MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

TELEFONICA CELULAR DEL PARAGUAY S.A.

Results of Operations

Three months ended March 31, 2014 and 2013

The following table sets forth certain income statement items and operating information at or for the periods and dates indicated:

	Three months ended March 31,		Impact on comparative results for period	
	2014	**2013**	**Amount of variation**	**Percent change**
	(in thousands of PYG, *except percentages,subscribers, employees and ARPU)*			
Revenues	799,867	789,781	10,086	1%
Cost of sales	(278,729)	(250,782)	(27,947)	11%
Gross profit	**521,138**	**538,999**	**(17,861)**	**(3)%**
Sales and marketing	(138,824)	(121,725)	(17,099)	14%
General and administrative expenses	(101,250)	(94,753)	(6,497)	7%
Operating profit	**281,064**	**322,521**	**(41,457)**	**(13)%**
Interest expense	(26,898)	(24,419)	(2,479)	10%
Interest income	709	2,077	(1,368)	(66)%
Foreign exchange gains (loss), net	35,814	29,109	6,705	23%
Profit before tax	**290,689**	**329,288**	**(38,599)**	**(12)%**
Charge for taxes	(31,883)	(83,955)	52,072	(62)%
Net profit	**258,806**	**245,333**	**13,473**	**5%**
Operating Data:				
Number of mobile subscribers	**3,817,027**	**3,930,929**	**(113,902)**	**(3)%**
Postpaid	904,877	884,201	20,676	2%
Prepaid	2,912,150	3,046,728	(134,578)	(4)%
Monthly churn %				
Postpaid handset	1.8%	2.9%	(1.1)%	(37)%
Postpaid datacard	3.6%	5.8%	(2.2)%	(37)%
Total postpaid	2.1%	3.2%	(1.1)%	(34)%
Prepaid handset	3.8%	4.0%	(0.1)%	(4)%
Prepaid datacard	6.1%	11.0%	(4.9)%	(45)%
Total prepaid	3.9%	4.0%	(0.2)%	(4)%
Total monthly churn (1)	3.6%	3.6%	(0.0)%	(1)%
Monthly ARPU (US$) (2)				
Postpaid	24.5	21.5	3.0	14%
Prepaid	7.6	8.6	(1.0)	(12)%
Total monthly ARPU (3)	15.7	16.7	(1.0)	(6)%
Number of employees	**740.0**	**740.0**	**0.0**	**0%**

(1) Our total monthly churn is individually calculated by reference to our aggregate prepaid and postpaid customers.
(2) ARPU is calculated based on a historical exchange rate of [LC x] to US$1.00.
(3) Our total ARPU is individually calculated by reference to our aggregate prepaid and postpaid customers.

Revenues

Total revenue increased by 1% for the three months ended March 31, 2014 to Gs.799,867 million from Gs.789,781 million for the three months ended March 31, 2013. Growth in revenue was impacted primarily by growth in telephone and equipment sales and the type and number of value-added services purchased by customers, which trended toward an increasing level of higher-revenue generating value-added services. Our recurring revenue from value-added services represents 50% of total recurring revenue for the three months ended March 31, 2014, the same level as the three months ended March 31, 2013.

As of March 31, 2014, our mobile customer base was 3.82 million, a decrease of 3% from 3.93 million as of March 31, 2013. As of March 31, 2014, prepaid customers accounted for 76%, or 2.92 million, of our total mobile customers compared to 78%, or 3 million, as of March 31, 2013.

Growth in our mobile customer base slowed during the three months ended March 31, 2014 given the high level of penetration in the Paraguayan market. However, capital expenditures resulted in further improvements in the quality of our networks and increased capacity and coverage (2G and 3G) which attracted additional postpaid customers during the three months ended March 31, 2014. We further expanded our distribution network, which helped drive customer growth and consumption by increasing the number of points of sale where we sell our products, making the products more accessible. Additionally, the cable TV business contributed revenue of Gs. 81,239 million during the three months ended March 31, 2014.

Customer base

As of March 31, 2014, our total mobile customer base was 3,817,027, an decrease of 3% from 3,930,929 as of March 31, 2013, with prepaid customers accounting for 76% or 2,912,150 of our total mobile customers at such time. Capital expenditures over the first three months of 2014 have resulted in improvements in the quality of our networks and increased capacity and coverage which we believe has attracted additional customers during the period. Strengthening our distribution network has also helped drive customer growth by making our products more accessible. We further improved the volume and variety of products and services we provide to our customers, as well as the accessibility and availability of our products and services by using innovative distribution channels and techniques.

Cost of sales

Cost of sales increased by 11% for the three months ended March 31, 2014 to Gs.278,729 million from Gs.250,782 million for the three months ended March 31, 2013. Our cost of sales primarily related to the increased cost of transmission and bandwidth as we continued to focus on data penetration and the expansion of our networks, an increase in cable TV programing costs in line with incremental revenue from Tigo Home, an increase in bad debt as a result of the migration of customers from prepaid to postpaid, obsolescence due to change in handset portfolio mix (an increase in high-end smartphones and datacards) and depreciation due to 3G network expansion. Interconnection and roaming costs decreased despite the growth in revenue described above.

Gross profit margin decreased to 65.2% for the three months ended March 31, 2014 from 68.2% for the three months ended March 31, 2013, resulting primarily from higher telephone and equipment sales, which are typically sold for low or no margin, representing a larger portion of revenue as well as an increase in content revenue and its related costs and the depreciation of the fixed assets and amortization of intangible assets coming from the 2012 purchase of Cablevision (our cable TV business).

Sales and marketing

Sales and marketing expenses increased by 14% for the three months ended March 31, 2014 to Gs.138,824 million from Gs.121,725 million for the three months ended March 31, 2013. Sales and marketing costs were comprised mainly of commissions to dealers for the sale of prepaid reloads, smartphone subsidies aimed at obtaining and maintaining customers, as well as general advertising and promotion costs, point of sale materials for our retail outlets and staff costs. The increase in sales and marketing costs was mainly attributable to increased handset subsidies to increase smartphone penetration and our postpaid customer base. As a percentage of revenue, sales and marketing expenses increased to 17.4% for the three months ended March 31, 2014 from 15.4% for the three months ended March 31, 2013.

General and administrative expenses

General and administrative expenses increased by 7% for the three months ended March 31, 2014 to Gs.101,250 million from Gs.94,753 million for the three months ended March 31, 2013. The increase was mainly attributable to higher billing costs and higher network maintenance costs as a result of our continued network expansion. As a percentage of revenue, general and administrative expenses increased to 12.7% for the three months ended March 31, 2014 from 12% for the three months ended March 31, 2013.

Operating profit

Operating profit decreased by 13% for the three months ended March 31, 2014 to Gs.281.064 million from Gs.322.521 million for the three months ended March 31, 2013. The operating margin decreased from 40.8% for the three months ended March 31, 2013 to 35.1% for the three months ended March 31, 2014. This decrease was mainly as a result of the higher subsidies and sales commisions related to data mobile plans and TV plan sales and telephone and equipment sales representing a larger portion of revenue, handset subsidies related to these higher sales and the lower operating margin of the Cablevision businesses.

Net finance costs

Net finance costs, which include interest expense, net of interest income, increased by 17% for the three months ended March 31, 2014 to Gs.26,189 million from Gs.22,342 million for the three months ended March 31, 2013. This increase was mainly due to the bonds issued in order to finance the acquisition of Cablevision businesses.

Foreign exchange gain (loss)

Exchange loss, net increased by 23% for the three months ended March 31, 2014 to Gs.35,814 million from Gs.29,109 million for the three months ended March 31, 2013. Exchange gains and losses resulted primarily as a result of movements in the PYG/USD exchange rate resulting in a revaluation of our U.S. dollar borrowings, trade payables and cash and cash equivalents. The majority of our borrowings and cash and cash equivalents are denominated in U.S. dollars. The PYG/USD exchange rate moved from 4,007.00 as of March 31, 2013 to 4,439.00 as of March 31, 2014.

Charge for taxes

The charge for taxes decreased by 62%, to Gs. 31,883 million for the three months ended March 31, 2014, from Gs. 83,955 million for the three months ended March 31, 2013, due primarily to a lower profit before tax in the three months ended March 31, 2014 compare to the same period of 2013 and additional income tax over dividends paid at march 31, 2013. The effective tax rate for the three months ended March 31, 2014 was 11% compared to 26% for the three months ended March 31, 2013.

Net profit for the period

Net profit for the three months ended March 31, 2014 increased by 5% to Gs.258,806 million compared to a net profit of Gs.245,333 million for the three months ended March 31, 2013 principally as a result of higher revenues and less charge for taxes.

Trend Information

Our strategy is to maintain our voice and SMS revenue and market share while growing our revenue in value-added products and services such as mobile internet access, content downloads, and music and video streaming. For the three months ended March 31, 2014, value-added services represents 50% of recurring revenue, the same level as the three months ended March 31, 2013. Data usage is increasing among consumers as a result of an increasingly digital lifestyle. At the same time, smartphone market penetration is increasing as a result of lower prices and more phone options available to consumers. We expect innovation to be an important driver of growth in the years ahead. Although these new services tend to have lower profit margins than our core communications business, we aim to limit any drop in margins by controlling costs and through economies of scale. New competitors entering our markets and/or price competition could erode the profitability of our mobile operations, however.

Liquidity and Capital Resources

Historically we have relied, and in the future we intend to continue to rely, primarily on cash from operations and external financings to fund our operations, capital expenditures and working capital requirements.

We intend to continue to focus on investments in property, systems and equipment (fixed assets) and working capital management, including timely collection of accounts receivable and efficient management of accounts payable.

Capital Expenditures

Our capital expenditures on property, plant and equipment, licenses and other intangible assets for the three months ended March 31, 2014 and 2013 amounted to Gs.76,278 million and Gs.65,894 million, respectively.

Financing

As of March 31, 2014, our total outstanding indebtedness and other financing was Gs.1,593,295 million. As of December 31, 2013, our total outstanding indebtedness and other financing was Gs.1,645,443 million.

Our interest expense for the three months ended March 31, 2014 was Gs.26,898 million and for the three months ended March 31, 2013 was Gs.24,419 million.

Dividends

After analyzing our results of operations, our board of directors makes a recommendation to our shareholders on the amount of dividends, if any, that should be paid. The shareholders then resolve in a shareholders' meeting the amount of dividends, if any, that should be paid to shareholders. At the same time it decides whether the amount not paid as dividends should be retained as retained results of the Company or directed to a legal reserve account. Our dividend policy historically has been to pay dividends to our shareholders up to the level of free cash generated after debt repayments which is not required to fund our operations and not in excess of yearly net income. In the first three months of 2013 we paid dividends to our shareholders of Gs.880,689 million. This year we expect to pay 100% of dividends the next months.

Cash Flows

The table below sets forth our cash flows for the periods indicated:

	Three months ended March 31,	
	2014	**2013**
	(in PYG Million)	
Net cash provided by operating activities	346,466	273,270
Net cash used in investing activities	(73,830)	(63,196)
Net cash used in financing activities	(71)	(881,804)
Net (decrease) increase in cash and cash equivalents	**222,881**	**(717,300)**
Cash and cash equivalents at the end of the period	858,348	354,534

Three months ended March 31, 2014 and 2013

For the three months ended March 31, 2014 cash provided by operating activities was Gs.346,466 million compared to Gs.273,270 million for the three months ended March 31, 2013. The slight increase was mainly due to an decrease in accounts receivable.

Cash used in investing activities was Gs.73,830 million for the three months ended March 31, 2014 compared to Gs.63,196 million for the three months ended March 31, 2013.

Cash used in financing activities was Gs.71 million for the three months ended March 31, 2014 compared to Gs.881,804 million for the three months ended March 31, 2013. The lower cash used for financing activities for the three months ended March 31, 2014 was mainly as a result of the dividend paid at the same period of 2013 of Gs.880,689 million.

The net increase in cash and cash equivalents for the three months ended March 31, 2014 was Gs.222,881 million compared to a decrease of Gs.(717,300) million for the three months ended March 31, 2013. We had closing cash and cash equivalents of Gs.858,348 million as of March 31, 2014 compared to Gs.354,534 million as of March 31, 2013.