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 2019

We believe in better. We believe in tigo

1. Overview

We are a leading provider of telecommunications services, including the affiliates companies, in 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 aproximately 3.50 million mobile customers, while our Hybrid Fiber-Cable (HFC) network passes more than 769,9 thousand homes. In the year ended 31 December 2019, we generated revenue of PYG 2,861 billion and EBITDA of PYG 1,279 billion.

2. Recent Developments

Bonds issuance

In April 2019, Telecel issued $300 million (PYG 1,914,000 million) 5.875% senior notes due 2027 (the “2027 Notes”). The 2027 Notes bear interest at 5.875% p.a., payable semi-annually in arrears on April 15 and October 15 of each year, starting on October 15, 2019. The net proceeds of the Telecel 2027 Notes were used to finance the purchase of the Telecel 2022 Notes.

The 2027 Notes are general unsecured obligations of Telecel and rank equal in right of payment with all future unsecured and unsubordinated obligations of Telecel. The 2027 Notes are unguaranteed.

In June 2019, Telecel issued a bond on the local Paraguayan stock market. Telecel registered to issue up to PYG 300,000 million (approximately $47 million with the closing rate as of September 30, 2019) in different series from 1 year to 10 years. On June 5, 2019, 3 initial series for up to PYG 230,000 million (approximately $37 million) were registered and issued as follows: (i) PYG 115,000 million (approximately $18 million), at 8.75%, due June 3, 2024, (ii) PYG 50,000 million (approximately $7.8 million), at 9.25%, due May 29, 2026 and (iii) PYG 65,000 million (approximately $10 million), at 10%, due May 31, 2029.

On December 27, 2019, we issued PYG 35 billion in 2 tranches: (i) PYG 10 billion which bears a fixed annual interest rate of 9.25% and matures on December 30, 2026; and (ii) PYG 25 billion which bears a fixed annual interest rate of 10% and matures on December 24, 2029.

In September 2019, Telecel entered into an amended and restated agreement with Banco Continental S.A.E.C.A., to consolidate three existing loans, for a PYG 370,000 million (approximately $58 million), which bears an annual interest of 9% paid on a quarterly basis and has a maturity of 7 years.

The outstanding amount of Bond financing as at December 31, 2019 was PYG 2,172,554 million (December 2018: PYG 1,769,553 million).

The carrying amounts of borrowings do not significantly differ from their fair value at the balance sheet dates.

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 as well the increase of traffic/usage and the introduction of new products and value-added services. Our results of operations are therefore dependent on our customer base, the ARPU 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, with our affiliate SPM.

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 increasing our customer base through portability and new customers with segmented plans to increase traffic per user and on expanding coverage and capacity of our 4G/LTE network. As of December 31, 2019, we had approximately 1.4 million customers on 4G/LTE, an increase of 42% compared to December 31, 2018. Our mobile subscriber base increased by 6.7% to 3.5 million during the same period. At December 31, 2019, 4G/LTE customers accounted for 40% of the total mobile customer base compared to 30% at December 31, 2018.

Home

As of December 31, 2019, our HFC network (including SPM the affiliate company) covered approximately 770,000 homes in Paraguay (a 16.8% increase from December 31, 2018), and we provided services to around 519,000 RGUs, a 14.7% increase from December 31, 2018. 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 around the country. As we are growing our HFC network (in SPM) this impact our Wimax customers which are been migrated to HFC and WTTX.

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 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 December 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. Also, since this year we offer our home streaming service named "ONE TV" have the possibility to watch cable television and video content on a single platform, with the same control and from any screen. In the mobile business we launched "Roaming like Home" where our customers can be able to call and traffic in other countries in post-paid and pre-paid segment. Our Tigo Business unit also looks for ways to grow through innovation, with 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.

Balance sheet capital investment totalled PYG 348 billion during the year ended December 31, 2019, compared to PYG 695 billion during the year ended December 31, 2018. The latter period included the acquisition of 4G/LTE spectrum 700Mhz. 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. 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/$ exchange rate moved from PYG 5,961 as of December 31, 2018 to PYG 6,453 as of December 31, 2019. This variation impacted our 2019 Net Profit PYG 83,138 million, mainly due to higher interest expense, as most of our debt financing is denominated in U.S. dollars. Additionally, there is a significant part of our operating costs and capital investments that are also denominated in foreign currency and therefore impacted by currency devaluation.

4. Results of Operations

Year ended 31 December 2019 and 2018

PYG million	Year ended 31 December		Percent change
	2019	2018	
Revenue	2,860,480	3,096,572	(7.6%)
Cost of sales	(511,416)	(634,706)	(19.4%)
Gross profit	**2,349,064**	**2,461,866**	**(4.6%)**
Sales and marketing	(712,501)	(640,284)	11.3%
General and administrative expenses	(357,238)	(389,908)	(8.4%)
Operating expenses	(1,069,739)	(1,030,192)	3.8%
EBITDA	**1,279,325**	1,431,674	(10.6%)
Depreciation	(397,452)	(363,934)	9.2%
Amortization	(199,047)	(158,321)	25.7%
Other operating income (expenses), net	(6,995)	104,299	(106.7%)
Operating profit	**675,831**	**1,013,718**	**(33.3%)**
Interest expense	(393,328)	(285,314)	37.9%
Interest and other financial income	57,824	17,862	223.7%
Exchange gain (loss), net	(83,138)	(77,045)	7.9%
Profit before tax	**257,189**	**669,221**	**(61.6%)**
Income tax expense	(46,182)	(67,362)	(31.4%)
Net profit and comprehensive income for the period.	**211,007**	**601,859**	**(64.9%)**

Operating Data:			
Number of mobile subscribers	**3,496,086**	**3,277,746**	**6.7%**
Postpaid	937,436	913,976	2.6%
Prepaid	2,558,650	2,363,770	8.2%
Monthly churn %			
Postpaid handset	2.3%	2.1%	0.2%
Postpaid datacard	3.0%	3.6%	(0.6%)
Total postpaid	2.3%	2.2%	0.1%
Prepaid handset	2.9%	3.1%	(0.2%)
Prepaid datacard	2.8%	4.9%	(2.1%)
Total prepaid	2.9%	3.1%	(0.2%)
Total monthly churn(1)	2.7%	2.9%	(0.1%)
Monthly ARPU (US$)(2)			
Postpaid	100,817.3	100,694	0.1%
Prepaid	34,178.9	38,185	(10.5%)
Total monthly ARPU(3)	52,627.2	54,903	(4.1%)
Number of employees	**1,042**	**1,062**	**(1.9%)**

(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.

Revenue

Revenue decreased by 7.6%, year-on-year to PYG 2,860 billion for the year ended December 31, 2019 primarily as a result of lower handset sales in our mobile business and by the ongoing trend of declining 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 1% in 2019, while voice and SMS revenue fell by 17%, due to increased price competition impacting ARPU and the legacy of SMS and voice. Mobile data accounted for 66% of total mobile service revenue for the year ended December 31, 2019, compared to 61% in 2018.

Fixed service revenue decreased by 7% year-on-year, with fixed B2B revenue increasing by 6% and residential cable revenue falling by 12%. Fixed B2B revenue increased due to new solutions and services offered to customers, while the decline in residential cable reflects increased competition and the impact of migrating customers from our legacy UHF network to the HFC network operated by our affiliate SPM.

Cost of sales

Cost of sales decreased by 19.4% year-on-year, to PYG 511.4 billion for the year ended December 31, 2019.

Gross profit margin increased to 82.1% for the year ended December 31, 2019 from 79.5% for the year ended December 31, 2018.

Sales and Marketing

Increased by 11.3% year on year to PYG 712.5 billion for the year ended December 31, 2019 from PYG 640.3 billion for the year ended December 31, 2018, as a result of our plan to accelerate our customer growth.

General and administrative expenses

Decreased by 8.4% year on year to PYG 357.2 billion for the year ended December 31, 2019 from PYG 389.9 billion for the year ended December 31, 2018 mainly due to a reduction in Network maintenance costs from PYG 95 billion to PYG 54 billion.

Operating expenses

Operating expenses increased by 3.8% for the year ended December 31, 2019 to PYG 1,069.7 billion from PYG 1,030.1 billion for the same period in 2018. The increase stems primarily from higher programming costs and sponsorship costs, partially offset by positive adjustment to accrued expenses. As a percentage of revenue, operating expenses increased to 37.4% for the year ended December 31, 2019 from 33.3% in 2018.

EBITDA

PYG million	Year Ended 31st December	
	2019	2018
EBITDA [(1)]	1,279,325	1,431,674
EBITDA margin [(2)]	44.7%	46.23%
Net debt to LTM EBITDA [(3)]	2.39	1.99
Total debt to LTM EBITDA [(4)]	2.53	2.10

(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 2019.
(4) We calculate Total debt to EBITDA by dividing our total borrowings by our LTM EBITDA.

EBITDA decreased by PYG 152.3 billion (11% year-on-year), and EBITDA margin decreased by 1.5 percentage points year-on-year, due to the decline in revenue and in the increase in operating expenses.

Operating profit

Operating profit decreased by 33.3% for the year ended December 31, 2019 to PYG 675.8 billion from PYG 1,013.7 billion for the same period ended December 31, 2018 as a result of the above. The operating margin decreased from 32.7% for the year ended December 31, 2018 to 23.6% for the year ended December 31, 2019. The year-on-year variation reflects the lower EBITDA, as described above, as well as the gain of PYG 79.8 billion on the sale of 440 towers during 2018. At the year ended December 31, 2019. For the year ended December 31, 2019, the gain on sale of towers amounted to PYG 14.7 billion.

Net finance costs

Net finance costs, which include interest expense, net of interest income, increased by 25.4% for the year ended December 31, 2019 to PYG 335.5 billion from PYG 267.5 billion for the year ended December 31, 2018. This increase was mainly due to Loan Redemption Fee $9.9 million (PYG 64.5 billion) and IFRS 16 impact in interest $2.6 million (PYG 16.9 billion).

Exchange gain (loss)

Exchange loss, net, for the year ended December 31, 2019 was a net loss of PYG 83.1 billion compared to a net loss of PYG 77.0 billion for the year ended December 31, 2018. Exchange gains and losses were primarily a result of movements in the PYG/$ 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/$ exchange rate increased from PYG 5,961 as of December 31, 2018 to PYG 6,453 as of December 31, 2019.

Income tax expenses

The charge for taxes decreased by 31.4% to PYG 46.2 billion for the year ended December 31, 2019, from PYG 67.4 billion for the year ended December 31, 2018, due primarily to a lower profit before tax.

Net profit

Net profit for the year ended December 31, 2019 decreased by 64.9% to PYG 211.0 billion, compared to a net profit of PYG 601.9 billion for the year ended December 31, 2018, as a result of the above.

Liquidity and Capital Resources

We 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.

Financing

Our total outstanding indebtedness and other financing for the years ended December 31, 2017, December 31, 2018 and December 31, 2019 was PYG 2,726 billion, PYG 3,003 billion and PYG 3,240 billion respectively.

Our interest expense for the years ended December 31, 2017, December 31, 2018 and December 31, 2019 was PYG 236.1 billion, PYG 285.3 billion and PYG 393.3 billion respectively.

Cash Flows

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

Year Ended 31st December	2019	2018
	(in millions of PYG)	
Net cash provided by operating activities	875,575	1,001,061
Net cash used by investing activities	(431,002)	(803,918)
Net cash used by financing activities	(412,443)	(545,631)
Net (decrease) increase in cash and cash equivalents	**39,370**	**(340,275)**
Cash and cash equivalents at the end of the period	187,141	147,771

For the year ended December 31, 2019 cash provided by operating activities was PYG 875.5 billion compared to PYG 1,001 billion for the year ended December 31, 2018. The decrease was mainly due to a decrease in trade receivables and payables, and a decrease in taxes paid.

For the year ended December 31, 2019 cash used by investing activities was PYG 431 billion compared to PYG 803,9 billion for the year ended December 31, 2018, mainly due to less proceeds from sale of property, plant and equipment. At the year ended December 31, 2019 we sold 135 towers, compared to 440 towers at the year ended December 31, 2018.

For the year ended December 31, 2019 cash used by financing activities was PYG 412.4 billion compared to PYG 545.6 billion for the year ended December 31, 2018. The change in cash used for financing activities during the year ended December 31, 2019 is the net effect between repayment of debt and financing and proceeds from issuance of debt and other financing.

The net increase in cash and cash equivalents for the year ended December 31, 2019 was PYG 39.4 billion compared to PYG 340.3 for the same period of 2018. We had closing cash and cash equivalents of PYG 187.1 billion as of December 31, 2019, compared to PYG 147.8 as of December 31, 2018.

6. Subsequent events

Itau loan

On January 23, 2020, Telecel obtained a four-year loan from ITAU Paraguay S.A. Bank for PYG 154.6 billion, denominated in Paraguayan guaranies and bears a fixed annual interest rate of 9%.

International Bonds

On January 28, 2020, Telecel closed a $250 million re-tap on its international bonds with seven-years maturity and bears a fixed annual interest rate of 5.75%.

Local Bonds

On February 13, 2020, Telecel topped up the local bond issue in 2019 by an additional for PYG 35.0 billion. Bonds are denominated in local currency guaranies with two different maturities (7 and 10 years) and interest rate (9.25% and 10%).

Legal Claim

On January 2020, Telecel received a notification from the customer protection authority (SEDECO: Secretaría del Consumidor) N° 23/2020 regarding a 15 minute service interruption that affected our cable customers during an important soccer event. We have provisioned for a $13,000 penalty, but are contesting a customer reparation request (10% of the monthly invoice or $1 million).

We believe that the customer reparation request is without merit, and we have not provisioned for this.

IPS-BID Loan

On February 28, 2020, Telecel repaid and cancelled the loan for PYG 304,446 million.

COVID-19

The recent outbreak of a novel and highly contagious form of coronavirus (“COVID-19”), which the World Health Organization has declared to constitute a pandemic, has resulted in numerous deaths, adversely impacted global commercial activity and contributed to significant volatility in certain equity and debt markets. The global impact of the outbreak is rapidly evolving, and many countries have reacted by instituting quarantines, prohibitions on travel and the closure of offices, businesses, schools, retail stores and other public venues. Businesses are also implementing similar precautionary measures. Such measures, as well as the general uncertainty surrounding the dangers and impact of COVID-19, are creating significant disruption in supply chains and economic activity and are having a particularly adverse impact on transportation, hospitality, tourism, entertainment and other industries. The impact of COVID-19 also led to significant volatility and declines in the global public equity markets and it is uncertain how long this volatility will continue. We are monitoring the potential impact of the recent outbreak of COVID-19, which could negatively impact our global business and results of operations in future reporting periods which, as a consequence, could trigger potential asset impairments. As COVID-19 continues to spread, the potential impacts, including a global, regional or other economic recession, are increasingly uncertain and difficult to assess.