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

TELEFONICA CELULAR DEL PARAGUAY S.A.E.

Nine-month period ended 30 September 2020

We believe in better. We believe in tigo

1. Overview

Telefonica Celular del Paraguay S.A.E. (“Telecel”) is 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 approximately 3.60 million mobile customers, while our Hybrid Fiber-Cable (HFC) network passes more than 811 thousand homes. In the nine-month period ended 30 September 2020, we generated revenue for PYG 2,177 billion and EBITDA for PYG 893 billion.

Covid-19

Social distancing in the country has reduced infections compared to other countries in the region, though it has had a negative impact on economic activity levels across many industries. The telecom industry is no exception to the negative effects of COVID-19 and the social restrictions and sanitary measures. As a company, we are focusing on increasing network resiliency and reliability to improve consumer experience.

2. Key factors affecting 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:

Acquisition of subsidiaries

During the second quarter of 2020, Telecel made the following acquisitions:

a) Mobile Cash Paraguay S.A. :

On 20 May 2020, Telecel SAE acquired a 99.99% shareholding in Mobile Cash Paraguay S.A. (“MCP”) from Telecel’s parent company. As consideration for this acquisition, Telecel issued 272 new shares to its parent company for a value of PYG 4,461 million. Since that date, Telecel controls Mobile Cash Paraguay S.A. (MCP) and fully consolidates it, recognizing non-controlling interests for the 0.01% shareholding it does not own.

b) Servicios y Productos Multimedios S.A. :

On 29 June 2020, through a Share Purchase Agreement (SPA), Telecel acquired 99.90% of the shares of Servicios y Productos Multimedios S.A. (“SPM”) from Millicom Holdings 300 NV for US$ 372 million (after the adjustment in the purchase price finally remained US$ 370.1) in cash, payable within 90 days from closing the shares purchase agreement.

The transfer of ownership of shares of SPM was approved by the appropriate regulator “Comisión Nacional de Telecomunicaciones (“CONATEL”)” on June 3, 2020 by Board Resolution Nº 1182/2020.

Since 29 June 2020, Telecel controls SPM and fully consolidates it, recognizing non-controlling interests for the 0.10% shareholding it does not own.

Revenue

2. Key factors affecting 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:

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, ICT and mobile financial services. We generally seek to increase our revenue through the growth of our customer base as well as 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.

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 September 30, 2020, we had approximately 1.71 million customers on 4G/LTE, an increase of 26.4% compared to September 30, 2019, while our mobile subscriber base increased by 7.7% to 3.60 million during the same period. At September 30, 2020, 4G/LTE customers accounted for 47% of the total mobile customer base compared to 40% at September 30, 2019.

Mobile Financial Services

Through our mobile financial services (MFS) many of our customers, who have limited access to more traditional banking services, have access to secure, appropriate and affordable means of transfer and payment at a lower cost, and safe storage of funds. Branded as Tigo Money, we provide mobile financial services that drive greater financial inclusion, help retain subscribers, and enhance ARPU through access to a wider range of services and increased customer engagement.

As of September, 1.3 million customers used our MFS services, representing 36% of our mobile customer base. Thus, MFS generated revenue of PYG 57.3 billion in the nine-month period ending September 30, 2020.

In response to COVID-19 the government is providing subisides to the most affected and in-need people in the country. The government used Tigo Money to distribute these subsidies to the beneficiaries.

MFS provides sustainable financial services to unbanked people in Paraguay.

During the second quarter, Tigo Money was a key strategic partner to the Government paying subsidies to 415,000 people, of which 6 out of 10 beneficiaries were women. Small businesses without POS sold food and collected funds with their mobile wallets and cell phones, multiplying the government's help that also reached small businesses in very remote areas of our country and thus helping reactivate the economy.

Home

As of September 30, 2020, our HFC network covered approximately 811,000 homes in Paraguay (a 12.9% increase from September 30, 2019), and we provided services to around 524,000 revenue-generating units (RGUs), a 3.4% increase from September 30, 2019. 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 expand our HFC network, we are also migrating customers from our legacy Wimax network to HFC.

Tigo Sports is a multiplatform sports content producer and a key differentiator for our pay-TV service. Tigo Sports is also available as an exclusive value-added service for our mobile phone subscribers, allowing access to content through an app for smartphones and other mobile devices. 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. Through Tigo Sports, we own the rights to broadcast the Paraguayan national football championship until December 2023.

Capital expenditure 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 expenditure ultimately increases our revenue and operating profit, but it also increases 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 295.7 billion during the period ended September 30, 2020 (including PYG 168.1 billion related to SPM) mainly due to the 3500Mhz extension approved in 2020 for 4 years, compared to PYG 321.3 billion during the period ended September 30, 2019.

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.

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/US$ exchange rate moved from PYG 6,380 as of September 30, 2019 to PYG 6,990 as of September 30, 2020. This variation impacted our 2020 Net loss for PYG 161,384 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.

3. Results of Operations

Period ended 30 September 2020 and 2019

PYG million	Period ended September 30		Percent change
	2020 (*)	2019	
Revenue	2,176,905	2,155,472	1.0%
Cost of sales	(442,403)	(392,079)	12.8%
Gross profit	**1,734,502**	**1,763,393**	**(1.6%)**
Sales and marketing	(556,708)	(515,371)	8.0%
General and administrative expenses	(284,516)	(277,550)	2.5%
Operating expenses	(841,224)	(792,921)	6.1%
EBITDA	**893,278**	**970,472**	**(8.0%)**
Depreciation	(312,815)	(304,434)	2.8%
Amortization	(169,255)	(144,991)	16.7%
Other operating income (expenses), net	11,244	26,269	(57.2%)
Corporate fees	(130,656)	-	100.0%
Operating profit	**291,796**	**547,316**	**(46.7%)**
Interest expense	(306,134)	(310,378)	(1.4%)
Interest and other financial income	51,823	42,458	22.1%
Other non-operating income (expenses)	107,721	-	100%
Exchange gain (loss), net	(161,384)	(64,938)	148.5%
Profit before tax	**(16,178)**	**214,458**	**(107.7%)**
Charge for taxes, net	1,252	(32,719)	(103.8%)
Net profit/(loss) and comprehensive income for the period.	**(14,926)**	**181,739**	**(108.2%)**

Operating Data:			
Number of mobile subscribers	**3,599,380**	**3,342,562**	**7.7%**
Postpaid	885,635	911,311	**(2.9%)**
Prepaid	2,713,745	2,431,251	**11.6%**
Monthly churn %	**2.9%**	**2.8%**	**0.1**
Monthly ARPU(1)	**47.0**	**52.2**	**(14.8%)**
Home			
Homes passed	851	778	9.4%
Customer Relationships	446	436	2.2%)
TV customers (2)	360	362	(0.3%)
Broadband RGU	275	258	6.4%
Monthly ARPU(1)	**199.2**	**201.0**	**(0.9%)**
Monthly churn %	**2.14%**	**1.53%**	**0.61**
Number of employees (**)	5.303	5.634	(5.9%)

(1) ARPU in local currency is expressed in thousand
(2) Including HFC, UHF and DTH
(*) Includes SPM and Mobile Cash impact
(**) includes 4268 employees from SPM

Revenue

Revenue increased by 1.0%, year-on-year to PYG 2,177 billion for the period ended September 30, 2020 primarily as a result of the acquisition of the subsidiaries SPM and MCP. If we disregard the effect of the acquisitions, revenue would have decreased 4.9%.

In our mobile operation, revenue decreased by 7%. Normalizing for a favorable one-off deferred revenue adjustment in 2019, revenue would have decreased by 2.6%, mainly due to a decline in the postpaid customer base due to COVID-19.

As for home operation, revenue increased by 31% due to the acquisition of SPM.

In our content operation, revenue decreased by 30%, as a result of less advertising (due to COVID-19) and the customer migration from UHF network to DTH.

Additionally, revenue from financial services increased significantly as a result of the acquisition of MCP.

Cost of sales

Cost of sales increased by 12.8% year-on-year, to PYG 442.4 billion for the period ended September 30, 2020. Impacted mainly by Bad debt due to COVID-19 pandemic and the change in accounting criteria for the football broadcasting rights from expenses to cost, net of other savings due to COVID-19.

Gross profit margin decreased to 79.7% for the period ended September 30, 2020 from 81.8% for the period ended September 30, 2019.

Sales and Marketing

Sales and marketing increased by 8% year on year to PYG 556.7 billion for the period ended September 30, 2020 from PYG 515.4 billion for the period ended September 30, 2019, mainly due to inter-company salesforces recharge from SPM. Excluding that effect, the variation would have been a decrease of 5.2% due to lower advertising and promotional activity due to COVID-19 and due to the previously-mentioned change in accounting treatment for the football rights.

General and administrative expenses

General and administrative expenses increased by 2.5% year on year to PYG 284.5 billion for the period ended September 30, 2020 from PYG 277.6 billion for the period ended September 30, 2019 mainly impacted by new consultancy fees offset by lower lease costs impacted by new IFRS16 contracts in 2020, and the remaining variance coming from a one-off 2019 accrual expenses provision.

Operating expenses

Operating expenses increased by 6.1% for the period ended September 30, 2020 to PYG 841.2 billion from PYG 792.9 billion for the same period in 2019. The increase stems primarily from intercompany salesforces cost offset by the change in football rights accounting in 2020 from expenses to direct costs.

As a percentage of revenue, operating expenses increased to 38.6% for the period ended September 30, 2020 from 36.8% in 2019.

EBITDA

PYG million	Period ended September 30	
	2020	2019
EBITDA (1)	893,278	970,472
EBITDA margin (2)	41.0%	45.0%
Net debt to LTM EBITDA (3)	3.10	1.89
Total debt to LTM EBITDA (4)	3.65	2.24

(1) We define EBITDA as our earnings before interests, taxes, depreciation and amortization, including Telecel, Teledeportes and Lothar year to date results, MCP from June and SPM from July.
(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 12 months ended 30 September 2020.
(4) We calculate Total debt to LTM EBITDA by dividing our total borrowings by our LTM EBITDA.

EBITDA decreased by PYG 77.2 billion (8% year-on-year), and EBITDA margin decreased by 1.05 percentage points year-on-year, due to the increase in cost of sales and sales and marketing expenses.

Operating profit

Operating profit decreased by 46.7% for the period ended September 30, 2020 to PYG 291.8 billion from PYG 547.3 billion for the same period ended September 30, 2019 as a result of the above. The operating margin decreased from 25.4% for the period ended September 30, 2019 to 13.4% for the period ended September 30, 2020. The year-on-year variation reflects the lower EBITDA and higher corporates fees (Value Creating Fee), as described above.

Net finance costs

Net finance costs, which include interest expense, net of interest income, decreased by 5.1% for the period ended September 30, 2020 to PYG 254.3 billion from PYG 267.9 billion for the period ended September 30, 2019. This decrease was mainly as an effect of the recognition of income from the intercompany loans cancelled in advance (PYG 9.3 billon), and the net effect of decreased loan redemption fees (PYG 64.5 billion), decrease by the premature cancelation of the IDB/IPS loan (PYG 18.2 billion), decrease in bank interests (PYG 4.5 billion) and an increase of interests resulting from the bonds retap (PYG 91.5 billion).

Other non-operating result

Other non-operating income of PYG 107.7 billion reflects a gain on the acquisition of Mobile Cash Paraguay.

Exchange gain (loss)

Exchange loss, net, for the period ended September 30, 2020 was a net loss of PYG 161.4 billion compared to a net loss of PYG 64.9 billion for the period ended September 30, 2019. This reflects 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 has depreciated over the past year, with the exchange rate increasing from PYG 6,380 as of September 30, 2019 to PYG 6,990 as of September 30, 2020.

Charge for taxes increased by 103.8% to PYG 1.2 billion for the period ended September 30, 2020, from PYG 32.7 billion for the period ended September 30, 2019.

Net profit

As a result of the above factors, the net loss for the period ended September 30, 2020 decreased by 108.2% to PYG 14.9 billion compared to a net profit of PYG 181.7 billion for the period ended September 30, 2019.

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 to meet our current requirements.

Financing

Our total outstanding indebtedness and other financing for the periods ended September 30, 2018, September 30, 2019 and September 30, 2020 was PYG 2,988 billion, PYG 3,244 billion and PYG 4,945 billion respectively.

Our interest expense for the periods ended September 30, 2018, September 30, 2019 and September 30, 2020 was PYG 211.3 billion, PYG 310.4 billion and PYG 306.1 billion respectively.

Cash Flows

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

Period ended September 30	2020	2019
	(in millions of PYG)	
Net cash provided by operating activities	826,554	731,537
Net cash used by investing activities	(1,402,612)	(475,868)
Net cash used by financing activities	1,002,708	58,372
Net (decrease) increase in cash and cash equivalents	**426,650**	**314,041**
Cash and cash equivalents at the end of the period	613,791	461,812

For the period ended September 30, 2020 cash provided by operating activities was PYG 826.6 billion compared to PYG 731.5 billion for the period ended September 30, 2019. The increase was mainly to a better performance vs prior year due to an increase in trade receivables and payables, and a decrease in taxes paid and interest received.

For the period ended September 30, 2020 cash used by investing activities was PYG 1,402 billion compared to PYG 475 billion for the period ended September 30, 2019, mainly due to the acquisitions of SPM and MCP and to intercompany loans reimbursement.

For the period ended September 30, 2020 cash used by financing activities was PYG 965.9 billion compared to PYG 58.4 billion for the period ended September 30, 2019. The change in cash used for financing activities during the period ended September 30, 2020 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 period ended September 30, 2020 was PYG 426.7 billion compared to PYG 314.0 for the same period of 2019. We had closing cash and cash equivalents of PYG 613.8 billion as of September 30, 2020, compared to PYG 461.8 billion as of September 30, 2019.

4. Subsequent events

The Group has no subsequent events to report.