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

## TELEFONICA CELULAR DEL PARAGUAY S.A.

**As at and for the six month period ended 30 June 2018**

We believe in better. We believe in tigo

## 1. Overview

We are a leading provider of telecommunications services, including mobile telephony, broadband internet, pay television, and other related products, such as digital media. We hold the number one position in the mobile market with more than 3.32 million mobile customers, while our Hybrid Fiber Cable (HFC) network passes more than 602.1 thousand homes. In the six month period ended 30 June 2018, we generated revenue of PYG 1,579.1 billion and EBITDA of PYG 748 billion.

## 2. Recent Developments

### Acquisitions or disposals

On 26 April 2017, we announced an agreement to sell and lease back approximately 1,400 wireless communications towers to a subsidiary of American Tower Corporation ("ATC") whereby we agreed the sale of tower assets and to lease back a dedicated portion of each tower for our network equipment in exchange for cash. As a result of this transaction, we will receive approximately PYG 700 billion (equivalent to $125 million) in cash.

The second closing of 121 towers occurred on 3 January 2018 and American Tower Company paid PYG 67 billion (approximately $12 million). This triggered the recognition of an upfront gain on sale of $9 million under "Other operating income (expenses), net".

The third and fourth closing of 212 and 97 towers occurred on April and May respectively. American Tower Company paid PYG 118.3 billion (approximately $21.3 million), and PYG 51.5 billion (approximately $9.8 million). This triggered the recognition of an upfront gain on sale of $7.8 million and $2.7 million under "Other operating income (expenses), net".

The tower assets that have not yet been transferred are classified as assets held for sale as completion of their sale is highly probable.

## 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 several 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:

### Drivers for revenue growth

We are building state-of-the art fixed and mobile networks to deliver services for consumers and businesses. We are rapidly increasing the digital capabilities of our mobile network, extending our 4G network coverage – a technology that enables a step change in the speed of data services that can be delivered to our mobile customers. We are also expanding the footprint of our HFC fixed network, passing homes and business premises and connecting them to our infrastructure.

We are monetizing the substantial investment we make in fixed and mobile networks by providing high quality, secure connectivity as well as innovative, compelling value-for-money services that consumers and businesses demand.

On the mobile front, we continue to focus on high-value customers and on expanding coverage and capacity of our 4G network. On the fixed side, we continue to invest to provide faster and more reliable broadband connectivity needed to support the economic growth and the expansion of the middle class in Paraguay. Our fixed network buildout is also opening new opportunities for our B2B segment, where revenue continues to grow at a high-single-digit rate.

## Customers

### Mobile customers

Our mobile customer numbers as of 30 June 2018, 2017 and 2016 were as follows:

| In millions | Six-month period ended 30 June | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Mobile customers | 3.32 | 3.50 | 3.79 |

Our total mobile customer base decreased by 5.1% to 3.32 million from 3.50 million, with a net loss of 178 thousand customers year-on-year, mostly reflecting the loss of pre-paid customers with very low ARPU, consistent with our strategy. At the end of the period, our mobile data customer base reached 1.93 million and accounted for around 58% of the total mobile subscriber base. Meanwhile, our 4G customer base grew 90% year-on-year to 785.1 thousand and 4G customers accounted for 24% of the total mobile subscriber base.

## Home

Our HFC network is an integral part of Tigo Paraguay's broader network, which covers approximately 602.1 thousand homes in Paraguay, and we provide services to around 431.4 thousand Revenue Generating Units (RGUs, HFC only). Our home customers can choose from a complete suite of services, including pay TV, internet, and other digital services. Our pay 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 strategy is to expand our HFC network faster and more cost-effectively, increasing our homes passed, homes connected, and revenue.

The following tables shows the evolution of the home business, on HFC, on the previous years, including Tigo Paraguay's broader network:

| Homes Passed HFC | Q2'17 | Q3'17 | Q4'17 | Q1'18 | Q2´18 |
|---|---|---|---|---|---|
| Tigo Paraguay | 589,264 | 589,264 | 602,064 | 602,064 | 602,064 |

| Homes Connected HFC | Q2'17 | Q3'17 | Q4'17 | Q1'18 | Q2´18 |
|---|---|---|---|---|---|
| Telecel | 83,594 | 85,658 | 86,459 | 88,345 | 89,022 |
| Tigo Paraguay | 235,176 | 246,253 | 255,429 | 269,860 | 278,233 |

| RGUs HFC | Q2'17 | Q3'17 | Q4'17 | Q1'18 | Q2´18 |
|---|---|---|---|---|---|
| Telecel | 131,316 | 135,489 | 137,452 | 140,463 | 142,422 |
| Tigo Paraguay | 357,757 | 377,263 | 393,611 | 415,891 | 431,390 |

## New products and services

We use our LTE network to provide fixed telecom services such as high-speed internet in cities where we do not have the HFC coverage. Finally, our Tigo Business unit also looks for ways to grow with innovation, with the recent addition of its first UPTIME Tier 3 certified data center to help us expand into business services such as co-location and cloud solutions.

## Capital expenditures

We consistently improve the quality and increase the coverage of our mobile and cable networks. This requires the purchasing of new licenses and spectrum, investing in new infrastructure, and modernizing and upgrading our networks and IT backbones.

Balance sheet capital investment totaled PYG 333.9 billion during the six-month period ended 30 June 2018, compared to PYG 128.5 billion during the six-month period ended 30 June 2017, in which we invested in the acquisition of 4G spectrum. Our investments remain directed towards the strategic focus areas of 4G mobile, the HFC network rollout, and the IT infrastructure that underpins the future growth and our convergence capabilities.

### Competitive and regulatory pressures on pricing

The markets in which we operate are competitive in nature, and we expect competition will remain robust. 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. We seek to sustain our market leadership position by providing innovative services on fast and reliable networks, and by leading with significant positive initiatives that reflect our commitment to sustainability.

Our customers are front and center of everything we do. Our aim is to provide an efficient, first-time-right service that delivers real value. By building partnerships with major global content providers, we are able to connect our customers to a wide-range of audio, video, and other online media solutions. By continuing to innovate with our platforms, developing our services, and expanding our infrastructure, we offer our customers better ways to communicate, work, shop, and play.

### Effect of exchange rate fluctuations

The exchange rate for the Paraguayan Guarani fluctuates in relation to the U.S. dollar and such fluctuations may, from time to time, have a material adverse effect on our earnings, assets and liability valuation, and cash flows. Moreover, currency movements can also affect our financial leverage, as some of our debt is denominated in U.S. dollars.

The PYG/USD exchange rate moved from 5,560 as of 30 June 2017 to 5,703 as of 30 June 2018. This change in the exchange rate had an impact on our Net Profit for the six-month period ending 30 June 2018, due to the increase of the rate, impacting on our debt in US Dollars.

## 4. Results of Operations

### Six-month period ended 30 June 2018 and 2017

| PYG millions | Six-month period ended 30 June | | Percent change |
|---|---|---|---|
| | 2018 | 2017 | |
| Revenue | 1,579,145 | 1,534,299 | 2.9% |
| Cost of sales | (329,510) | (312,925) | 5.3% |
| **Gross profit** | **1,249,635** | **1,221,374** | **2.3%** |
| Operating expenses | (501,435) | (499,173) | 0.5% |
| Depreciation | (181,562) | (185,916) | (2.3%) |
| Amortization | (73,130) | (68,248) | 7.2% |
| Other operating income (expenses), net | 94,921 | (56) | NMF |
| **Operating profit** | **587,799** | **467,981** | **25.6%** |
| Interest expense | (136,739) | (102,759) | 33.1% |
| Interest and other financial income | 1,632 | 3,185 | (48.8%) |
| Exchange loss, net | (24,553) | 6,471 | (479.4%) |
| **Profit before tax** | **428,139** | **374,878** | **14.2%** |
| Income tax expense | (60,674) | (62,116) | (2.3%) |
| **Net profit and comprehensive income for the period.** | **367,465** | **312,762** | **17.5%** |

| | | | |
|---|---|---|---|
| **Operating Data:** | | | |
| **Number of mobile subscribers** | **3,324,615** | **3,502,820** | **(5.1%)** |
| Postpaid | 905,457 | 875,090 | 3.5% |
| Prepaid | 2,419,158 | 2,627,730 | (7.9%) |
| **Monthly churn %** | | | |
| Postpaid handset | 2.1% | 2.0% | 0.1 ppts |
| Postpaid datacard | 3.9% | 3.0% | 0.9 ppts |
| Total postpaid | 2.2% | 2.0% | 0.2 ppts |
| Prepaid handset | 3.4% | 3.0% | 0.4 ppts |
| Prepaid datacard | 5.6% | 5.7% | (0.01 ppts) |
| Total prepaid | 3.4% | 3.0% | 0.4 ppts |
| Total monthly churn (1) | 3.1% | 2.8% | 0.3 ppts |
| **Monthly ARPU (2)** | | | |
| Postpaid | 97.5 | 109.6 | (11.0%) |
| Prepaid | 38.8 | 35.8 | 8.4% |
| Total monthly ARPU (3) | 54.5 | 54.0 | 0.9% |
| **Number of employees** | **1,073** | **1,147** | **(6.5%)** |

(1) Our total monthly churn is individually calculated by reference to our aggregate prepaid and postpaid customers.

(2) ARPU in local currency is expressed in thousand

(3) Our total ARPU is individually calculated by reference to our aggregate prepaid and postpaid customers. Postpaid include B2C and B2B

## Revenue

Total revenue of PYG 1,579.1 billion increased 2.9% year-on-year as reported. Our mobile business performance was impacted by lower handset sales and by the ongoing erosion of revenue from voice and SMS services, partly offset by continued growth from data services, consistent with trends seen in many mobile markets globally. Mobile data revenue grew by nearly 9.1% in the six-month period ended 30 June 2018, while voice and SMS revenue fell by 12%. In the current period, mobile data accounted for 55.7% of total mobile revenue, compared to 49.2% in the previous year, with the share of voice and SMS in the mix correspondingly falling to 31.9% from 35.6%.

## Customer base

As of 30 June 2018, our total mobile customer base was 3,32 million which represents a decrease of 5% from 3,50 million as of 30 June 2017, with prepaid customers accounting for 73% or 2.42 million of our total mobile customers. We continue to focus on attracting higher quality customer and use subsidies to stimulate adoption of data services. We have been investing to improve the quality of our networks, increasing both capacity and coverage, something that we believe has helped retention of our most valuable customers. Strengthening our network distribution through digital channels has also contributed to making our products more accessible.

## Cost of sales

Cost of sales increased by 5.3% for the six-month period ended 30 June 2018 to PYG 162.5 billion from PYG 151.2 billion for the same period in 2017. Our cost of sales is affected by lower T&E costs and some costs such as voice and SMS decreased in line with the decrease of revenue related to those services.

Gross profit margin decreased to 79.1% for the six-month period ended 30 June 2018 from 79.6% for the same period in 2017.

## Operating expenses

Operating expenses increased by 0.5% for the six-month period ended 30 June 2018 to PYG 501.4 billion from PYG 499.2 billion for the same period in 2017. As a percentage of revenue, general and administrative expenses decreased to 31.8% for the six-month period ended 30 June 2018 from 32,5% in 2017.

## EBITDA

| | Six-month Period Ended 30 June | |
|---|---|---|
| | 2018 | 2017 |
| EBITDA (1) | 748,200 | 722,201 |
| EBITDA margin (2) | 47.4% | 47.1% |
| Net debt to LTM EBITDA (3) | 1.78 | 1.51 |
| Total debt to LTM EBITDA (4) | 1.99 | 1.61 |

(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 six-month period ended 30 June 2018.

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

EBITDA increased by PYG 26 billion (4% year-on-year), and EBITDA margin improved by 0.3 percentage points year-on-year. The margin improvement mostly reflects a decrease in handset revenue and cost, as well as costs associated with the provision of voice and SMS services.

## Operating profit

Operating profit increased by 25.6% for the six-month period ended 30 June 2018 to PYG 587.8 billion from PYG 467.9 billion for the same period ended 30 June 2016. The operating margin decreased from 37% at end of 30 June 2017 to 31% on 30 June 2018. The year-on-year variation stems mostly from the gain on the sale of towers during the first two quarters of 2018, for approximately PYG 90 billion.

### Net finance costs

Net finance costs, which include interest expense, net of interest income, increased by 35.7% in the six-month period ended 30 June 2018 to PYG 135.1 billion from PYG 99.6 billion for the same period ended 30 June 2017. This increase was mainly due to higher interest accretion of football rights, interest accretion of new financial debts, and finance leases, and the effect of increased foreign exchange rate on our financial debt which is mainly denominated in US Dollars.

### Foreign exchange gain (loss)

Exchange loss, net, increased by 479.4% at the end of June 2018 to a net loss of PYG 24.6 billion from a net gain of PYG 6.5 billion at the end of June 2017. Exchange gains and losses resulted primarily as a result of movements in the PYG/USD exchange rate resulting in the revaluation of our U.S. dollar borrowings, trade payables, receivables, supplier 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, on 2017 from 5,767 on December 2016, to 5,560 on June 2017, generating a gain of PYG 6.5 billion. On 2018, the rate increased from 5,590 on December 2017, to 5,703 as of 30 June 2018, generating a net loss of PYG 24.6 billion.

### Charge for taxes

The charge for taxes decreased by 2.3% to PYG 60.7 billion for the six-month period ended 30 June 2018, from PYG 62.1 billion for the same period ended 30 June 2017. The effective tax rate for the period ended 30 June 2018 was 14.2% compared to 16.6% for the same period ended 30 June 2017.

### Net profit for the period

Net profit at the end of 30 June 2018 increased by 17,5% to PYG 367.5 billion compared to a net profit of PYG 312.8 billion at the end of 30 June 2017 as a result of the effects explained above.

## 5. Trend Information

Our strategy is centered on the deployment of high-speed data networks, both mobile and fixed. On the revenue side, we accelerated the migration from mobile legacy voice and SMS to data, as well as continued expanding our cable footprint as an enabler for our fast-growing Home and Business-to-Business (B2B) businesses. On the operational side, we continued the reconfiguration of our cost base, with Digital as a key enabler to capture efficiencies and increase operational leverage to drive cash flow growth. We also increased our focus and efforts to delight our customers with a superior customer experience.

Our strategy to monetize the rapidly growing demand for mobile data is built around expanding our 4G coverage. We are driving the adoption of data-capable smartphone devices that enable customers to use data services on the move. By the end of June 2018, our smartphone user base reached 1.8 million subscribers, or 54% of our total customer base. We are creating compelling data-centric products and services to encourage our consumers to consume more data, while maintaining price discipline. By the end of June 2018, we had almost 2 million data users, representing more than a half of our total customer base.

Demand for Pay TV and fixed broadband access continues to grow rapidly in our market, as coverage, usage and affordability increase. Our strategy to address this attractive digital growth opportunity is built around accelerating the roll-out of our high-speed HFC fixed network. We fill the network as fast as possible, converting homes passed into homes connected. We upsell through bundling of services to ensure we maximize the number of revenue-generating units per household, and we drive customer connections onto our network by expanding our range of digital services and aggregating content, including exclusive local content, enabling us to differentiate our offerings from others in the market.

### 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.

### Financing

As of 30 June 2018, our total outstanding indebtedness and other financing was PYG 2,859 billion. As of 30 June 2017, our total outstanding indebtedness and other financing was PYG 2,726 billion.

Our interest expense for the year ended 30 June 2018 was PYG 136.7 billion and for the same period ended 30 June 2017 was PYG 102.8 billion.

### Cash Flows

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

| PYG million | Six-month period ended 30 June | |
|---|---|---|
| | 2018 | 2017 |
| Net cash provided by operating activities | 452,387 | 446,308 |
| Net cash used in investing activities | (691,149) | (252,587) |
| Net cash used in financing activities | 42,490 | (357,745) |
| **Net (decrease) increase in cash and cash equivalents** | **(190,418)** | **(174,669)** |
| Cash and cash equivalents at the end of the period | 297,628 | 136,253 |

For the period ended 30 June 2018 cash provided by operating activities was PYG 452.4 billion compared to PYG 446.3 billion for the same period ended 30 June 2017. The decrease was mainly due to an increase of payments made to suppliers.

For the period ended 30 June 2018 cash used by investing activities was PYG (691.1) billion compared to PYG (252.6) billion for the same period ended 30 June 2017, mainly due to debt and other financing granted to related parties.

For the period ended 30 June 2018 cash provided by financing activities was PYG 42.5 billion compared to PYG (357.7) billion used on the same period ended 30 June 2017. The variation of cash provided and used for financing activities during the period ended 30 June 2018 is mainly due to new loans from local banks.

The net decrease in cash and cash equivalents for the period ended 30 June 2018 was PYG 190.4 billion compared to PYG 174.7 billion for the same period of 2017. We are closing with a cash and cash equivalents of PYG 297.6 billion as of 30 June 2018 compared to PYG 136.3 billion as of 30 June 2017.

## 6. Subsequent events

### *Dividends advanced*

On 26 July 2018, The Company transferred USD 35 million to Millicom International Operations S.A. as dividend advance related to the results of FY 2018.

### *Loans*

On 30 July 2018, The Company was granted a loan in LC of PYG 115 billion (USD 20 million) by Banco Regional S.A.E.C.A