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

TELEFONICA CELULAR DEL PARAGUAY S.A.

As at and for the year ended 31 December 2016

We believe in better. We believe in tigo

1. Overview

We are a leading multinational telecommunications and media group operating in Paraguay. We provide a wide range of mobile communications and cable services, as well as other related products, including MFS, digital media and e-commerce, to residential, business and wholesale customers. We hold the number one position in the market on our mobile business. As of 31 December 2016, we had over 3.64 million mobile customers, provided cable services to 410.5 thousand households (HFC only) and had 1.22 million MFS customers. In the year ended December 2016, we generated Gs.3,088 billion in revenue and an EBITDA of Gs.1,388 billion.

2. Recent Developments

2.1 Acquisitions or disposals

On February 27, 2015 Telecel concluded the process of selling the fully-owned company Unicanal S.A. (99% of shares) to Grupo JBB, a Paraguayan multimedia group, by finishing the negotiations and transferring all the resources and facilities of this business unit to the buyer. The transaction amount was USD 3.65 million of which USD 2.5 million was collected in cash at the time of the transference in February 2015. The outstanding balance was collected on November 2015.

3. Key factors affecting the Telefónica Celular del Paraguay S.A.'s business

Our performance and results of operations have been and will continue to be affected by a number of internal and external factors. The key factors that have had or, in the future, may have an effect on the results of our operations are set forth below:

3.1 Drivers for revenue growth

We generate revenue mainly from fees associated with communication, entertainment, data, information and financial services that we provide to our customers, including: airtime and data usage fees, roaming fees, interconnection fees, connection fees, monthly subscription fees, broadband internet, fixed-line telephone, VoIP, data transmission, mobile money transfer and related financial services, cable TV, sale of content and other services and sales of equipment. We generally seek to increase our revenue through growth of our customer base and introduction of new products and VAS. Our results of operations are therefore dependent on our customer base and the number of services that each customer uses. Our monthly ARPU, calculated based on historical exchange rates for the applicable periods, decreased from $9.8 in December 2015 to $8.9 in December, 2016 mainly due to 9% higher foreign exchange rate. ARPU decreased 0.1% YoY in local currency due, in part, to pricing pressures and increased competition.

Customers

Mobile customers

Our mobile customer numbers as of 31December 2016, 2015 and 2014 were as follows:

In millions	Period ended December 31,		
	2016	2015	2014
Mobile customers at the end of the period	3.64	3.94	3.89

As of 31 December 2016, our total mobile customer base decreased by 7.6% to 3.64 million from 3.93 million as of 31 December 2015. Prepaid customers accounted for 75.7%, or 2,8 million, of the total mobile customers as of 31 December 2016.

Cable customers

As of 31 December 2016 our cable business covers approximately 410.5 thousand homes in Paraguay, and we provide services to approximately 264 thousand RGUs (HFC only). Our cable customers are offered a full consolidated suite of services, including cable TV, internet and other digital services. Our cable TV services are generally the first point of entry into our customers' homes, which allows us to increase our penetration by offering internet and mobile services as well, which we believe creates a strong brand affinity. Our aim is to increase our customer take-up of services by investing in network upgrades so it becomes bidirectional (allowing both uploads and downloads over a communication line) and both broadband internet and cable TV can be accommodated within it.

New products and services

Innovation continues to be a major focus as we seek to grow revenue by developing and selling additional products and services through which we can gain a greater share of the disposable income of our customers. Selling new VAS, and other data services to our existing customers increases ARPU and decreases churn. The introduction of innovative or exclusive products and services also helps us to attract new customers, increasing revenue.

In order to improve our clients' level of satisfaction we have developed post-paid plans in bundle format that are tailored according to their consumption. These bundles, which were launched in August 2015, allow clients to make a better use of their credit and helped the company to improve ARPU and reduce the deferred revenue liability.

During the year ended 31 December 2016, VAS as a percentage of our total revenue increased to 59.5%, compared to 54.3% and 52.8% during the same period of 2015 and 2014, respectively. Growth in our data revenues has outpaced revenue growth from voice and SMS usage. We expect innovation to be a key driver of growth in the years ahead as data and internet-related services make an increasingly substantial contribution to the business.

Capital expenditure to expand and improve our networks and increase our footprint

We consistently improve the quality and increase the coverage of our mobile and cable networks, which requires purchasing new licenses and spectrum, investing in new infrastructure, and modernizing and upgrading our networks and IT backbones. Spending money on capital expenditures ultimately increases our revenue and operating profit, but it also decreases our investing cash flows, our carrying value of property, plant and equipment and intangible assets, and increase depreciation and amortization expense. In addition, as customers increase their utilization of our networks, we incur higher operating expenses, including interconnection charges, network operation and maintenance costs, employee costs and selling, general and administrative expenses.

Capital expenditure during fiscal 2015 resulted in improvements in the quality of our networks and increased capacity and coverage, which attracted additional customers. In the year ended 31 December 2016, we invested Gs.820 billion in capital expenditure, which represented an amount equal to 26.3% of our total revenue.

Competitive and regulatory pressures on pricing

The markets in which we operate are competitive in nature, and we expect competition will remain high. Mobile telecommunications operators compete for customers principally on the basis of price, services offered, advertising and brand image, quality and reliability of service and coverage area. Price competition is significant on voice and SMS services, which still represent the vast majority of our revenue (together they represented 46.6% of our revenue in December 2014, 39.1% in 2015 and 34.7% in 2016) but they are largely commoditized, as the ability to differentiate these services among operators is limited and penetration is high. Competition has resulted in pricing pressure, reduced margins and profitability, increased customer churn and the loss of revenue and market share.

Pricing pressure has resulted in a decline in ARPU, since clients have been shifting from high margin products such as voice and SMS to mobile data products thanks to the variety of OTT services available to them, which constitutes a challenge to develop innovative products that could at the same time balance client satisfaction and profitability.

The prices we are allowed to charge our customers are also heavily regulated which may result in reduced profitability. For example, in Paraguay, we can no longer set an expiry date to our customer's balance of prepaid minutes or SMS bundles, which hinders revenue recognition and affects margins of mobile services. Changes such as these require us to monitor our pricing models and margins consistently to adjust them if required.

Cost optimization and efficiencies

In fiscal year 2014, we started to implement several restructuring and efficiency initiatives that we believed will result in future cost savings and efficiency but could also produce one-off costs and expenses that will be necessary to implement them. As of 31 December 2016, the measures adopted made our costs to decrease 5% and improved our gross margin and operating profit by 1pp and 4.2%, respectively.

Effect of exchange rate fluctuations

The exchange rate for the Paraguayan Guarani fluctuates in relation to the U.S. dollar and such fluctuations may have a material adverse effect on our earnings, assets and liabilities valuation or cash flows. Exchange rates affects our earnings and cash flows due to U.S. dollar-denominated debt held at the local operational level, in a market where local currency borrowing facilities are either not available or cannot be obtained under commercially acceptable terms.

The effect of the decrease in the PYG/USD exchange rate in 2016 has not affected significantly our Net Profit.

Results of Operations

Year ended 31 December 2016 and 2015

PYG millions	Year ended December 31,		Percent change
	2016	2015	
Revenue	3,088,659	3,172,136	(2.6%)
Cost of sales	(713,194)	(750,630)	(5.0%)
Gross profit	**2,375,465**	**2,421,506**	**(1.9%)**
Sales and marketing	(612,147)	(647,123)	(5.4%)
General and administrative expenses	(375,234)	(338,506)	17.2%
EBITDA	**1,388,084**	**1,435,877**	(3.3%)
Depreciation	(360,008)	(307,182)	17.2%
Amortization	(126,105)	(119,142)	5.8%
Other operating income (expenses), net	(6,479)	(74,083)	(91.3%)
Operating profit	**895,492**	**935,470**	**(4.3%)**
Interest expense	(197,870)	(150,526)	31.5%
Interest and other financial income	9,043	8,934	1.2%
Exchange loss, net	9,468	(431,045)	(102.2%)
Profit before tax	**716,133**	**362,833**	**97.4%**
Income tax expense	(104,148)	(54,581)	90.8%
Net profit and comprehensive income for the period.	**611,985**	**308,252**	**98.5%**

Operating Data:			
Number of mobile subscribers	**3,635,439**	**3,935,573**	**(7.6%)**
Postpaid	882,357	909,843	(3.0%)
Prepaid	2,753,082	3,025,730	(9.0%)
Monthly churn %			
Postpaid handset	1.9%	1.9%	0.6%
Postpaid datacard	3.6%	4.0%	(9.2%)
Total postpaid	2.0%	2.0%	(1.4%)
Prepaid handset	6.0%	1.5%	290.5%
Prepaid datacard	24.9%	9.8%	154.9%
Total prepaid	6.0%	1.6%	286.8%
Total monthly churn (1)	5.0%	1.7%	203.2%
Monthly ARPU (US$) (2)			
Postpaid	15.7	19.5	(19.6%)
Prepaid	6.8	6.8	(1.0%)
Total monthly ARPU (3)	8.9	9.8	(8.6%)
Number of employees	**1,148**	**833**	**37.8%**

(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 5,766.93 and 5,807 to US$1.00 in 31 December 2016 and 2015, respectively.

(3) Our total ARPU is individually calculated by reference to our aggregate prepaid and postpaid customers.

Revenue

Total revenue decreased by 2.6% for the year ended 31 December 2016 to Gs.3,089 billion from Gs.3,172 billion for the same period of 2015. The decrease was due to less voice (-9.6%) revenue compensated with higher revenue from T&E revenue (+30.7%). Our recurring revenue from value-added services represents 65.5% of total recurring revenue for the year ended 31 December 2016, versus 61.7% in the same period of 2015.

The cable TV business has contributed revenue of Gs.297 billion during 2016 in comparison to Gs.312 billion in 2015.

Customer base

As of 31 December 2016, our total mobile customer base was 3,635,439, which represents a decrease of 7.6% from 3,935,573 as of 31 December 2015, with prepaid customers accounting for 76.9% or 3,025,730 of our total mobile customers at such date. Additionally we have been investing in improvements in the quality of our networks and increased capacity and coverage, something that we believe has helped to retain and increase our customers base and keep it satisfied. Strengthening our network distribution has also helped making our products more accessible.

Cost of sales

Cost of sales decreased by 5% for the year ended 31 December 2016 to Gs.713 billion from Gs.750 billion for the same period in 2015. Our cost of sales is affected by higher T&E costs due to strong campaigns to push adoption of smartphones and mobile data during 2016. Decrease in cable TV programing costs in line with reduced revenue from Tigo Home. Interconnection costs decreased 0.9% YoY due to regulatory measures. Bad debt decreased by 32.9% YoY. Some costs such as voice and SMS decreased in line with the decrease of revenue related to those concepts.

Gross profit margin increased to 76.9% for the year ended 31 December 2016 from 76.3% for the same period of 2015, primarily from reduction of costs in the mobile business and despite lower revenue from TV business.

Sales and marketing

Sales and marketing expenses decreased by 5.4% for the year ended 31 December 2016 to Gs. 612 billion from Gs.647 billion for the same period ended 31 December 2015. Sales and marketing costs were comprised mainly of commissions to dealers for the sale of prepaid reloads (-52.5% YoY) smartphone subsidies aimed at obtaining and maintaining customers (+23.1% YoY), as well as general advertising and promotion costs (+6.2% YoY).

General and administrative expenses

General and administrative expenses increased by 10.9% for the year ended 31 December 2016 to Gs.375 billion from Gs.338 billion for the same period in 2015. The increase was mainly attributable to higher ERC, external services, billing costs and network maintenance costs as a result of our continued network expansion. As a percentage of revenue, general and administrative expenses increased to 12.1% for the period ended 31 December 2016 from 10.7% in 2015.

EBITDA

	Year ended December 31	
	2016	2015
EBITDA (1)	1,388,084	1,435,877
EBITDA margin (2)	44.9%	45.3%
Net debt to LTM EBITDA (3)	1.47	1.52
Total debt to LTM EBITDA (4)	1.70	1.66

(1) We define EBITDA as our earnings before interests, taxes, depreciation and amortization.

(2) We define EBITDA Margin as our EBITDA divided by revenue. EBITDA Margin is not a recognized term or measure of performance under IFRS.

(3) We calculate Net debt to LTM EBITDA by dividing our total borrowings, less cash and cash equivalents, by our EBITDA from the twelve months ended 31 December 2016.

(4) We calculate Total debt to EBITDA by dividing our total borrowings by our LTM EBITDA.

Operating profit

Operating profit decreased by 4.3% for the year ended 31 December 2016 to Gs.895 billion from Gs.935 billion for the same period ended 31 December 2015. The operating margin decreased from 29.5% at end of 31 December 2015 to 29% in 31 December 2016.

Net finance costs

Net finance costs, which include interest expense, net of interest income, increased by 33.4% in the year ended 31 December 2016 to Gs.189 billion from Gs.142 billion for the same period ended 31 December 2015. This increase was mainly due to higher interest accretion on financing of football rights and the effect of increased foreign exchange rate on our financial debt which is 78% denominated in US Dollars.

Foreign exchange gain (loss)

Exchange loss, net decreased by 102% at the end of December, 2016 to a net gain of Gs.9,5 billion from a net loss of Gs.431 billion at the end of December, 2015. Exchange gains and losses resulted primarily from the movements in the PYG/USD exchange rate in a revaluation of our U.S. dollar borrowings, trade payables, receivables, suppliers advances 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 5,807 as of 31 December 2015 to 5,767 as of 31 December 2016.

Charge for taxes

The charge for taxes increased by 90.8%, to Gs.104 billion as of 31 December 2016, from Gs.55 billion for the same period ended 31 December 2015, due primarily to profit before tax produced by higher financial expenses and net exchange loss which are tax-deductible. The effective tax rate for the period ended 31 December 2016 was 14.54% compared to 15.04% for the same period ended 31 December 2015.

Net profit for the period

Net profit at the end of 31 December 2016 increased by 99% to Gs.612 billion compared to a net profit of Gs.308 billion at the end of 31 December 2015.

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, cable TV, content downloads, and music and video streaming. In the year ended 31 December 2016, value-added services represent 65.5% of recurring revenue, versus 61.7% in the same period ended 31 December 2015. 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.

Revenue from our cable business, which includes TV and broadband internet, decreased by 8.65% in the year 31 December 2016 to Gs. 351 billion from Gs. 385 billion in 31 December 2015.

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 year ended 31 December 2016 and 2015 amounted to Gs.820 billion and Gs.758 billion, respectively.

Financing

As of 31 December 2016, our total outstanding indebtedness and other financing was Gs.2,354 billion. As of 31 December 2015, our total outstanding indebtedness and other financing was Gs.2,390 billion.

Our interest expense for the period ended 31 December 2016 was Gs.197 billion and for the same period ended 31 December 2015 was Gs.150 billion.

Cash Flows

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

PYG millions	Year ended December 31,	
	2016	2015
Net cash provided by operating activities	1,331,782	775,118
Net cash used in investing activities	(889,652)	(1,075,126)
Net cash (used)/provided in financing activities	(335,192)	149,892
Net (decrease) increase in cash and cash equivalents	**106,938**	**(150,116)**
Cash and cash equivalents at the end of the period	310,922	203,984

For the year ended 31 December 2016 cash provided by operating activities was Gs.1,332 billion compared to Gs.775 billion for the same period ended 31 December 2015. The increase was mainly due to reduced revenue and higher payments to suppliers.

For the year ended 31 December 2016 cash used by investing activities was Gs.890 billion compared to Gs.1,075 billion for the same period ended 31 December 2015, mainly due to lower financing granted to related parties and higher CAPEX than the previous year.

For the year ended 31 December 2016 cash used by financing activities was Gs.(335) billion compared to Gs.150 billion provided for the same period ended 31 December 2015. The cash used for financing activities for the year ended 31 December 2016 was mainly as a result of issuance of debt and other financing.

The net increase in cash and cash equivalents for the year ended 31 December 2016 was Gs.107 billion compared to Gs.(150) billion for the same period of 2015. We had closing cash and cash equivalents of Gs.311 billion as of 31 December 2016 compared to Gs.204 billion as of 31 December 2015.

*****