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 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 Mobile Financial Services (MFS) and digital media. We hold the number one position in the mobile market with more than 3.28 million mobile customers, while our Hybrid Fiber-Cable (HFC) network passes more than 501,4 thousand homes. In the year ended 31 December 2018, we generated revenue of PYG 3,096.6 billion and EBITDA of PYG 1,432 billion.

2. Recent Developments

Sale and Leaseback Transactions

On April 25, 2017, we announced an agreement to sell and lease back approximately 1,410 wireless communications towers to a subsidiary of American Tower Corporation ("ATC") whereby we agreed to sell tower assets and lease back a dedicated portion of each tower for our network equipment in exchange for cash. This is consistent with our growth strategy and funding needs. As a result of this transaction, we expect to receive approximately PYG 700 billion in cash. To date, we have sold 1,276 towers for aggregate proceeds of PYG 649.6 billion, recognizing an upfront gain of 257.4 billion as other operating income, including PYG 110.1 billion recognized in 2018.

The tower assets that have not yet been transferred are classified as assets held for sale.

We have the option to sell additional tower sites under the agreement.

We believe the transaction will allow us to focus our capital investment on other fixed assets, such as network equipment, thereby increasing our network coverage, capacity, and the overall quality of our service, while also improving our return on invested capital.

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 described below:

Revenue

We generate revenue mainly from fees associated with communication, entertainment, data, and information services that we provide to our customers, including: airtime and data usage fees, roaming fees, interconnection fees, connection fees, monthly subscription fees, broadband internet, VoIP, data transmission, cable TV, sale of content and other services and sales of equipment, cloud and ICT. We generally seek to increase our revenue through the growth of our customer base and the introduction of new products and value-added services. Our results of operations are therefore dependent on our customer base and the number of services that each customer uses.

Drivers for revenue growth

We are building state-of-the-art fixed and mobile networks to deliver services for consumers and businesses. We intend to rapidly increase the digital capabilities of our mobile network, extending our 4G/LTE network coverage – a technology that increases 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 intend to monetize 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 business demand.

Mobile

On the mobile front, we continue to focus on high-value customers and on expanding coverage and capacity of our 4G/LTE network. As of December 31, 2018, we had approximately 1.1 million customers on 4G/LTE, an increase of 48% compared to December 31, 2017. Our mobile subscriber base decreased by 5.4% to 3.28 million between December 31, 2018 and December 31, 2017, mostly reflecting the loss of pre-paid customers with lower ARPU, consistent with our strategy. In 2018, our 4G/LTE customer base grew 48%, ending the year at 1.1 million. At December 31, 2018, 4G/LTE customers accounted for 33.1% of the total mobile subscriber base.

Home

As of December 31, 2018, our HFC network (including SPM the affiliate company) covered approximately 659 thousand homes in Paraguay (a 9.4% increase from December 31, 2017), and we provided services to around 453 thousand RGUs, a 14% increase from December 31, 2017. 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 than our competitors, increasing our homes passed, homes connected, and revenue. We continue to invest to provide faster and more reliable broadband connectivity taking into account the expansion of the middle class in Paraguay.

In 2014, we launched Tigo Sports, a multiplatform sports content producer and differentiator of Tigo pay-TV service. The service is also available as a value-added service for mobile phone subscribers, allowing access to content through an app for smartphones. This step represents an important component of our strategy to increase client loyalty by offering exclusive content to our customers in the pay-TV and mobile areas and a significant enhancement to the value of the Tigo brand, as it differentiates us from our competitors and provides our customers with sought-after premium content. For instance, through Tigo Sports, we own the rights to broadcast the Paraguayan national football championship until 2020.

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 offer HFC coverage. Our Tigo Business unit also looks for ways to grow through innovation, with the recent addition of the first UPTIME Tier 3 certified data center to help us expand into business services such as co-location and cloud solutions. This data center allows us to offer services such as virtualization, cloud, storage, backup and housing to our business customers.

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

We consistently seek to 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 infrastructure. Spending 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 increases 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 expenditures during the years ended December 31, 2016, 2017 and 2018 of PYG 823.3 billion, PYG 629.5 billion and 695.0 billion, respectively, resulted in improvements in the quality of our networks and increased capacity and coverage, which improved customer experience.

Balance sheet capital investment totaled PYG 695.0 during the year ended December 31, 2018, compared to PYG 629.5 during the year ended December 31, 2017, in which we invested in the acquisition of 4G/LTE spectrum. Our investments remain directed towards the strategic focus areas of 4G/LTE 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 market in which we operate is 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.

The regulatory environment has become more challenging in our market. Over the past year, new regulation has allowed customers to roll over their unused minutes, SMS bundles and data balances at the end of the month rather than losing these. These changes in regulation have hindered revenue recognition and have affected the profitability of our mobile services, forcing us to quickly adapt our pricing models as needed to achieve our desired margin and return targets.

Effect of exchange rate fluctuations

The exchange rate for the Paraguayan Guaraní 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, 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. See “Risk Factors—Certain factors relating to Paraguay—Fluctuations of the Guaraní relative to the U.S. dollar or the implementation of restrictive currency exchange control policies by the Paraguayan government could result in an increase in our cost of financing and limit our ability to make timely payments on foreign currency-denominated debt.”

The PYG/USD exchange rate moved from PYG 5,590 to US$1.00 as of December 31, 2017 to PYG 5,961 to US$1.00 as of December 31, 2018. This variation impacted significantly on our Net Profit for the year ended December 31, 2018, in PYG 77,045 million, mainly due to our borrowings that are denominated in U.S. dollars.

4. Results of Operations

Year ended 31 December 2017 and 2016

PYG million	Year ended 31 December		Percent change
	2018	2017	
Revenue	3,096,572	3,106,130	(0.3%)
Cost of sales	(634,706)	(609,897)	4.1%
Gross profit	**2,461,866**	**2,496,233**	**(1.4%)**
Sales and marketing	(640,284)	(680,469)	(5.9%)
General and administrative expenses	(389,908)	(402,373)	(3.1%)
Operating expenses	(1,030,192)	(1,082,842)	(4.9%)
Depreciation	(363,934)	(367,294)	(0.9%)
Amortization	(158,321)	(138,053)	14.7%
Other operating income (expenses), net	104,299	168,230	(38.0%)
Operating profit	**1,013,718**	**1,076,274**	**(5.8%)**
Interest expense	(285,314)	(236,130)	20.8%
Interest and other financial income	17,862	5,404	230.5%
Exchange gain (loss), net	(77,045)	(4,651)	1556.5%
Profit before tax	**669,221**	**840,897**	**(20.4%)**
Income tax expense	(67,362)	(137,683)	(51.1%)
Net profit and comprehensive income for the period.	**601,859**	**703,214**	**(14.4%)**

Operating Data:			
Number of mobile subscribers	**3,277,746**	**3,465,254**	**(5.4%)**
Postpaid	913,976	889,439	2.8%
Prepaid	2,363,770	2,575,363	(8.2%)
Monthly churn %	**2.4%**	**2.1%**	**11.0%**
Total monthly churn (1)			
Monthly ARPU			
Postpaid	100,694	108,041	(6.8%)
Prepaid	38,185	37,028	3.1%
Total monthly ARPU(2)	54,903	54,748	0.3%
Number of employees	1,062	1,179	(8.4%)

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

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

Revenue

Total revenue decreased by 0.3%, or PYG 9,558 million, from PYG 3,106 billion for the year ended December 31, 2017 to PYG 3,097 billion for the year ended December 31, 2018 primarily as a result of lower handset sales in our mobile business and by the ongoing trend of lower 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 6.09% for the year ended December 31, 2018, while voice and SMS revenue fell by 14.3%. In 2018, mobile data accounted for 53.5% of total mobile revenue, compared to 48% in 2017, with the share of voice and SMS in the mix correspondingly falling to 33.3% in 2018 from 36.5% in 2017

Fixed service revenue grew by 8% year-on-year as reported, with fixed B2B revenue increasing by 13% and residential cable revenue falling by 2%. Fixed B2B revenue increased due to new solutions and services offered to customers and residential cable decreased due to competitive landscape. Our recurring revenue from value-added services represented 90% of our fixed service revenue for the year ended December 31, 2018 compared to 93% of total recurring revenue for the year ended December 31, 2017.

Cost of sales

Cost of sales increased by 4.1%, or PYG 24.8 billion, from PYG 609.8 billion for the year ended December 31, 2017 to PYG 634.7 billion for the year ended December 31, 2018. The increase in cost of sales is due to higher telephone and equipment costs, transmission costs and the effect of the implementation of IFRS15.

Gross profit margin decreased to 79.5% for the year ended December 31, 2018 from 80.4% for the year ended December 31, 2017, primarily from lower margins on services provided as a result of economies of scale and the mix of equipment sales.

Sales and marketing

Sales and marketing expenses decreased by 5.9%, or PYG 40 billion, from PYG 680 billion for the year ended December 31, 2017, to PYG 640 billion for the year ended December 31, 2018. Sales and marketing costs were comprised mainly of commissions to dealers for obtaining customers on our behalf as well as selling prepaid reloads, handset subsidies, general advertising and promotion costs, point of sales materials for the retail outlets, sponsorship and staff costs. The decrease in sales and marketing costs was mainly attributable to lower subsidies and commissions due to the implementation of IFRS15. As a percentage of revenues, sales and marketing expenses decreased from 21.9% for the year ended December 31, 2017 to 20.7% for the year ended December 31, 2018.

General and administrative expenses

General and administrative expenses decreased by 3.1%, or Gs. 12 billion, from Gs.402 billion for the year ended December 31, 2017, to Gs. 390 billion for the year ended December 31, 2018. The decrease in general and administrative expenses was attributable to savings mainly in site leases as a benefit of the sale of towers in 2017 (see “Recent Developments”), other taxes and other payment and collection costs. As a percentage of revenues, general and administrative expenses decreased from 13% for the year ended December 31, 2017 to 12.6 % for the year ended December 31, 2018.

Operating expenses

Operating expenses decreased by 4.9% for the year ended December 31, 2018 to PYG 1,030.2 billion from PYG 1,082.8 billion for the same period in 2017 as a result of lower football payments as other shared costs and employee related costs. As a percentage of revenue, operating expenses decreased to 33.3% for the year ended December 31, 2018 from 34.9% in 2017.

EBITDA

	Year Ended 31st December	
	2018	2017
EBITDA (1)	1,431,674	1,413,391
EBITDA margin (2)	46.23%	45.50%
Net debt to LTM EBITDA (3)	1.99	1.58
Total debt to LTM EBITDA (4)	2.10	1.93

(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 year ended 31 December 2018.
(4) We calculate Total debt to EBITDA by dividing our total borrowings by our LTM EBITDA.

EBITDA increased by PYG 18,3 billion (1.8% year-on-year), and EBITDA margin improved by 56.2 basis points year-on-year. The margin improvement mostly reflects a decrease in handset revenue and cost, as well as lower costs associated with the provision of voice and SMS services.

Operating profit

Operating profit decreased by 5.8% for the year ended December 31, 2018 to PYG 1,013.7 billion from PYG 1,076.2 billion for the same period ended December 31, 2017 as a result of the above. The operating margin decreased from 34.6% for the year ended December 31, 2017 to 32.7% for the year ended December 31, 2018. The year-on-year variation was primarily driven by the gain on the sale of 837 towers (approximately 60% of the total number of towers), which represented a gain of PYG 147.3 billion during 2017. In 2018 we sold 440 towers (approximately 31% of the total number of agreed towers), which represented a gain of PYG 110.1 billion.

Net finance costs

Net finance costs, which include interest expense, net of interest income, increased by 16% for the year ended December 31, 2018 to PYG 267.5 billion from PYG 230.7 billion for the year ended December 31, 2017. This increase was mainly due to higher interest costs on financing, interest costs on new financial debts, and finance leases. This impact is offset by the interests accretion on loans granted to related parties.

Exchange gain (loss)

Exchange loss, net, for the year ended December 31, 2018 was a net loss of PYG 77.1 billion compared to a net loss of PYG 4.6 billion for the year ended December 31, 2017. Exchange gains and losses were primarily 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 decreased from PYG 5,590 to US$1.00 as of December 31, 2017 to PYG 5,961 to US$1.00 as of December 31, 2018 on a year-end basis.

Income tax expenses

The charge for taxes decreased by 51.1% to PYG 67.4 billion for the year ended December 31, 2018, from PYG 137.7 billion for the year ended December 31, 2017, due primarily to a lower profit before tax. The effective tax rate for the year ended December 31, 2018 was 10% compared to 16.4% for the year ended December 31, 2017.

Net profit

Net profit for the year ended December 31, 2018 decreased by 14.4% to PYG 601.9 billion, compared to a net profit of PYG 703.2 billion for the year ended December 31, 2017, as a result of the above.

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 bond and bank financings to fund our operations, capital expenditures and working capital requirements.

We believe that our sources of liquidity are sufficient for our present requirements. Although we believe that we should be able to meet our debt service obligations and fund our operating requirements in the future through cash flow from our operations, we may seek additional financing in the capital markets from time to time, depending on market conditions and our financial requirements. We intend to continue to focus on investments in property, systems and equipment (fixed assets) and working capital management, including the timely collection of accounts receivable and efficient management of accounts payable.

Financing

Our total outstanding indebtedness and other financing for the years ended December 31, 2016, December 31, 2017 and December 31, 2018 was PYG 2,354 billion, PYG 2,726 billion and PYG 3,003 billion, respectively.

Our interest expense for the years ended December 31, 2016, December 31, 2017 and December 31, 2018 was PYG 197.8 billion, PYG 236.1 billion and PYG 285.3 billion, respectively.

Cash Flows

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

Year Ended 31st December	2018	2017
	(in million of PYG)	
Net cash provided by operating activities	1,001,061	953,085
Net cash used by investing activities	(803,918)	(422,130)
Net cash used by financing activities	(545,631)	(340,384)
Net (decrease) increase in cash and cash equivalents	**(340,275)**	**177,124**
Cash and cash equivalents at the end of the period	147,771	488,046

For the year ended December 31, 2018 cash provided by operating activities was PYG 1,001,061 compared to PYG 953,085 for the year ended December 31, 2017. The increase was mainly due to an increase in interests received, increase in trade receivables and payables, and a decrease in taxes paid.

For the year ended December 31, 2018 cash used by investing activities was PYG 803,918 compared to PYG 422,130 for the year ended December 31, 2017, mainly due to the purchase of property, plant and equipment, and increase in debt granted to related parties.

For the year ended December 31, 2018 cash used by financing activities was PYG 545,631 compared to PYG 340,384 for the year ended December 31, 2017. The change in cash used for financing activities during the year ended December 31, 2018 is mainly due to the repayment of debt, a decrease on issuances of new loans and an increase on payments of dividends to equity holders.

The net increase in cash and cash equivalents for the year ended December 31, 2018 was PYG 340,275 compared to PYG 177,124 for the same period of 2017. We had closing cash and cash equivalents of PYG 147,771 as of December 31, 2018, compared to PYG 488,046 as of December 31, 2017**.**

6. Subsequent events

BBVA loan

On January 2nd, 2019, Telecel obtained a seven-year loan from BBVA Bank for PYG 117,000 million, denominated in Paraguayan Guaranies and bears a fixed annual interest rate of 8.94%.

Legal Entity

On February 11th, 2019, the Ministerio de Hacienda, local tax authority, authorized the change of the legal entity of Telefónica Celular del Paraguay Sociedad Anónima to Telefónica Celular del Paraguay Sociedad Anónima Emisora.