting on the quality of Vivo Fibra. To do that, we conducted joint campaigns, taking advantage of our partnership with channels such as HBO and Telecine to promote key releases and reinforce the quality of Vivo's TV.

The communication of our post-paid mobile services continued to highlight 4G+ Family Plans and followed the evolution of their positioning. We featured different family formations that are real, showing true and moving stories under the concept "Experience more of new families and less of same plans."

We also highlighted the new benefits of post-paid plans through an innovative content initiative: the "*cacos de família*" web series, an exclusive digital content, produced for*Youtube* and featuring the actress Julia Rabelo, with 5 episodes that show the daily life of a super connected family in amusing situations that evidence the advantages of being a Vivo Pós customer, which includes: Vivo Bis, Vivo Renova, Valoriza, Internet sharing, dependents at no cost. The series had 50 million views, high engagement, and it will be continued in 2018.

In 2017, we saw the evolution of 4G with the implementation of 4G+ in the country – a technology that offers up to twice the speed of the mobile network. The service was announced countrywide through sketches in free-to-air TV, paid TV, and OOH in Brazil's major capital cities that already count with the service.

To communicate the expansion of 4G network coverage in Brazil, we used a regionalized communication strategy, with OOH and promotional materials made to more than 2,000 cities in 9 phases throughout the year. We also highlight the communication in the states where we lead the coverage.

Throughout the year, we produced more than 30 campaigns jointly with partners in the manufacturing sector, such as Samsung, Motorola, LG and Apple, including the campaign to launch iPhone 8, which featured the film *Unicorn*: a history of approximation between a father and his daughter through a 'virtual unicorn', an augmented reality resource that became a bond between them. We also set up a new strategy to sell devices with the *Smart Offers* campaign, whose communication was targeted to retail, in newspapers and shopping malls in São Paulo. We will strengthen this strategy in 2018 by adding more manufacturers and diversifying the promotional strategy.

In the pre-paid mobile segment, we continued our strategy of featuring digital influencers together with the singer Ivete Sangalo. In 2017, besides reinforcing Vivo Turbo as the best choice for pre-paid customers, we communicated new advantages: the promotion of a 1GB bonus for recharges above R$30 and the exclusive data sharing functionality.

In the digital environment, we sought to reinforce our proximity to the market of games, so that Vivo can always be seen as the best choice for this audience, through the launch of the second season of the *Game Changers* web series. In the first season, featured in 2016, we were the first to show the size of this segment and highlight some curiosities. Now, under our "less of the same" brand vision, we seek to present episodes whose main characters are persons with unique stories, such as the Counter Strike player Naná Fraga, who is fully devoted to the game. The first episodes are available on Vivo's*Youtube* and this season will finish in 2018.

In the e-Care segment, our challenge was to develop the communication of Meu Vivo application, which, in addition to the mobile solution, now includes a platform for fixed telephony customers. We maintained previously used didactics, and launched the concept "What time are you living in?" in order to challenge the audience, which, in spite of being acquainted with several forms of technology, still uses traditional

customer service channels. The campaign was aired on TV and on the Digital channel, through four films that highlighted the following functionalities: 2nd copy of the invoice, Troubleshooting, Recharging, Change in Plans, Data Consumption, and Digital Account.

In the second semester, we launched the Vivo Meditação application to reinforce the perception of Vivo as company with innovative digital solutions, and that is close to its customers. With over one thousand meditations guided by master Satyanatha, the application encourages both beginners and experienced practitioners to connect with a new perspective of themselves through the concept "Connecting you with your peace." Our strategy counted on a delivery based on the daily lives of users and reinforced by celebrities and influencers, such as bloggers connected to wellbeing topics and health consultants.

For the first time, we communicated our mobile marketing platform Vivo Ads in an extensive manner. We highlighted the massive reach of our solution, with a base of over 70 million people, the quality of data, and the advantages of the contract, which is paid for only if the use of this media is successful. A specific promotional strategy was created with a focus on differentiated formats for the advertising market. In the end of the year, we were nominated for the Caboré Award in the "Communication Vehicle of the Year" category, competing with giants such as Instagram.

In the end of 2017, we released two films featuring the tennis player Rafael Nadal, a personality that is closely connected to the Vivo brand, and the communication strategy in ATP tournaments and sponsorships relating to tennis. Taking advantage of his top position in the world's ranking, we produced films that raise awareness regarding the Vivo brand and contribute to building our "Leave less of the same" positioning.

Our new positioning also took the leading role in three institutional campaigns aired in commemorative dates with the purpose of rescuing the importance of human relations through technological connection. The first initiative was the *#Renamore* campaign, which tells the story of a young man who was tired of seeing his girlfriend giving more attention to her mobile's screen. He manages to capture her attention again by using the connection, through a playful game that leads them to a personal romantic meeting. With this campaign, we challenge people "to live more of their love, and less of all the rest" and create a connection between the physical and the virtual world.

For Father's Day in Brazil, we released the*#reaproxime* campaign, a moving story about the relationship between father and son. The film shows the connection between them since boyhood until the adult life, highlighting their emotional reuniting. The scenes show that digital connection can help them have a closer relationship.

To celebrate the end of 2017, we invited people to think about different possibilities and live less of pre-established standards and concepts. The *#repense2018* campaign discusses current issues of contemporary society and proposes that people review their opinions on matters such as couples without kids, women's empowerment, and cultural movements, like graffiti and funk.

The evolution of our brand was also communicated to the corporate audience. In the second half of 2017, we launched a new Vivo Empresas positioning with the concept "Open up your company to the New." We reinforced our belief that, to start a new business, enterprise, or even to maintain a consolidated company, one must be very creative and innovative. This concept is closely related to our "Less of the same" vision. Through TV advertising, a strong presence in the Digital segment, and promotional actions in the events in which we participated and sponsored in the segment, we highlighted Telephony, Internet, Information Security, Cloud, Big Data and IT services, consolidating Vivo Empresas as a solutions market place.

Finally, with the imminence of the year 2018 and the World Cup, we defined our position in advance in order to mark our presence in this territory. We understand that our role as sponsors of Brazil's Soccer Team is to place it next to our customers. On this line, we created the concept "Everybody playing together,"

summarized in the hashtag *#JogueJunto*, which will guide all actions for the 2018 World Cup in Russia and serves as the base for our first film: a tribute to the classic Brazilian song *Na cadência do samba,* with a new rhythm and language, also uniting generations: *Que Bonito é* is a show of color and movement, showing that all Brazilians are stars – inside or outside the soccer field.

Relationship events and initiatives

In 2017, Vivo continued to be an important supporter of the Brazilian culture by sponsoring several theater plays, museums and events.

Our theater platform offered cultural experiences to more than 11 thousand customers, who were able to redeem tickets through the *Vivo Valoriza* Relationship Program. We supported 352 sessions of 17 music concerts and theater plays, including the musical play *Les Misérables*, based on Victor Hugo's novel and watched by more than 70 million people in 44 countries.

Throughout the year, Teatro Vivo received over 12 thousand persons who watched 5 plays. The Vivo Rio music hall, a naming rights sponsorship since 2006, was the venue of 124 concerts offered to 160 thousand people, 30 thousand of which used the discounts received through the relationship program.

We reinforced Vivo's commitment to increasingly promote the connection between the audience and the art in Brazil through the sponsoring of *SP Arte* and *SP Arte-Foto* exhibitions. During *SP Arte*, Vivo presented a new concept of open lounge, which was developed and signed by artist Eduardo Srur. More than 30 thousand people visited the exhibition, and 675 pairs of tickets were distributed to the customers of Vivo Valoriza program. The coverage reached over 450 thousand users in social medias, through influencers, and on *Glamurama* website. Guided visits offered by Vivo during *SP Arte-Foto* received over 1,000 adult visitors and 50 children.

For the first time, we sponsored the Brazil Game Show (BGS), the largest games fair in Latin America. Our objective was to consolidate Vivo as a major operator for the gamer audience, and reinforce our "Live less of the same" positioning. Our participation in the event included the name of the central area, "Arena Vivo", where the most important competitions took place, and the supply of the 300 MB Vivo Fibra internet infrastructure to competitors' computers. Vivo also counted on a booth of the Vivo Keyd team, where fans were able to take photos and get autographs from one of the most traditional electronic sports team in Brazil. Other novelties presented by Vivo in the event were: the Vivo Games4U application – a digital service of games that offers full experience, with over 300 games that can be downloaded and played online; evaluations and analyses made by youtubers; and rollout of a new season of the documentary "Game Changers," which tells the story and the challenges of important Brazilian gamers.

In 2017, we also performed actions related to sponsoring Brazil's national soccer team, in partnership with the Vivo Valoriza Relationship Program: customers could enjoy the professional player lifestyle experience at the Granja Comary training center (in Rio de Janeiro) with free tickets for the team's matches and training sessions too.

The Vivo brand had great visibility on the field's signs and on uniforms worn by the men's and women's soccer teams, as well as their coaching and support staff. With Brazil's early winning of a place in the 2018 World Cup qualifying games, we maintained a positive position in the media, being close to our customers and proud to support the national team.

With the sponsorship of *Brasil Open* (the second biggest tennis tournament in the country) and continuity of our support to the Tennis Institute (a center of excellence in training young athletes), we maintained the

visibility of the brand and were close to customers who are passionate for that sport.

With regard to corporate customers, in 2017 we organized events aimed at generating opportunities, improving satisfaction and loyalty, and reinforcing our brand's positioning, based on three pillars: box seats in stadiums, experiences and sponsorships.

We carried out 321 actions with impact on more than 1,300 customers in exclusive spaces – Brazil's largest soccer stadiums, Citibank Hall, Vivo Rio and Teatro Vivo.

Vivo offered 30 gastronomic experiences that enabled us to get closer to 490 companies located in the largest and more important market places in the country (São Paulo, Rio de Janeiro, Porto Alegre, Fortaleza, Curitiba, and Salvador, among others). In sponsoring 35 technology events (Latam Retail Show, IT Forum, and Security Leaders, among others) in order to promote our digital services portfolio (Security, Big Data, Cloud and IoT), we reached 45,000 people and obtained expressive results with business events, with more than 280 exclusive meetings with customers.

Corporate Business Unit

Corporate segment customers (B2B), in particular vertically integrated businesses in commerce, services and industry, are the biggest users of telecommunications services. Although these businesses were among the hardest hit by sluggish GDP growth in 2017, we nevertheless focused our strategy on our new voice offerings and their better cost-benefit ratios in addition to growing IT revenues and tapping potential for synergies arising from our merger with GVT in 2015. Since we have consistently applied credit, billing and collection policies and ensured proper internal governance, we were able to keep delinquency levels under control.

For our mobile business, there was the rollout of Unlimited SmartVivo Empresas plans, which comprise the first portfolio dedicated to B2B customers, including unlimited calls and Digital Services. These plans also include data sharing allowances and unlimited SMS. Regarding this portfolio, we also reinforced our offers with allowances of up to 700 offnet minutes, and allowances of data that may reach 40 GB.

We advanced in our strategy to digitalize revenues from traditional products. Our first step was the rollout of the first bundle including Voice, Mobile Internet and the Vivo Segurança Online solution targeting the Massive Segment. This way, we started the massification of SVAs in our client base.

As highlights of our landline business, we leveraged both our fiber network investments in São Paulo and the synergies with GVT's network elsewhere. In the broadband segment, we continued to see major growth of migrations to fiber lines. In the fixed-line data segment, we continued to grow in the mid-sized customer segment which also saw more potential driven by GVT's network coverage, and we consolidated our position in the major customer segment.

In 2017, our mobile data packages added 18 pp to penetration and 34% to net sales revenues. We also posted 16% growth of fiber revenues due to the large volume of additions and customers migrating from other technologies. In the Machine to Machine (M2M) market, we consolidated our leadership, having reached a 41% market share in November 2017.

In the IT segment, following Telefónica's global initiative to position itself as a MultiCloud provider, we expanded our portfolio of Cloud Computing offers with the inclusion of Microsoft Azure in the IT Products catalog, and launched the new portfolio of Vivo Soluciona TI. Another highlight was the 107% growth in revenues from Security services. Net IT revenues increased by 44%, boosted by the agreement on the supply of equipment to our client Santander.

Telefónica Brasil is continuing to pursue its strategy of growing digital revenues, finding new customers and building its share of fixed-line revenues in states other than São Paulo while simplifying procedures and portfolios, and enhancing the quality of customer services and our responses.

3. **Business performance**

Telefônica Brasil and its wholly-owned subsidiaries, Telefônica Data S.A. (TData) and POP, are operating mainly as nationwide providers of fixed telephony and mobile telephony services through a concession agreement and authorizations issued by ANATEL for Switched Fixed Telephony Services (STFC). Telefónica Brasil S.A. and its wholly-owned subsidiaries also have ANATEL's authorizations to provide other telecommunications services such as data traffic, broadband internet, and pay TV as well as value-added services not classified as "telecommunications."

Infrastructure and Network

Since 2013, the Company has been consolidating a robust network capable of fulfilling customers' expectations customers. We have been able to make progress on migration from Time Division Multiplex (TDM) exchanges to Next Generation Networks (NGN), which has reached 60.2% of migrated landline traffic, while modernizing exchanges and adapting data-center infrastructure. Most of this effort has been made to replace fiber optic enclosure cabinets (ARO) with multi-service access nodes (MSAN) that enable us to offer broadband to large numbers of customers who have not yet had access to this service.

Telefónica Brasil continued to expand its mobile network capacity and coverage in order to absorb growing voice and data traffic and get an even bigger edge over the competition by significantly expanding coverage for 3G technology, in which it is absolute leader.

By the end of 2017, coverage through our mobile networks based on LTE, WCDMA, GSM/EDGE and CDMA digital technologies included 4,265 municipalities (76.61% of the total number) containing 94.44% of Brazil's population. The 2G/GSM-EDGE network showed 2017 ending with 645 municipalities covered in the state of São Paulo and a total of 3,758 elsewhere in Brazil. In the same period, the 3G/WCDMA network was present in 645 municipalities in the state of São Paulo making for a total of 4,005 nationwide.

Substantial progress was made to expand our HSPA+ network (or 3G Plus, as it is known commercially), which operates throughout our 3G network. This technology enables customers who have compatible terminals to attain even higher data transmission speeds of up to three times the traditional 3G levels.

The 4G technology (known as LTE), launched in 2013, was an important advance in the mobile network, since its transmission rates surpass those of the HSPA+ network. In 2017, we continued to expand the coverage of this technology and, by year-end, the 4G/LTE network reached 2,600 municipalities in Brazil.

In 2017, our fiber optic network with GPON technology reached total coverage of 18.4 million homes passed, of which 7.7 million in the state of São Paulo and 10.7 million elsewhere, with speeds ranging up to 300Mbps.

Telefónica Brasil is constantly working to offer market differentiators such as new integrated services, speed upgrades and coverage for more localities.

Our fiber optic portfolio in the state of São Paulo includes IPTV for high definition (HDTV) services. In addition to IPTV, in 2017 the company expanded its portfolio of advanced products for corporate customers with GPON fiber optic services to grow its optical-access customer base to 11,100.

Sales

Telefônica Brasil's nationwide commercial distribution network ended 2017 with approximately 2,000 points of sale owned and managed by authorized resellers, as well as 10,000 retail outlets. This solid capillarity strategy is boosting the company's leadership in the Brazilian telecommunications market and its dominant

share of the high-value segment.

Our commercial operation started a process of transformation of commercial channels that includes the review of its structure and remuneration models, as well as the consolidation of strategic partners, the increase in our capillarity optimization plan started in the previous year, and the unification of programs that are common to all channels, which is resulting in a more intelligent and responsible allocation of resources. In addition, we leveraged sales of higher value-added services that directly drove the operation's profitability, and continued to accelerate the digital transformation of our business.

At the stores, where customers experience Vivo's offers at their most, we made significant advances to improve the infrastructure and systems that may assure sales operations and leverage customers' experience. We have also accelerated the penetration of our landline services portfolio; renegotiated rent agreements; developed new customer relationship opportunities by giving a new meaning to store spaces; and delivered our accessibility project (regulatory obligation). Finally, we were recognized for the best store design (*Popai* award) of our first iconic store in JK Iguatemy shopping mall, in São Paulo. In November, we opened our second store under this concept and the largest in Brazil, located in Barra Shopping mall, in Rio de Janeiro.

In our Retail channel, important items were remodeled aiming at increasing operating profit. The incentive program for retailers now includes easier routines for the staff, a more friendly interface that facilitates usability, and even more attractive incentives. We have also reviewed the Retail business model, implementing fully variable commissions that are adjusted to different partner profiles.

Regarding door-to-door services, which have an itinerant profile, we started a transformation process with creation of operations focused on the high-value segment. This operation, which already prospected for customers in remote regions not reached by face-to-face channels, now counts on an action front to capture high-value converging sales to residential and condominium customers. At present, this channel's operation has about 280 outsourced companies and some 4,000 salespersons.

Our Distribution Channel, which includes, among others lottery outlets, post offices, bank branches, pharmacies, newsstands, and bakeries is responsible for the high level of capillarity of our commercial operations, providing our customers with prepaid and hybrid plan offerings of credits for services through approximately 600,000 points of sale recharging credits. These channels are also the main vehicle for sales of prepaid lines, for which the remuneration model is based on capturing profitable lines that actually drive revenues from recharging credits. In addition, we launched a relationship, incentive and loyalty platform for all components of the distribution chain with the purpose of building loyalty of distributors and sales outlets by promoting the increase in sales of recharging credits, chips, Combo and Hybrid plans.

Sales by Telephone continued to unify partnership agreements in order to consolidate converging sales in this channel, which delivered the single front end, and reviewed the actions of partners arising from the former hybrid operation of the Door-to-door channel. Telephone Sales also developed the chip delivery project intended to leverage hybrid and pure postpaid offers.

Alongside the standout numbers from physical channels, our digital sales and services channels were consistently evolving. The mobile segment's e-commerce channel grew 460% in 2017 against 2016, whereas our fixed-line service posted just 10% annual growth. Ongoing improvements in e-commerce usability are enriching the digital experience for customers and consequently boosting the Vivo brand's digital presence to directly impact these results.

Meu Vivo, a self-service channel of considerable importance in the Company's digital service strategy, also contributed to the positive performance of digital channels: the volume of downloads grew 50%. The number of unique users active in the application grew annually 88%.

Another digital service available for our customers that contributed significantly to the performance of the digital channel was "Vivi," a virtual assistant that reached 1 million accesses for the first time in October 2017.

To complement all of the strategic initiatives mentioned above and effectively take advantage of the Internet's business potential and enhance its digital maturity, the Company also tookadvantage of the Black Friday/Black November promotional period in Brazil. Sales increased 32% in the period, compared to the same period of the previous year.

Information systems

In 2017, the Information Technology (IT) area acted to continue to materialize our strategy represented by the slogan “*Escolhemos Tudo*” [We choose everything] through efforts focused on five pillars: **resources** - ensuring the best allocation of the IT budget, privileging the best practices at the workplace and the team’s professional excellence; **business transformation** – large projects that enable improving digitalization and IT quality; **value delivery** – focused on adding value to the experience of end customers; **operating excellence** – leveraging the use of new technologies to provide savings and efficiency to operations; and **delivery model** – changes in our way of working, aiming at aligning business demands to the performance of projects, avoiding rework and reducing delivery times.

In order to leverage business transformation, we implemented large projects, such as the complete unification of the landline products sale and services solution, with migration of more than three million customers. Simultaneously, we completed the first phase of implementation of the new ‘full stack’ system for hybrid and post-paid customers, aiming at unifying end-to-end B2C systems and processes, and preparing a layer of communication of owned and third-party systems through the standardization of APIs. Among other integrations and efficiencies, this initiative enables development of applications using the AURA cognitive intelligence technology developed by Grupo Telefónica in Spain, which will qualify our customers for access to the fourth platform.

As a means of reaching excellence in customer experience, a daring plan is underway to modernize our digital channels and is already showing results with the revamping of Meu Vivo channels both for mobile and landline customers and both at our web channel or mobile applications. Also, we were the first operator to offer a virtual assistant (Boot) in Facebook Messenger. Additionally, a new generation of applications was launched with Meu Vivo Mais, which can now make and receive voice calls to/for any place in the world using the mobile phone number, through data access or wi-fi networks. Other projects have also added value directly to customers, such as the new humanized IVR for post-paid customers, repeating the success achieved with this technique among pre-paid customers.

In the B2B segment, a major development was the delivery of the new sales solution application, or *Vendas Express.* The implementation of this fully digital process reduced B2B sales time from 4 days to 9 hours.

The experience of Telefônica Brasil employees was transformed over the past year as a result of digital workplace initiatives, such as update and standardization of the employees’ IT equipment, eliminating obsolete machines and improving the efficiency of ticket services. Several collaboration solutions were adopted in their entirety, such as the integration of videoconference solutions, and the possibility to create access and share documents in any device, any time, anywhere. Thanks to these advances, the telecommuting pilot project started in the IT area was very successful, and is now being replicated across the Company.

As an evidence of the operating excellence of the area, the availability of systems was maintained in more than 99.8% of the time in 2017, as a result of the permanent work for continuous improvement of the monitoring of servers and handling of incidents. Security was under the spotlights in 2017, with new threats appearing each day. In the period, 100% of the company’s central systems were integrated to identity management systems, which enabled traceability and control of accesses. Our IT department’s ongoing efforts to simplify procedures and efficiency-focused initiatives were able to report substantial progress as measured by several indicators: 56 obsolete applications were phased out, and our server virtualization

level rose to 83%. These initiatives are not only producing immediate and long-term financial gains but will also lead to a number of operating gains.

In 2017, we started to expand the culture of agility inside the IT area, given the maturity of the model and the qualification of over 1,300 employees and 50% of our software factories. The automation of testing scenarios accelerated this development, with 6,400 scenarios automated in the year. One half of the IT projects are being carried out through this quick method, which ensures that deliveries are in line with business needs, and that project resources are being properly invested in delivering more value to our end customers.

Customer Service

In 2017, we saw the results of actions implemented in the end of 2016, and the maturity of the customer services agreement, which provided a model of competition among suppliers, stimulating the quality of customer services. In addition to operating actions, we invested in the digitalization of services, always keeping our focus on quality. The highlights were on self-service actions and a more humanized IVR.

In the case of Customer Service, the Company created a structure to leverage customers' on-line experience, transform the service model and enhance the quality perceived when interacting with them. It continued to work on integrating the systems used by the operation, on defining processes and business rules and on internalizing operations considered essential for transforming the customer experience in every channel and point of contact.

Always striving to be at the forefront, we qualified our digital channels seeking to provide customers with more self-service options, and to make these channels even more important to them. The application for direct access via mobile phones reached a level exceeding 40 million contacts in the month of December 2017, with a growing number of users. The "Virtual Vivi" assistant is currently capable of responding to over 90% of questions put to it, using artificial intelligence, being present in several channels that include social medias, such as Twitter and Facebook. Progress was also made in humanizing the electronic service (IVR) of the Relationship Center, using a more customer-friendly personalized language and intelligent dialog in order to speed up the response to requests. This process also made it possible for the electronic service itself to provide responses to customers, attaining levels of 72% in certain segments and providing shortcuts through a more convenient experience.

In 2017, we consolidated a new model for hiring call center service providers, with the emphasis on encouraging good performance fully based on quality targets. The Company enhanced its operational service indexes by reducing contact rates, making more agents available and increasing and enhancing the autonomy of call center agents in providing solutions on the first contact.

All these results, combined with customer satisfaction surveys, show that we are on the right path, listening to the customer and transforming contacts received into a positive experience with the brand. The percentage of customers that gave us a negative mark after receiving customer services decreased 50% in 2017, as a result of the efforts mentioned above.

In 2018, Telefônica Brasil will maintain the strategy of enhancing contact and increasing the functionalities available on each channel, seeking to integrate these so that the customer chooses how to interact with the

Company and obtains the best possible experience regardless of the channel chosen. The Company will continue to press ahead in automating customer services, improving digital channels' resolution capacity, autonomy and standardization of experiences across several customer service options. Our customer services are absolutely focused on quality and provision of the best experience possible to customers.

Operating Performance

At the end of 2017, the Company reached 74,940 thousand mobile accesses, reaffirming its leadership with a market share of 31.7% in December 2017. The figures below show the mobile service operating behavior:

With regard to fixed service, the Company closed 2017 with 22,857 thousand revenue generating units, down 2.1% over the previous year, due primarily to the maturity of fixed voice traffic and the more selective strategy for the pay TV service.

Broadband - reached 7,432 thousand customers at the end of 2017, up by 1.9%, or 136 thousand net additions, over 2016. Fiber optic accesses (FTTH) stood at 1,290 thousand customers, with annual growth of 45.3%. The number of ultra-fast broadband (FTTx) customers now accounts for 61.1% of total broadband accesses.

Lines in Service – reached 13,837 thousand customers in 2017, down 3.5% against 2016, due to the maturity of the residential landline voice service, as well as the impact of the macroeconomic scenario on corporate business.

Pay TV – reached 1,588 thousand customers in 2017, down 7.3% over 2016, reflecting the Company's selectivity, with the focus on higher-value customers. IPTV reached 381 thousand users, annual growth of 50.8%.

Thus, the Company ended 2017 with 97,797 thousand customers, a growth of 0.7% compared with the previous year, since disconnected landline customers are being offset by the addition of mobile customers, primarily post-paid.

4. **Financial Performance**

4.1. Net Operating Revenue

In 2017, the Company posted consolidated net operating revenue of R$43,207 million, up by 1.6% over 2016, when our net revenue was R$42,508 million. Growth benefited from higher revenues from data and mobile digital services, primarily mobile internet, in addition to landline broadband, partially offset by lower revenues from landline-to-mobile calls and by the lower interconnection tariffs, both landline and mobile, which were determined by the regulator.

4.2. Operating Costs and Expenses

Operating costs, less depreciation and amortizations, increased by 0.8%, reaching R$28,721 million in 2017 compared to the previous year (R$28,486 million), below the inflation rate of 2.9% for the period. The increase can be explained mainly by higher costs with the commercialization sales of services, due to the recovery of commercial activities. This effect is partially offset by the lower costs of services rendered, due to the reduction in landline-to-mobile interconnection charges in February of 2017, in addition to lower call center expenses as a result of the simplification of offers and automation of the Company.

4.3. Operating Profit before Net Financial Expenses and Equity Pick-Up

Operating profit before consolidated financial expenses and equity pick-up increased by 4.1%, from R$6,368 million in 2016, to R$6,632 million in 2017. This effect is primarily justified by a better operating performance.

4.4. EBITDA

EBITDA in 2017 was R$14,486 million, up by 3.3% against R$14,022 million in 2016. In turn, the EBITDA Margin stood at 33.5% in 2017, an increase of 0.5 pp against the margin of 33.0% posted the previous year. This result can be attributed to higher revenue from mobile services and cost efficiency measures adopted by the Company.

R$ million – Consolidated		
	2017	**2016**
Operating profit before net financial result and equity pick-up(*)	6,632.2	6,368.0
Depreciation and amortization		
In the cost of services rendered	5,963.1	5,821.6
In selling expenses	1,433.3	1,409.0
In general and administrative expenses	457.3	423.8
EBITDA	**14,485.9**	**14,022.4**
EBITDA Margin		
a) EBITDA	**14,485.9**	**14,022.4**
b) Net operating revenue (*)	**43,206.8**	**42,508.4**
a) / b)	33.5%	33.0%

(*) See Financial Statements

4.5. Indebtedness and Financial Result

R$ million – Consolidated	**2017**	**2016**
Loans and financing	(3,494.9)	(5,255.0)
Debentures	(4,520.8)	(3,554.3)
Contingent Consideration GVT	(446.1)	(414.7)
Total indebtedness	(8,461.8)	(9,224.1)
Derivative transactions	143.8	28.4
Indebtedness after derivatives	(8,318.1)	(9,195.7)

The Company ended the year 2017 with gross debt of R$8,318 million (R$9,196 million in 2016), or 12.0% of shareholders' equity (13.3% in 2016). Funding is 3% denominated in foreign currencies (US dollars and a basket of currencies – UMBNDES) and 97% local currency denominated, whereby total foreign currency debt is covered by hedge transactions.

4.6. Annual results

Consolidated results for the year according to Brazilian corporate law, shows net profit of R$4,609 million in 2017 (R$4,085 million in 2016), up by 12.8% over the same period of 2016. Telefônica Brasil's net margin in 2017 was 10.7% (9.6% in 2016).

R$ million	**2017**	**2016**
a) Net profit for the year (*)	4,608.8	4,085.2
b) Net operating revenue (*)	43,206.8	42,508.4
a) / b)	**10.7%**	**9.6%**

(*) See Financial Statements.

4.7. Investments

In 2017, the Company invested R$7,997 million, slightly below the amount invested in the previous year (R$8,189 million) due to the purchase of new spectrum licenses in 2016. If the acquisition of such licenses was not taken into account, maintained the amounts invested in projects would remain stable, showing Telefônica Brasil's continuous commitment to the country. These investments seek to consolidate the leadership of the Company in Brazil's market, leveraging its short-term results through a greater and better offer to customers.

With regard to investments in projects, 75% of investments were allocated to the growth and quality of services, enabling the provision of better services to an increasingly connected society, and supporting

growth in the demand for data by our customers, whether in fixed or mobile data services, or in the corporate market.

In 2017, we continued to expand our fixed telephony services by providing fiber optic services (FTTH) to 16 new cities and more than 400 thousand new accesses. Therefore, Telefônica Brasil’s FTTH is now present in 87 cities with more than 7 million homes passed countrywide. We also expanded our paid TV services with IPTV technology to 65 municipalities, doubling the number of municipalities served as of the end of 2016 (32 municipalities). This has been accompanied by accelerated commercial activity, surpassing the milestone of 1.2 million FTTH customers and 380 thousand IPTV customers in 2017.

We made important investments in maintaining and expanding the voice service and mobile internet, which account for a significant part of our revenues. In 2017, we accelerated 4G implementation, reaching the milestone of 2,600 municipalities, 118 of which with 4G+ technology, and 397 with 700 MHz LTE. Additionally, we improved the signal quality in several regions, and made significant investments in maintenance services (proactive and reactive).

Telefônica Brasil has also invested in integrating telecommunications systems and networks of the landline and mobile business, and improved its business support infrastructure (systems and points of sale and service). In 2017, we continued to invest in improving operating systems, and expanding and consolidating data centers. Worthy of note is the transformation of Big Data billing environment and projects, which will support the rollout of new products and services, particularly focusing on the experience of customers.

5. **Capital Markets**

Telefônica Brasil’s common (ON) and preferred shares (PN) are traded on the B3 under the ticker symbols VIVT3 and VIVT4, respectively. The Company’s ADRs are also traded on the NYSE, under the ticker symbol VIV.

The VIVT3 and VIVT4 shares ended 2017 at R$41.20 and R$48.62, representing, respectively, annual appreciation of 13.2% and 10.3%, against the annual appreciation of 26.9% for the Bovespa Index. The ADRs ended the year at US$14.83, appreciating by 10.8% in the period, against a rise in the Dow Jones Index of 25.1%.

The average financial daily volumes of the VIVT3 and VIVT4 shares during the year were R$925 thousand and R$80,307 thousand, respectively. In the same period, the average daily volume for the ADRs was US$20,248 thousand.

The graph below shows the share performance for last year:

5.1. Shareholder remuneration policy

Under its by-laws, the Company must distribute a minimum of 25% of its adjusted net profit for the year as dividends, while holders of preferred shares are entitled to 10% more than the amount distributed to each common share.

Interest on equity and dividends, based on earnings for 2017, declared by Telefônica Brasil amounted to R$4.6 billion, as shown in the table below:

				Net Amount				
Dividends (based on Dec-17)	04/12/2018	04/12/2018	2,191.9	2,191.9	ON PN	1.217277 1.339005	1.217277 1.339005	Up to 12/31/2018
IOC (based on Nov-17)	12/14/2017	12/26/2017	1,486.6	1,263.6	ON PN	0.825623 0.908185	0.701779 0.771957	Up to 12/31/2018
IOC (based on Aug-17)	09/18/2017	09/29/2017	305.0	259.3	ON PN	0.169385 0.186324	0.143978 0.158375	Up to 12/31/2018
IOC (based on May-17)	06/19/2017	06/30/2017	95.0	80.8	ON PN	0.052759 0.058035	0.044845 0.049330	Up to 12/31/2018
IOC (based on Feb-17)	03/20/2017	03/31/2017	350.0	297.5	ON PN	0.194377 0.213814	0.165220 0.181742	Up to 12/31/2018
IOC (based on Jan-17)	02/13/2017	02/24/2017	180.0	153.0	ON PN	0.099965 0.109962	0.084970 0.093467	Up to 12/31/2018

Those declarations resulted in a payout of 99.99% for 2017.

5.2. Shareholding Breakdown

Controlling Group	540,033,264	704,207,855	1,244,241,119
	94.47%	*62.91%*	*73.58%*
Minority Shareholders	29,320,789	415,131,868	444,452,657
	5.13%	*37.09%*	*26.27%*
Treasury shares	2,290,164	983	2,291,147
	0.40%	*0.00%*	*0.14%*
Total number of shares	571,644,217	1,119,340,706	1,690,984,923
Book value per share:	R$ 41.13		
Subscribed Paid-in-Capital:	R$ 63,571.40	Million	

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5.3. Corporate Events

On July 3, 2017, the Company informed that its wholly-owned subsidiary Telefônica Data S.A. (“TData”) purchased, on that date, shares representing the capital stock of Terra Networks Brasil S.A. (“Terra Networks”), from SP Telecomunicações Participações S.A. (“SPTE”), which is the Company’s controlling shareholder (“Transaction”).

Terra Networks is a provider of digital services (own and third-party value-added services (“SVA”) and carrier billing, as well as mobile sales and relationship channels) and advertising services.

TData is a company that explores SVA, integrated corporate solutions in telecommunications, technical assistance for telecommunication equipment and networks, maintenance of equipment and networks, and preparation of projects.

The purpose of the Transaction is to expand and integrate the commercial offer of digital services that may add immediate value to the portfolio of customers of TData and the Company, as well as generating the offer of TData services to the base of customers and subscribers of Terra Networks services, and, thanks to Terra Networks’ countrywide reach and expertise, leverage TData’s advertising business. Also, considering that the Company has the competence to create new digital media products for the mobile and advertising channels, and that Terra Networks has knowhow on sales, customer services and operation of digital services for specific customers, the purchase made by TData will also facilitate the exchange of knowhow between the companies involved, in addition to maximizing the unification of the commercial conditions agreed with suppliers of both TData and Terra Networks, as well as with common suppliers.

The total price paid by TData for the acquisition of the shares issued by Terra Networks was R$250 million, in a lump sum, without the need for financing, using only TData’s available cash. Calculation of the amount was based on the economic value of the company, in accordance with the discounted cash flow, based on the valuation report ordered by TData’s Executive Board.

The Transaction is not subject to any regulatory authorizations or approvals by the Company’s bodies and, due to the way it was organized, it will not change the Company’s ownership structure or cause any dilution to shareholders. Generation of value to shareholders will derive from accelerated growth in digital services and increased efficiency of operations with no significant costs arising from the Transaction.

6. Corporate Structure

7. **Corporate Governance**

The fundamental principles of corporate governance at Telefônica Brasil S.A. (“Telefônica Brasil” or “Company”) are set out in its by-laws and in the internal rules and regulations that supplement the concepts contained in the law and standards governing the securities market. The purpose of these principles, which guide the activities of the Company’s management, can be summarized as follows:

- Maximizing the Company’s value;
- Transparency in the Company’s accounts and in the disclosure of material information of interest to the market;
- Transparency in the relations with shareholders, employees, investors, customers and public entities;
- Equal treatment of shareholders;
- Participation by the board of directors in overseeing and managing the Company and in accountability to the shareholders;
- Participation by the board of directors regarding corporate responsibility, ensuring the Company’s continuity.

Inspired by these concepts and to promote good corporate governance and increase the quality of information disclosures, the Company has instituted measures that render its actions clear and objective, while avoiding conflicts of interest. It believes that these measures benefit shareholders and current and future investors, as well as the market in general. Among the measures taken, worthy of note are:

(a) Implementation of the following internal rules:

(i) Material Act or Fact Disclosure, and Securities Trading Policy: sets out the practices for disclosing, using and preserving the secrecy of the Company’s material acts or facts. It establishes the obligations and mechanisms for Company’s disclosures to the market by Connected Persons, as well as theconducts, rules, restrictions and procedures to be followed by Connected Persons and Persons with Access to Material Information when trading the Company’s securities.

(ii) Directive on Communication with the Market: sets out the principles by which the control processes and systems involving information to be disclosed to market function. It seeks to ensure the quality and control of such information, in accordance with the rules of the markets where the Company's securities are traded.

(iii) Directive on the Registration, Communication and Control of Financial and Accounting Information: regulates the internal control procedures and mechanisms for preparing the Company's financial and accounting information, ensuring the adoption of the appropriate accounting practices and policies.

(iv) Code of Conduct for Finance Employees: sets the standards of conduct for positions of responsibility involving the Company's finances, regulating access to and the use of inside information.

(v) Directive on Prior Approval of Services to be Rendered by the Independent Auditor: establishes the criteria and procedure for retaining the services of the independent auditors, at all times subject to prior approval by the Audit and Control Committee. Its provisions include the rules of the CVM on this subject matter, in addition to the applicable legislation.

(vi) Anti-Corruption Guidelines: consolidate and clarify the measures adopted by the Company for curtailing and countering corruption in its daily business and across its entire supply chain.

(vii) Responsible Business Principles: define the way Telefônica develops its activities and relates to its stakeholders. More than a code of ethics, the Responsible Business Principles help with making decisions and acting with integrity and professionalism in everything we do. These principles are applicable to all employees, who must put them into practice in their daily routines and refer to them in the case of difficult ethical issues. These principles are shared with customers, suppliers, the community and other stakeholders. Any practices and/or attitudes that fail to comply with these principles should be reported through a specific channel, using a system link available on the Responsible Business Principles website.

(b) Establishment of the Board of Directors' committees:

- Audit and Control Committee;
- Commercial Attention and Service Quality Committee;
- Appointments, Remuneration and Corporate Governance Committee;
- Strategy Committee.

(c) Establishment by the Audit and Control Committee, under its own regulations, of procedures for receiving and dealing with complaints involving accounting and audit issues (Whistleblower Channel).

(d) ISE Portfolio: since 2012, the Company has been part of the ISE (Corporate Sustainability Index), a tool developed by the B3 for analyzing performance in sustainability (economic efficiency, environmental equilibrium, social development and corporate governance), and which seeks to offer investors the option of a portfolio consisting of shares of companies with acknowledged commitment to social responsibility and corporate sustainability.

7.1. Investor Relations

In order for its shares to achieve fair assessment, the Company embraces practices intended to properly clarify its policies and any events arising to shareholders, investors and analysts.

Material information is made available on the Company's web portal (www.telefonica.com.br/ri), with versions in Portuguese and English. All notices, material facts, accounting statements and others corporate documents are filed with the regulatory bodies – CVM (Brazilian Securities Commission), in Brazil, and the SEC (the Securities Exchange Commission), in the United States. In addition, the Company has an Investor Relations team that clears up doubts by telephone or in individual meetings, when so requested.

7.2. Board of Directors

Under its by-laws, the Company's board of directors consists of at least five, and at the most, seventeen members, with a three-year term of office and reelection permitted. The Company's board of directors currently consists of twelve members, one of whom is elected by the shareholders of preferred shares, in a separate vote and without the participation of the parent company, while the others are elected by a general vote of the common shareholders.

It normally convenes five times per year and, exceptionally, whenever necessary, in response to a call notice from its chairman. The resolutions of the board of directors are taken by a majority vote, in the presence of a majority of its members in office, and, in addition to the ordinary vote, the casting vote rests with the chairman. It is also the chairman's responsibility to represent the board at shareholders' meetings; to chair the shareholders' meetings, while choosing a secretary from among those present; to convene, install and chair board meetings; to use the casting vote attributed to him in the by-laws in the event of a tie in board resolutions; to ensure the efficacy and the performance of the Board; to set up and coordinate, with the collaboration of the General Secretary and the Legal Counsel, the agenda of the meetings; and to coordinate the discussions and decisions made at its meetings, by promoting an active debate of all members in decision making processes, safeguarding their freedom of position, and being responsible for the effective performance of the meeting.

7.3. Executive Board

In accordance with its by-laws, the executive board consists of at least three and, at the most, fifteen members, shareholders or not, resident in Brazil, who are elected by the board of directors for a three-year term of office, and reelection permitted. It currently consists of three members with the following positions: Chief Executive Officer; Chief Financial and Investor Relations Officer; and General-Secretary and Legal Counsel.

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The executive board is the Company's representative body, and it is incumbent on it and its members, individually, to comply with the provisions of the by-laws, the resolutions of the board of directors and the general meeting of shareholders; to perform all acts required or convenient for managing the business, within the limits set forth in the law and in the Company's by-laws; to propose initiatives, business plans and policies; and to conduct the daily operations of the Company.

7.4. Code of Conduct for Employees (Conduct Principles)

The ethical conduct of our management and our employees is ensured by the Responsible Business Principles – Telefônica's code of ethics. These guidelines are global and define the way that we relate to our stakeholders, ensuring the generation of value to our shareholders and to society, in the long run, and enabling decision-making mechanisms to be in place when or professionals are faced with ethical dilemmas and situations that may contradict the legislation. We carry offer a comprehensive training program to reinforce the Responsible Business Principles to all employees.

The mission of the Compliance area is to be a benchmark regarding conformity with the norms and business ethics by adding value to our stakeholders; protecting the company and the employees; avoiding non-compliance risks; and increasingly improving our culture based on integrity and ethics. The Compliance area works together with other company areas to constantly maintain our business excellence.

At Telefônica Brasil, the solid implementation of the Compliance program, which is called *#VivoDeAcordo*, is grounded on the following important pillars: total commitment of the senior management; a strong structure that counts on specialized employees who are responsible for the program's actions; ongoing analysis and assessment of business risks; internal policies that deal with several issues, such as anti-corruption measures, information security, gifts and entertainment, among others, in accordance with well-structured global guidelines and internal norms that are available to the employees; periodic compliance training programs for current and new employees; and an active inquiry channel that helps with solving doubts about the whole program.

The program is applicable to all employees, including officers and directors, as well as to allies, and it takes place through prevention, detection, correction and integrity actions, such as exhaustive communication of the Compliance program to all Telefônica's stakeholders, anti-corruption training about the legislation applicable, including the Foreign Corrupt Practices Act (FCPA), creation of the policies portal, inquiry channel and others.

The Company is aware of the importance of its supply chain, both given its international presence and the impact and volume of its business. For this reason, it promotes, establishes and maintains high responsibility requirement levels regarding its suppliers, stimulating their commitment not only to product and service quality standards, but also to ethical, social, environmental and privacy standards in all relationships with Telefônica's supply chain.

As one of the basis of our Responsible Business Principles, the respect and commitment to human rights guide the regular and periodic assessment of impacts on our value chain. We seek to identify, reduce and manage risks in accordance with the guiding principles for application of UN's "Protect, Respect and Remedy" framework.

7.5. Fiscal Council

As provided for in the Company's by-laws, the Fiscal Council is permanent in nature. The council members are elected by the general meeting of shareholders for term of office of one year, with reelection possible. In accordance with Brazilian corporate law, preferred shareholders are entitled to elect a full member and an alternate member of the Fiscal Council, in a separate vote, without the participation of the preferred shares of the parent company.

By law, the remuneration of the members of the Fiscal Council, in addition to the reimbursement of expenses with travel and accommodation necessary for them to perform their functions, will be fixed by the annual general meeting that elects them, and, for each member in office, this cannot be less than 10% of the average attributed to each executive officer, without taking into account benefits of any nature, representation fees and profit sharing.

The by-laws set forth that the Fiscal Council will consist of at least three and a maximum of five full members and an equal number of substitutes. The Company's Fiscal Council currently consists of three full members and three substitutes.

7.6. Audit and Control Committee

The committee was created in December of 2002 as an auxiliary body linked to the board of directors and operating under its own regulations. Under the Committee' regulations, it will consist of between three and five members, elected by the board of directors among its members, for a unified term of office of three years, and reelection permitted. Their term of office always coincides with their term of office as board members. However, as long as their term of office as board members is effective, Committee members will remain in their respective positions until the election of their alternates by the board of directors. On December 31, 2017, the Audit and Control Committee consisted of four members. On February 16, 2018, the Committee's composition was altered to three members.

In addition to the legal powers and those that may be attributed by the board of directors, the powers and duties of the Audit and Control Committee are as follows:

(a) To propose the appointment of independent auditors to the board, as well as the replacement of the independent auditors, being responsible for: (i) making recommendations to the board about the compensation of the independent auditors of the Company; (ii) giving its opinion about the engagement of the independent auditor for provision of any other services to the Company; and (iii) overseeing the activities of the independent auditors in order to assess their independence, the quality of services provided, and the adequacy of the services to the Company's needs;

(b) To analyze management's report and the financial statements of the Company, including the capital budgets, making any recommendations deemed necessary to the board of directors;

(c) To analyze the financial information prepared and periodically disclosed by the Company;

(d) To analyze the reporting of transactions made with third parties in accordance with the Policy on Transactions with Related Parties;

(e) To assess the efficacy and sufficiency of the internal controls structure, and the processes of the internal and independent audit of the Company, recommending the improvement of policies, practices and procedures as it deems necessary, being responsible for: (i) overseeing the activities of the internal controls area; (ii) overseeing the activities of the internal audit and compliance area, including those relating to reports received through the Company's whistleblowing channel in connection with the scope of its activities, giving its opinion, or escalating or taking the necessary steps regarding these reports; and (iii)

assessing the efficacy and sufficiency of risk and contingencies control and management systems;

(f) To analyze the proposals made by management bodies regarding changes in capital stock; issue of debentures convertible into shares or warrants; and transformation, merger or spin-off of the Company, making the recommendations it deems necessary to the Board;

(g) To assess the fulfilment, by the Company's management, of the recommendations made by the independent and internal audits, and give an opinion to the board of directors, regarding any conflicts between the internal and external audits and/or the Company's management; and to prepare an opinion, on a yearly basis, to be presented together with the financial statements, in accordance with the legislation applicable.

7.7. Appointments, Remuneration and Corporate Governance Committee

Created in November 1998 as a supporting body to the Board of Directors, this committee has its own regulations. Pursuant to its regulations, this Committee will be made up of three to five members elected by the Board of Directors among its members, for a unified term of office of three years, and reelection permitted. Their term of office always coincides with their terms of office as Board members. However, as long as their term of office as board members is effective, Committee members will remain in their respective positions until the election of their alternates by the Board of Directors. The Appointment, Remuneration and Corporate Governance Committee is currently made up of three members.

In addition to the powers that may be attributed to it by the Board of Directors, the powers and duties of the Appointments, Remuneration and Corporate Governance Committee are as follows:

(a) To recommend proposals to change the Company's by-laws;

(b) To review proposals regarding the appointment of members of other Committees, for subsequent approval by the board of directors;

(c) To recommend proposals regarding the appointment and removal of statutory officers for subsequent approval by the board of directors;

(d) To resolve on proposals for engaging, compensating and promoting Company's vice-presidents and non-statutory officers in levels A, B and C;

(e) To analyze, on a yearly basis, the overall compensation of managers, including benefits of any nature and entertainment allowances, taking into account their responsibilities, the time spent in their functions, their expertise and professional reputation, and the value of their services on the market;

(f) To resolve on the annual adjustments granted to employees in management (annual program, assumptions and budget) and non-management positions (program, assumptions and budget), including the collective bargaining agreements (negotiation strategy and budget) to be entered into between the Company and the employees' unions, and to analyze and approve profit sharing programs whenever their rules are changed; and

(g) To analyze corporate governance issues submitted by the statutory executive board, recommending them to the board of directors, when applicable.

7.8. Commercial Attention and Service Quality Committee

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Established in December 2004 as a supporting body to the Board of Directors, this committee has its own regulations. Pursuant to its regulations, this committee will be made up of three to five members elected by the Board of Directors among its members, for a unified term of office of three years, and reelection permitted. Their term of office always coincides with their terms of office as Board members. However, as long as their term of office as Board members is effective, Committee members will remain in their respective positions until the election of their alternates by the Board of Directors. The Commercial Attention and Service Quality Committee is currently made up of three members.

In addition to the powers that may be attributed to it by the Board of Directors, the powers and duties of the Commercial Attention and Service Quality Committee are as follows:

(a) To assess and monitor the adequacy of the Company's customer services, and propose improvements by taking advantage of the opportunities found;

(b) To observe, analyze and regularly monitor the quality indices for the principal services provided by the Company and the quality levels of customer services, recommending actions upon identification of opportunities; and

(c) To observe, analyze and regularly monitor the Company's plans and quality actions.

7.9. Strategy Committee

This committee was established in October 2016 as an auxiliary body connected to the Board of Directors, and it has its own regulations. Pursuant to the Committee's regulations, it will be made up of three to five members elected by the Board of Directors among its members, for a unified term of office of three years, and reelection permitted. Their term of office always coincides with their term of office as Board members. However, as long as their term of office as Board members is effective, Committee members will remain in their respective positions until the election of their alternates by the Board of Directors. The Strategy Committee is currently made up of three members.

In addition to the powers that may be attributed to it by the Board of Directors, the powers and duties of the Strategy Committee are as follows:

(a) To analyze and oversee the Company's strategy policy; and

(b) To analyze other matters with strategic interest submitted by the Company's statutory executive board.

7.10. Independent Auditors

In compliance with CVM Instruction No. 381 of January 14, 2003 and Circular Letter CVM/SNC/SEP No. 01/2007 of February 14, 2007, the Company and its subsidiaries inform that the Company's policy regarding

its independent auditors and their services not related to the independent audit is based on principles that preserve the independence of the auditors. These principles are based on the fact that the auditors should never audit their own work nor carry out management activities or advocate in favor of their client or render any other services that are prohibited by current regulations, thus maintaining the independence of the independent auditors' work.

During 2017, no services other than the external audit were contracted with the independent auditors, PricewaterhouseCoopers Auditores Independentes.

8. **Human Resources**

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In 2017, we continued to reinforce the actions of Telefónica Group's "We choose everything" global strategic program, which, locally, resulted in the *Viva Tudo* actions, strengthening our high-performance culture even more.

In the scope of *Viva Tudo*, we defined four pillars of action that permeated our activities across the Company: Focus on Results, Transversal and Integrated Action, Ethics Principles, and Owner's Responsibility and Attitude. Based on these pillars, we designed new actions and reviewed some internal programs with the purpose of leveraging the digital transformation of our Company. By means of tools that provide support to management, the development of leaderships, of talents, and several corporate education programs, we sought to ensure the preparation of our employees for the challenges and opportunities arising from this transformation.

We believe that we can only show excellence in our delivery to the market if this is something natural within the Company, and part of the daily lives of Telefônica's employees. Accordingly, our employees' experience with HR services has also evolved, becoming more digital, light, flexible and focused on self-service, internally reflecting the values that guide our actions towards customers and the society.

The results of this action were reflected in our Organizational Climate Survey, which had a record participation of 91% of the eligible public, while the Acceptance rate was 86% (against 82% in 2016). Through the results of this survey, the VP People team and the management are able to map the areas for organizational climate improvement and work on action plans, supported by an online tool that provides a number of quantitative analyses of the results.

8.1. Interaction

In 2017, we strengthened our relationship with our team through a number of engagement actions and celebrations, and recognition. We created actions that reinforce our digital transformation, recognize our teams, and stimulate an emotional connection between the employee and the company and contribute to a positive organizational climate. These actions are classified according to three pillars:

- **Celebrations:** we continued with four types of celebration, with the aim of strengthening the ties between the company and its employees and their family members. We celebrated Mother's Day, Father's Day and Children's Day. We also organized end-of- -year celebrations with a team meeting in all cities to celebrate the accomplishments in the year.
- **Recognition:** we reinforced *Gente de Valor* [People of Value], our multi-platform program which provides recognition for employees from various hierarchical levels. In the "Colleague" category of the *Gente de Valor* program, any employee may provide recognition for a colleague, at any time, by sending virtual medals associated with Telefônica's values. In Brazil, more than 47,400 thousand virtual medals were sent. The *Valor em Qualidade* [Value in Quality]) award recognizes the best initiatives to improve customer experience. There were approximately 100 projects enrolled and 7 teams recognized for their contributions. This year saw the launch of the *Viva Tudo* award, which recognized the best projects related to corporate strategies. The initiative involved more than 1,700 employees in 190 projects enrolled. We also reinforced the *Gente de Valor - Gestor* [People of Value - Manager] modality for all company's stakeholders (Administrative, Stores, Call Center and Installation Technicians). This action gives public recognition to members of the teams by handing

them a corporate gift.

In 2017, we saw the launch of the new intranet, a more updated platform that can be accessed from any place, at any time, and that can be customized according to the user's profile. Through this channel, we published some 1,200 news, with 720 thousand views on average per year. Another communication highlight was the *Direto do Presidente* (Direct from the CEO) series, which put the employees closer to the senior management. This program was presented in three formats: *Eduardo Responde* (videos of the employees making questions do the CEO); *Circuito Executivo* (recording of the CEO's business meetings in several regional offices) and *Entrevista* (chat in which the CEO comments on the financial results achieved in the quarter).

8.2. Remuneration

The Company adopts a salary structure and remuneration policies in line with the best practices in the market, with the purpose of attracting and retaining the best professionals in a highly competitive industry and recognizing their individual performance through the achievement of goals and results. Variable remuneration programs and a wide variety of benefits supplement the total remuneration package.

The total remuneration concept is paying a nominal salary in line with the average paid in the market by the companies with the most aggressive remuneration packages. In 2017, 4,811 professionals were promoted and 6,388 were given salary increases. A total of 11,199 professionals received a remuneration increase on top of the applicable legal adjustments.

8.3. Recruitment & Selection and Development Programs

Telefônica Brasil attracts and retains the best talents on the market through rigorous selection and development processes, supported by online Recruitment & Selection platforms and assessment tools appropriate for each level of complexity - from the operational level to the strategic level. In addition, we have an important Internal Recruitment process, which gives visibility and career opportunities to all employees. In all selection processes, Telefônica adopts actions that reduce inequality, are in line with the best diversity and inclusion practices, and reinforce our belief that all persons must be given equal treatment and access to opportunities.

In order to strengthen our positioning and leverage the attraction of talents of the new generation, we attend several university meetings. In 2017, we participated in four recruitment fairs, organized ten road shows, and broadcast four webinars with the participation of our executives, with impacting approximately 30 thousand potential candidates.

In 2017, we invested approximately R$67.2 million in education, with over 464 thousand employees and 331 thousand partners taking part in our training courses, providing a total of 2,179 thousand hours of training to employees and 2,077 thousand hours of training to partners, both in-class and online. We reinforced the role of digital education through the Success Factors portal, and 27% of the training actions were online.

Our corporate educational actions focused on promoting the digital mindset by rolling out the Digital Learning platform (a hub of online courses offered by educational partners on topics relating to innovation and technology, career and self-development). We have also fostered important drivers through the

application of mandatory courses for all employees about compliance, data privacy and security, and promotion of our operation principles and responsible business. We continued to offer technical certifications that are important for our business, and subsidies for professional specialization and language courses.

For the third consecutive year, we held the Self-Development Week, which, in 2017, took place from November 6 to 10, and presented 84 actions (including lectures, talk shows, workshops and movie screenings) in 12 cities, with 4,626 participants. The actions focused on Digital Transformation and personal development, and were handled by external professionals, executives and experts of the Company, who shared their knowledge and information with the employees. The actions that took place at our head office in São Paulo were broadcast via streaming to all parts of Brazil. 6,581 users accessed the platform during the event, and the videos are still available for viewing at any time.

A new action launched in 2017 and specially designed to promote Digital Transformation was the “Digital Day.” The initiative is held by Digital Learning, and consists of one day of lectures and mini-workshops on current digital topics, in-person forums and live broadcasting.

In 2017, we held two versions of the Digital Day in São Paulo (one of them was conducted in the second day of the Self-Development Week), as well as four pocket versions in the regional offices (Belo Horizonte, Rio de Janeiro, Porto Alegre and Curitiba). Overall, the event was attended by 1,395 participants on-site and 3,274 participants via streaming.

Another highlight was the “Focus on the Customer” program, whose aim is to allow executives to experience the total customer experience, placing themselves in the customer’s situation and understanding the customer’s real needs. Since the launch of this program in October 2015, 283 employees have taken part in this action, scrutinizing our operations in a careful and creative manner. In 2017, the program was performed in the cities of Brasília, Curitiba, Porto Alegre, Recife, Rio de Janeiro, Salvador, Fortaleza, Belo Horizonte and São Paulo.

Recognizing the importance of attracting new talents for the sustainability and growth of our business, in 2017 we invested in three programs targeted at this audience:

- Telefônica Young Talents: with over 11 thousand applicants for Trainee positions, and almost 9 thousand for Intern positions, the program, which was resumed this year, selected 31 trainees and 40 interns to make up our staff, and has become an important source of attraction of talents to the Company. With a development trail of up to two years, the youths are prepared to work in the corporate environment and participate in projects that help them adapt to the organization’s culture.
- Young Leaders Programme: the purpose of this global initiative of Telefônica is to develop digital, transformation, and leadership skills of young talents from different operations of Telefónica Group worldwide. With a duration of two years, the program selects and qualifies youths through an extensive development program that includes training modules attended at Telefónica University, in Spain. Seven Brazilian youths graduated in the 2016 cycle, and 10 started the 2017 cycle.
- One Young World 2017: with focus on young audiences (aged up to 30), Telefônica selected 4 Brazilian young talents to represent the company in the forum that took place in Colombia. During 4 days, the youths were able to expand their networking, empower themselves, and develop solutions for some critical global problems.

We have also made great efforts to develop our leaderships, with on-site programs directed to several levels of our pipeline of Leaders, seeking to leverage our results and strengthen the company’s culture:

- Corporate Mentoring Program: this initiative was launched in 2017 with the purpose of boosting the development of leaders and preparing them for Telefônica’s current and future challenges. The program was attended by 30 instructors and 60 mentees who shared knowledge, exchanged insights, and expanded their networking. The result was a true bidirectional growth process.
- Leaders Academy: this initiative promotes the organization’s culture and strategy through a portfolio of courses that is constantly updated. Currently, it includes 20 material topics on leadership and business-related subjects. Held in 10 Brazilian cities, the Academy was attended by 2,867 participants from January to December 2017. Telefônica University (Barcelona): through

international development programs, we strengthened our connection with Telefónica Group's global strategy, and prepared our executives to face the challenges of the business. In 2017, we sent 184 leaders to the Telefônica University in Barcelona (including Vice-Presidents, Officers, Managers and Coordinators) to attend six different courses.

- Coaching Program: initiative focused on the development of executives. In 2017, based on the results of performance assessments, 18 executives were selected to attend Coaching sessions at consulting firms recognized on the market.

One of the main tools of the company, which supports the management of teams and drives the development plans of employees, is the Performance Assessment. With an eligible audience of 17,200 employees, it is intended for administrative professionals and managers. Through this tool, we can analyze, in a consistent and substantiated manner, the performance of the employees regarding the objectives established and the Company's values. It also provides an opportunity for feedback and provides clear information on opportunities for improvement. The 2017 cycle started in the first half of the year, and will be completed in the beginning of 2018, when a final assessment will be made.

With a focus on the strategy and sustainability of the business, we conducted the Management Review, which aims at identifying the employees with potential to take over more complex positions, and mapping the future successors for Executive positions. The Management Review contributes to the systematic development of people, based on the goals of the business and individual needs, driving the development of leaders and teams, and making them more prepared to face the changing scenario in the industry. In 2017, 1,174 Division Manager and Section Manager positions were analyzed. This process included a performance assessment, and an assessment of potential (with subsidies from the Learning Agility method) and readiness.

8.4. Benefits

In 2017, we invested more than R$762 million in benefits for our professionals (33,622 employees in December 2017) including:

- R$260.3 million in health expenses (healthcare and occupational health);
- R$54.7 million invested in a Private Pension fund to which the Company also contributes a fixed percentage on behalf of its employees.

In the case of healthcare costs, the Company has an area dedicated to promoting occupational health and safety, operating throughout the national territory in 20 clinics in the major capital cities, seeing employees in their own workplace in a personalized and qualified manner. The clinics are duly equipped, with a medical and nursing team that provide integrated assistance.

Telefônica Brasil runs a Quality of Life Program based on four pillars (Caring, Protecting, Welcoming and Our Club), in tune with the global Feel-Good program, with its own portal on the corporate intranet; in 2017, it engaged in actions such as:

- **Outpatient Centers:** medical service with general practitioners, gynecologists and obstetricians working at in-company clinics: 87,516 thousand employees were assisted.
- **The Feel-Good Nutrition Program:** assistance to employees in the more populous administration buildings and call centers that have their own outpatient center; 11,740 thousand employees were assisted.

- **Feel Good "Cuca Fresca" Program:** psychological assistance in more populous administration buildings and call centers that have their own outpatient center; 6,853 thousand employees were assisted.
- **"Conte Comigo" Program**: psychological, legal and social assistance and financial advice offered to all administrative employees in all regions of Brazil.
- **Physical Exercises at the Workplace:** assistance to call center employees in the cities of Curitiba, Fortaleza and Maringá.
- **Check-up Program:** Test package for members of management in reference hospital to promote health.
- **Flu vaccination program:** nationwide vaccination with 33,956 thousand immunized employees and their dependents.
- **Healthcare plan:** Nationwide health benefits, reaching all employees, with rights to medical appointments, tests, urgency and hospitalization.
- **Institutional partnership:** with the Ministry of Health, government entities and NGOs in the following prevention and healthcare campaigns: Pink October and Blue November.
- **Physiotherapy Program:** assistance focused on functional health and treatments, with in-company preventive care. 2,840 thousand employees were assisted.
- **Social Service Program:** its purpose is to provide employees and their dependents with tools that support personal and corporate issues through welcoming, protection and counselling actions, contributing to social wellbeing. 776 employees were assisted.

Occupational Health and Safety

The Company has an area dedicated to Occupational Health and Safety, which, as required by law, is dedicated to safety, prevention of occupational accidents and occupational medical examinations, with nationwide presence, with professionals (Doctors, Engineers, Nurses and Safety Specialists) duly qualified in Occupational Health and Safety.

Telefônica Brasil invests in the knowledge of its employees through specific training in the Occupational Safety area with the purpose of creating a preventive vision, so that every operational employee will understand their own functions in accident prevention and take responsibilities for them, striving to find continuous improvement in working conditions.

In 2017, more than 29 thousand occupational tests were conducted, 43% of which were periodic tests, thus strengthening the labor capacity of Telefônica Brasil’s workforce.

With regard to activities with greater exposure to occupational risk, more than 11,440 employees attended legal training sessions provided for in the Company’s Occupational Safety normative resolutions and practices, totaling over 13,750 hours dedicated to qualification and recycling based on Regulating Standards in 2017.

Aiming at developing human behavior of employees engaged in operational activities, in 2017 we totaled over 46 thousand hours dedicated to DSS – Weekly Dialogue on Safety, with topics relating to operational employees working in field activities, including Installers, Repairers, Assistants, Telecomm Technicians, Cabling Professionals, and OSP Officials.

We renewed over 65 Telefônica Brasil Units, including CIPA (Internal Accidents Prevention Commission) management. More than 253 employees were elected by direct voting, and another 253 employees were appointed by the Company to support Occupational Safety in preventing occupational accidents.

In 2017, we dedicated more than 20 weeks (100 hours overall) to reviewing our internal Occupational Health and Safety processes in order to fulfill the requirements of the e-Social program of the federal government, which will be effective as from January 2018.

Still in 2017, the Occupational Safety area structured the SST action model for application in the Management of Allies, establishing procedures for inspections, review of documents and checklist. Indicators were also implemented to follow up on and manage occupational accidents on a monthly basis.

Under the topic *Proteja-se e aproveite o seu tempo vivendo* (Protect yourself and enjoy your time by living), in 2017 we conducted the 1st SIPAT (Internal Occupational Accidents Prevention Week), in compliance with NR-5 Normative Ruling, in integration with all regional offices in Brazil, with over 400 hours dedicated to planning. Over 13,500 employees were involved in occupational health and safety actions. 18,000 gifts were distributed in more than 150 Brazilian cities, with over 350 participating units, and more than 20 thousand hours dedicated to the prevention of accidents during the SIPAT week.

8.5. Employee Profile

Broken Down by Age Group

Broken Down by Time of Service:

Broken Down by Gender – 2017

18% of all Executive Officers are women.

Broken Down by Macro Function

9. Sustainability

Applying sustainability in our strategy allows us to identify the opportunities offered by new technologies to create value for society and effectively manage the impacts that are inherent to our activity, making our business ever more responsible.

In order to guarantee effective implementation of this strategy in our actions, we consider the views of our staff and other stakeholders, endeavoring to create shared value, participating in the development of persons and society. In this way, we connect the objectives of sustainability with business development and management, incorporating processes and targets, so that they become an integral part of Telefônica's DNA.

The conduction of new business is guided by our "We choose everything" strategy, which establishes the targets and commitments to be achieved until 2020. This implies acting with integrity, transparency, and undertaking sustainable development commitments. This is why Telefónica Group developed its Global Responsible Business Plan, which is grounded on the seven pillars below:

- Promise to Client and Digital Trust.
- Sustainability Management in the Supply Chain
- Diversity and Talent Management
- Environment
- Sustainable innovation
- Contribution to Progress
- Ethics

In line with these commitments, Telefônica Brasil addresses the most relevant and priority business topics through projects and targets that involve all Company areas, in the scope of our Responsible Business Plan. The seven pillars above were identified through a structured process of consultation and engagement of our stakeholders. In 2016, 87% of the targets defined by Telefônica Brasil were achieved. The projects not completed in 2016 continued in the following year, and are being developed in order to be completed. In 2017, we reviewed our Responsible Business Plan and defined new targets for our business. The audited results will be disclosed in the 2017 Sustainability Report.

In an increasingly connected world, our business boosts the communication among people and the exchange of information and data, enabling connecting of ideas and projects that contribute to local and regional sustainable development. Simultaneously, topics such as climate change, diversity, digital security, and others, are increasingly important for society, and they may change the way we relate to our customers and other agents of our value chain. For this reason, we are open to dialogue with our stakeholders, and connected to key global initiatives that propose solutions for the world's social and environment dilemmas.

We are committed, for example, to the SDGs (Sustainable Development Goals), proposed by the UN to guide national policies and engage organizations worldwide in challenges such as the eradication of poverty, the fight against climate change and the conservation of natural resources. Our business model includes a reflection on how to take direct actions to reach these goals.

We actively participate in, and are signatories to, other important initiatives that also contribute to sustainable development. They include:

Pacto Global

United Nations initiative to stimulate companies to adopt corporate social responsibility and sustainability policies through the adoption of ten principles related to human rights, labor, environment and corruption.

***Carbon Disclosure Project* (CDP)**

This project gathers companies' global environmental performance indicators to help investors with decision making processes. It supports organizations all over the world in measuring carbon emissions and effectively reducing them, stimulating an economy that is more focused on the rational use of energy and renewable matrices.

GHG *Protocol*

This tool stimulates a corporate culture to prepare and disclose greenhouse gas (GHG) emissions inventories. We have published our inventory on a yearly basis since 2010, and we have been awarded the Gold Seal in the past five years.

Women's Empowerment Principles

In 2016, we signed the commitment created by UN Women and by the Global Compact, which lays down seven principles that help companies incorporate values and practices that aim at gender equality.

As another parameter for continuing improvement and incorporation of sustainability to strategic process, we use the model suggested by the Business Sustainability Index (ISE), with indicators monitored by the Company.

In 2017, Telefônica Brasil was included, for the sixth consecutive year, in the B3 Business Sustainability Index, which includes the shares of 34 companies recognized for their sustainability performance. This was a pioneering initiative in Latin America, launched in 2005 to establish an investment environment compatible with the demands made by sustainable development and stimulate ethics in corporations.

Telefônica Brasil's Environmental Management System holds the ISO 14001:2015 certification. This system encompasses processes relating to planning, implementation, maintenance, operation, and decommissioning of mobile and landline networks. Through our environmental management, we strengthen the commitments provided for in the Environmental Policy and improve our internal controls, reducing the impacts and risks relating to this topic.

Once a year, the Company publishes its Annual Sustainability Report, prepared in accordance with the international standards laid down by the *Global Reporting Initiative* (GRI). A copy of this report is available at the Sustainability area of our site www.telefonica.com.br or on the Company's Investor Relations site www.telefonica.com.br/ri.

9.1. Sustainability Governance

In order to ensure responsible management in our activities, always in tune with values such as equilibrium, transparency, responsibility, efficiency and innovation, our principal role is to contribute to increasing the presence of sustainability in our business model. Telefônica Brasil has a Sustainability area that has a local reporting line and an interface for strategic alignment with the area responsible for global management of

this subject at Telefónica Group. Accordingly, we are able to boost local investments by involving and engaging all corporate and operating areas, as well as to exchange knowledge and experiences with other Telefônica companies worldwide, thus enabling quick capturing of trends and innovating on the national level.

For further information, see our Sustainability Report available at Telefônica Brasil website: www.telefonica.com.br

9.2. Private social investment

The Telefônica Vivo Foundation, which is responsible for Vivo's social projects, believes in educational innovation as a means to inspire new paths for Brazil's development based oneducation. Guided by innovation and willingness to contribute to a future with more opportunities for all, the Foundation develops projects that use technology to generate new teaching-learning methods and encourage social entrepreneurship and citizenship. Operating since 1999, it is part of a network made up of other 17 Telefônica Group foundations located in Europe and Latin America.

In 2017, we benefited approximately 1.2 million people and invested R$64 million.

Pillars of action of Telefônica Vivo Foundation

Education - *Profuturo*

We encourage the development of multidisciplinary skills by betting on digital fluency, development of educators, and creation of new contents to support students, teachers and schools to get closer to the competencies of the twenty-first century.

Social Entrepreneurship

We stimulate social entrepreneurship with the main purpose of creating empowerment opportunities for young people, so that they can search for solutions to improve their lives and communities.

Citizenship

We believe that technology-related social actions are the entry gates for people to recognize their social roles and power.

Knowledge Base

We generate and share quality and free knowledge through publications, documentaries and research.

To learn more about Telefônica Vivo Foundation, go to: www.fundacaotelefonica.org.br

10. Outlook

It is expected that the steady pace of the economic recovery will continue to guide the recovery of the telecommunications industry. New consumption standards, greater automation, and customers demanding more quality should guide the sector’s behavior. In this context, Telefônica Brasil is well placed to continue to understand and assist more than 97 million customers with growing quality, a pillar that we regard as essential for maintaining our leadership in the telecommunications market.

BOARD OF EXECUTIVE OFFICERS

Eduardo Navarro de Carvalho

Chief Executive Officer

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David Melcon Sanchez-Friera

Chief Financial and Investor Relations Officer

Breno Rodrigo Pacheco de Oliveira

General Secretary and Legal Counsel

Carlos Cesar Mazur

Accountant – CRC – 1PR-028067

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		TELEFÔNICA BRASIL S.A.		
Date:	March 26, 2018	By:	/s/ Luis Carlos da Costa Plaster	
			Name:	Luis Carlos da Costa Plaster
			Title:	Investor Relations Director