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

TELEFONICA CELULAR DEL PARAGUAY S.A.

Results of Operations

Nine months ended September 30, 2014 and 2013

	Nine months ended September 30,		
	2014	**2013**	**Percent change**
	(in millions of PYG, except percentages, subscribers, employees and ARPU)		
Revenue	2,389,127	2,399,488	(0.4%)
Cost of sales	(814,626)	(778,977)	4.6%
Gross profit	**1,574,501**	**1,620,511**	**(2.8%)**
Sales and marketing	(429,413)	(413,824)	3.8%
General and administrative expenses	(538,439)	(271,893)	98.0%
Operating profit	**606,649**	**934,794**	**(35.1%)**
Interest expense	(87,931)	(73,634)	19.4%
Interest and other financial income	6,099	3,713	64.3%
Foreign exchange gains (loss), net	16,024	(108,195)	(114.8%)
Profit before tax	**540,841**	**756,678**	**(28.5%)**
Charge for taxes	(104,471)	(138,365)	(24.5%)
Net profit	**436,370**	**618,313**	**(29.4%)**
Operating Data:			
Number of mobile subscribers	**3,846,778**	**3,908,857**	**(1.6%)**
Postpaid	888,785	961,434	(7.6%)
Prepaid	2,957,993	2,947,423	0.4%
Monthly churn %			
Postpaid handset	1.3%	2.3%	(44.7%)
Postpaid datacard	4.4%	4.8%	(8.0%)
Total postpaid	1.5%	2.6%	(41.5%)
Prepaid handset	2.2%	2.9%	(24.6%)
Prepaid datacard	5.0%	4.7%	7.4%
Total prepaid	2.2%	2.9%	(24.5%)
Total monthly churn (1)	(2.0%)	(3.5%)	(42.6%)
Monthly ARPU (US$) (2)			
Postpaid	22.3	24.3	(8.3%)
Prepaid	8.2	8.0	3.1%
Total monthly ARPU (3)	11.5	12.0	(4.3%)
Number of employees	**819**	**798**	**2.6%**

(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 4378 to US$1.00.
(3) Our total ARPU is individually calculated by reference to our aggregate prepaid and postpaid customers.

The following table is a reconciliation of our total comprehensive income to EBITDA:

	Period ended September 30,	
	2014	2013
Net profit (loss)	436,370	618,314
Net finance costs	81,832	69,921
Income tax	104,471	138,365
Depreciation and amortization	308,776	252,558
Royalties/ Franchise fess	240,718	35,824
Net other non-operating expense (income)	(11,245)	115,579
EBITDA	**1,160,922**	**1,230,560**

	Period ended September 30	
	2014	2013
EBITDA (1)	1,160,922	1,230,560
EBITDA margin (2)	48.6%	51.3%
Net debt to LTM EBITDA (3)	1.08x	0.97x
Total debt to LTM EBITDA (4)	1.35x	1.33x

(1) We calculate EBITDA by adding net finance costs; income tax; depreciation and amortization; and net other non-operating expense (income) to our total comprehensive income. EBITDA is not a recognized term or recognized measure of performance under IFRS and should not be considered as an alternative to net profits as a measure of operating performance or to net cash provided by operating activities as a measure of liquidity. EBITDA as used herein is the same as ‘‘EBITDA’’ as defined in the Indenture for purpose of the Notes. EBITDA as presented may not be comparable to similarly titled measures of other companies.
(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 EBITDA by dividing our total borrowings, less cash and cash equivalents, by our EBITDA.
(4) We calculate Total debt to EBITDA by dividing our total borrowings by our EBITDA.

Revenue

Total revenue decreased by 0,4% for the nine months ended September 30, 2014 to Gs.2,389,127 million from Gs.2,399,488 million for the nine months ended September 30, 2013.The slight decrease was due to less non-recurring revenue from visitors roaming (-14.9%YoY), the recurring revenue remained at almost the same level as of September 2013. Our recurring revenue from value-added services represents 48.7% of total recurring revenue for the nine months ended September 30, 2014, versus 50.9% in the nine months ended September 30, 2013.

Additionally, the cable TV business has contributed revenue of Gs.283,756 million during the nine months ended September 30, 2014 in comparison to Gs. 246.898 million in September 30, 2013.

Customer base

As of September 30, 2014, our total mobile customer base was 3,846,778 a decrease of 1.6% from 3,908,857 as of September 30, 2013, with prepaid customers accounting for 76.9% or 2,957,993 of our total mobile customers at such time. Additionally we have been investing in improvements in the quality of our networks and increased capacity and coverage which we believe has helped to maintain our customers during the period despite the high level of penetration in the Paraguayan market. Strengthening our distribution network has also helped making our products more accessible.

Cost of sales

Cost of sales increased by 4.6% for the nine months ended September 30, 2014 to Gs.814,626 million from Gs.778,977 million for the nine months ended September 30, 2013. Our cost of sales primarily related to the increased cost of frequency 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.

Gross profit margin decreased to 65.9% for the nine months ended September 30, 2014 from 67.5% for the nine months ended September 30, 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 intangible assets coming from the 2012 purchase of Cablevision (our cable TV business).

Sales and marketing

Sales and marketing expenses increased by 3.8% for the nine months ended September 30, 2014 to Gs. 429,413 million from Gs.413,824 million for the nine months ended September 30, 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 18.0% for the nine months ended September 30, 2014 from 17.2% for the nine months ended September 30, 2013.

General and administrative expenses

General and administrative expenses increased by 98.0% for the nine months ended September 30, 2014 to Gs.538,439 million from Gs.271,893 million for the nine months ended September 30, 2013. The increase was mainly attributable to higher technical service fee as well as higher 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 22.5% for the nine months ended September 30, 2014 from 11.3% for the nine months ended September 30, 2013.

Operating profit

Operating profit decreased by 35.1% for the nine months ended September 30, 2014 to Gs.606,649 million from Gs.934,794 million for the nine months ended September 30, 2013. The operating margin decreased from 39.0% for the nine months ended September 30, 2013 to 25.4% for the nine months ended September 30, 2014. This decrease was mainly as a result of the higher expense in technical service fee, subsidies and sales commissions related to data mobile plans and TV subscriptions 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 17.0% for the nine months ended September 30, 2014 to Gs.81,832 million from Gs.69,921 million for the nine months ended September 30, 2013. This increase was mainly due to interest accretion on financing of football rights.

Foreign exchange gain (loss)

Exchange gains, net increased by 114.8% for the nine months ended September 30, 2014 to Gs.16,024 million from a net loss of Gs. 108,195 million for the nine months ended September 30, 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 4,441 as of September 30, 2013 to 4,492 as of September 30, 2014.

Charge for taxes

The charge for taxes decreased by 24.5%, to Gs. 104,471 million for the nine months ended September 30, 2014, from Gs. 138,365 million for the nine months ended September 30, 2013, due primarily to a higher depreciation of fixed assets in the nine months ended September 30, 2014 compared to the same period of 2013. The effective tax rate for the nine months ended September 30, 2014 was 19.3% compared to 18.3% for the nine months ended September 30, 2013.

Net profit for the period

Net profit for the nine months ended September 30, 2014 decreased by 29.4% to Gs.436,370 million compared to a net profit of Gs.618,313 million for the nine months ended September 30, 2013 principally as a result of higher costs and expenses, less charge for taxes and gain on foreign exchange offset by a higher cost of sales and higher G&A expenses.

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 nine months ended September 30, 2014, value-added services represent 48.7% of recurring revenue, versus 51.0% in the nine months ended September 30, 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 nine months ended September 30, 2014 and 2013 amounted to Gs.309,438 million and Gs.270,911 million, respectively.

Financing

As of September 30, 2014, our total outstanding indebtedness and other financing was Gs.1,568,796 million. As of December 31, 2013, our total outstanding indebtedness and other financing was Gs.1,645,443 million.

Our interest expense for the nine months ended September 30, 2014 was Gs.87,931 million and for the nine months ended September 30, 2013 was Gs.73,634 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 they decide 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. For the nine months ended September 30, 2014 we paid dividends to our shareholders Gs.648,548 million against Gs.1,041,435 for the same period of 2013.

Cash Flows

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

	Nine months ended September 30,	
	2014	**2013**
	(in PYG Million)	
Net cash provided by operating activities …………………..	758,917	633,231
Net cash used in investing activities ………………………..	(303,936)	(248,184)
Net cash used in financing activities ………………………..	(763,119)	(981,279)
Net (decrease) increase in cash and cash equivalents ……	**(325,134)**	**(621,887)**
Cash and cash equivalents at the end of the period ……..……	310,333	449,947

Nine months ended September 30, 2014 and 2013

For the nine months ended September 30, 2014 cash provided by operating activities was Gs.758,917 million compared to Gs.633,231 million for the nine months ended September 30, 2013. The increase was mainly due to a lower increase in trade receivables, more credit obtained from suppliers and fewer tax expense.

Cash used in investing activities was Gs.303,936 million for the nine months ended September 30, 2014 compared to Gs.248,184 million for the nine months ended September 30, 2013 mainly due to higher investments in intangibles assets for 3G and Cable TV networks expansion.

Cash used in financing activities was Gs.763,119 million for the nine months ended September 30, 2014 compared to Gs.981,279 million for the nine months ended September 30, 2013. The lower cash used for financing activities for the nine months ended September 30, 2014 was mainly as a result of lower dividend paid compare to the same period of 2013.

The net decrease in cash and cash equivalents for the nine months ended September 30, 2014 was Gs.325,134 million compared to a decrease of Gs.621,887 million for the nine months ended September 30, 2013. We had closing cash and cash equivalents of Gs.310,333 million as of September 30, 2014 compared to Gs.449,947 million as of September 30, 2013.