



**Annual Accounts  
and Directors' Report  
for the year  
ended 31 December 2015**

**(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)**

## **Independent Auditor's Report on the Annual Accounts**

(Translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

To the Shareholders of  
Euskaltel, S.A.

### **Report on the Annual Accounts**

We have audited the accompanying annual accounts of Euskaltel, S.A. (the “Company”), which comprise the balance sheet at 31 December 2015, the income statement, statement of changes in equity and statement of cash flows for the year then ended, and notes.

#### *Directors' Responsibility for the Annual Accounts*

The Directors are responsible for the preparation of the accompanying annual accounts in such a way that they give a true and fair view of the equity, financial position and financial performance of Euskaltel, S.A. in accordance with the financial reporting framework applicable to the entity in Spain, specified in note 2 to the accompanying annual accounts, and for such internal control that they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these annual accounts based on our audit. We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. This legislation requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the annual accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the annual accounts taken as a whole.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the accompanying annual accounts give a true and fair view, in all material respects, of the equity and financial position of Euskaltel, S.A. at 31 December 2015, its financial performance and its cash flows for the year then ended in accordance with the applicable financial reporting framework and, in particular, with the accounting principles and criteria set forth therein.

**Report on Other Legal and Regulatory Requirements**

The accompanying directors' report for 2015 contains such explanations as the Directors consider relevant to the situation of the Company, its business performance and other matters, and is not an integral part of the annual accounts. We have verified that the accounting information contained therein is consistent with that disclosed in the annual accounts for 2015. Our work as auditors is limited to the verification of the directors' report within the scope described in this paragraph and does not include a review of information other than that obtained from the accounting records of the Company.

KPMG Auditores, S.L.

*(Signed on original in Spanish)*

Enrique Asla García

25 February 2016

## EUSKALTEL, S.A.

### Balance Sheet at 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

ASSETS	Notes	31.12.2015	31.12.2014 (*)
<b>NON-CURRENT ASSETS</b>		<b>2,081,289</b>	<b>921,542</b>
Intangible assets	7	29,091	22,552
Property, plant and equipment	8	706,541	743,737
Land and buildings		108,726	113,259
Technical installations and other items		597,815	630,478
Non-current investments in Group companies and associates	6 & 9	1,196,040	8
Non-current investments	9	4,283	6,324
Deferred tax assets	14	145,334	148,921
<b>CURRENT ASSETS</b>		<b>45,014</b>	<b>56,785</b>
Inventories	10	1,936	2,313
Trade and other receivables	9	40,847	39,329
Current investments in Group companies and associates	9	5	3
Current investments	9	74	3,988
Prepayments for current assets		729	502
Cash and cash equivalents	9	1,423	10,650
<b>TOTAL ASSETS</b>		<b>2,126,303</b>	<b>978,327</b>
<b>EQUITY AND LIABILITIES</b>	<b>Notes</b>	<b>31.12.2015</b>	<b>31.12.2014 (*)</b>
<b>EQUITY</b>		<b>702,045</b>	<b>647,490</b>
Capital and reserves	11	702,109	652,037
Capital		455,536	379,613
Share premium		207,604	79,390
Reserves		33,617	162,352
(Own shares and equity holdings)		(1,429)	-
Prior years' profit and loss		-	(6,101)
Profit for the year		6,781	36,783
Valuation adjustments		(64)	(4,547)
Available-for-sale financial assets		(64)	(64)
Hedging transactions		-	(4,483)
<b>NON-CURRENT LIABILITIES</b>		<b>1,353,524</b>	<b>212,949</b>
Non-current payables	13	1,353,524	212,949
<b>CURRENT LIABILITIES</b>		<b>70,734</b>	<b>117,888</b>
Current payables	13	20,226	69,285
Trade and other payables	13 & 14	50,176	47,807
Prepayments for current assets		332	796
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>2,126,303</b>	<b>978,327</b>

(\*) Restated

Derio, 24 February 2015

## EUSKALTEL, S.A.

### Income Statement for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	Notes	2015	2014 (*)
Revenues	15	322,292	315,109
Work performed by the entity and capitalised	7 & 8	5,097	5,721
Supplies	15	(71,090)	(71,524)
Other operating income		367	331
Personnel expenses	15	(26,947)	(30,318)
Other operating expenses	15	(86,994)	(63,469)
Amortisation and depreciation	7 & 8	(79,654)	(81,508)
Impairment and losses on disposal of fixed assets	7	2,199	289
Other losses		(1,415)	(1,432)
<b>RESULTS FROM OPERATING ACTIVITIES</b>		<b>63,855</b>	<b>73,199</b>
Finance income		2,185	36
Finance costs		(56,016)	(23,434)
Exchange losses		(34)	(9)
Impairment and gains/(losses) on disposal of financial instruments		(40)	143
<b>NET FINANCE COST</b>	15	<b>(53,905)</b>	<b>(23,264)</b>
Profit before income tax		9,950	49,935
Income tax	14	(3,169)	(13,152)
<b>PROFIT FOR THE YEAR</b>	11	<b>6,781</b>	<b>36,783</b>

(\*) Restated

## EUSKALTEL, S.A.

### Statement of Changes in Equity for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

#### A) Statement of Recognised Income and Expense for the year ended 31 December 2015

	Notes	2015	2014 (*)
a) Profit for the year	11	6,781	36,783
b) Income and expense recognised directly in equity	11	(88)	(4,787)
Cash flow hedges		(123)	(6,649)
Tax effect		35	1,862
c) Amounts transferred to the income statement	11	4,571	881
Cash flow hedges		6,349	1,224
Tax effect		(1,778)	(343)
<b>TOTAL RECOGNISED INCOME AND EXPENSE</b>		<b>11,264</b>	<b>32,877</b>

(\*) *Restated*

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Derio, 24 February 2016

## EUSKALTEL, S.A.

### Statement of Changes in Equity for the year ended 31 December 2015

#### B) Statement of Total Changes in Equity for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	Registered capital	Share premium	Reserves and prior years' profit	Own shares	Profit for the year	Valuation adjustments	Total
Closing balance, 2013	379,613	79,390	41,778	-	50,092	63,740	614,613
Adjustment for change in criteria (tax credits for investments, see note 2.2)	-	-	72,179	-	(7,798)	(64,381)	-
Adjusted opening balance 2014	379,613	79,390	113,957	-	42,294	(641)	614,613
Total recognised income and expense	-	-	-	-	36,783	(3,906)	32,877
Transactions with shareholders	-	-	-	-	-	-	-
Distribution of profit	-	-	42,294	-	(42,294)	-	-
Closing balance, 2014	379,613	79,390	156,251	-	36,783	(4,547)	647,490
Total recognised income and expense	-	-	-	-	6,781	4,483	11,264
Transactions with shareholders	-	-	-	-	-	-	-
Own shares	-	-	60	(1,429)	-	-	(1,369)
Capital increases	75,923	179,178	(3,408)	-	-	-	251,693
Dividends	-	(50,964)	(156,069)	-	-	-	(207,033)
Distribution of profit	-	-	36,783	-	(36,783)	-	-
Closing balance, 2015	455,536	207,604	33,617	(1,429)	6,781	(64)	702,045

Derio, 24 February 2016

## EUSKALTEL, S.A.

### Statement of Cash Flows for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	2015	2014
<b>Profit for the year before tax</b>	<b>9,950</b>	<b>49,935</b>
<b>Adjustments for</b>	<b>133,511</b>	<b>105,501</b>
Amortisation and depreciation	79,654	81,508
Impairment	2,150	1,018
Impairment and gains/(losses) on disposals of fixed assets	(2,199)	(289)
Impairment and gains/(losses) on disposals of financial instruments	41	(143)
Finance income	(2,185)	(36)
Finance costs	56,016	23,434
Exchange losses	34	9
<b>Changes in operating assets and liabilities</b>	<b>(46,681)</b>	<b>(12,581)</b>
Inventories	456	886
Trade and other receivables	(4,307)	(4,044)
Other current assets	(227)	180
Trade and other payables	(2,398)	(9,780)
Other current liabilities	(464)	177
Other non-current assets and liabilities	(39,741)	-
<b>Other cash flows used in operating activities</b>	<b>(16,157)</b>	<b>(16,497)</b>
Interest paid	(18,342)	(14,148)
Interest received	2,185	36
Income tax paid	-	(2,385)
<b>Cash flows from operating activities</b>	<b>80,623</b>	<b>126,358</b>

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Derio, 24 February 2016



## EUSKALTEL, S.A.

### Statement of Cash Flows for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	<u>2015</u>	<u>2014</u>
<b>Payments for investments</b>	<b>(1,243,934)</b>	<b>(37,582)</b>
Group companies and associates	(1,196,040)	-
Intangible assets	(18,298)	(15,786)
Property, plant and equipment	(29,548)	(20,600)
Other financial assets	(48)	(1,196)
<b>Proceeds from sale of investments</b>	<b>3,461</b>	<b>335</b>
Group companies and associates	3	171
Other financial assets	3,458	164
<b>Cash flows used in investing activities</b>	<b><u>(1,240,473)</u></b>	<b><u>(37,247)</u></b>
<b>Proceeds from and payments for equity instruments</b>	<b>253,732</b>	<b>-</b>
Issue of equity instruments	255,102	-
Acquisition of own equity instruments	(1,370)	-
<b>Proceeds from and payments for financial liability instruments</b>	<b>896,891</b>	<b>(84,750)</b>
Issue of:	1,353,487	23,353
Loans and borrowings	1,353,487	23,353
Repayment of:	(249,563)	(108,103)
Loans and borrowings	(249,563)	(108,103)
Dividends and interest on other equity instruments paid	(207,033)	-
Dividends	(207,033)	-
<b>Cash flows from/(used in) financing activities</b>	<b><u>1,150,623</u></b>	<b><u>(84,750)</u></b>
Cash and cash equivalents at beginning of year	10,650	6,289
Cash and cash equivalents at year end	1,423	10,650
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b><u>(9,227)</u></b>	<b><u>4,361</u></b>

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Derio, 24 February 2016

## **EUSKALTEL, S.A.**

### **NOTES TO THE ANNUAL ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2015**

**(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)**

#### **NOTE 1.- General information**

Euskaltel, S.A. (hereinafter the Company) was incorporated with limited liability on 3 July 1995. Its first product was launched on the market on 23 January 1998. Its registered office is located in Derio (Bizkaia) and its products are primarily marketed and sold in the Basque Country.

The Company's statutory and principal activity since incorporation has been the rendering, management, installation, operation and marketing and sale of telecommunications networks and services in accordance with prevailing legislation, as well as the marketing and sale of goods required to carry out these services. The Company's main facilities are located at the Bizkaia technology park.

On 1 July 2015 the Company's shares were admitted to trading on the Barcelona, Bilbao, Madrid and Valencia stock exchanges.

On 27 November 2015 the Company acquired the entire share capital of R Cable y Telecomunicaciones Galicia, S.A. (hereinafter R. Cable) (see note 6), an entity incorporated in A Coruña on 1 August 1994 whose principal activity is the rendering of services similar to those of the Company, in Galicia. R Cable is the leading telecommunications operator in Galicia, with access to an extensive fibre optic network, and provides mobile telephone services through an agreement with a virtual mobile operator. As a result of this acquisition, under prevailing legislation the Company is the parent of a group of companies, and is obliged to present consolidated annual accounts, which were authorised for issue on 24 February 2016 and show consolidated profit of Euros 7,237 thousand and consolidated equity of Euros 702,923 thousand.

#### **NOTE 2.- Basis of presentation**

##### **2.1. True and fair view**

The accompanying annual accounts have been prepared based on the accounting records of Euskaltel, S.A. and in accordance with prevailing legislation and the Spanish General Chart of Accounts, to give a true and fair view of the equity and financial position at 31 December 2015 and results of operations, changes in equity, and cash flows for the year then ended.

The Company's directors consider that the annual accounts for 2015, authorised for issue on 24 February 2016, will be approved with no changes by the shareholders at their annual general meeting.

##### **2.2. Comparative information**

As a result of the acquisition of R Cable, Euskaltel, S.A. must prepare its consolidated annual accounts in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU).

Up to 31 December 2014, tax credits in respect of income tax deductions for the acquisition of fixed assets were recognised under valuation adjustments in the year in which the right to the deduction originated, and taken to the income statement as the assets were depreciated. However, application of this criteria under Spanish accounting principles is optional, and recognising these deductions in the income statement in the year in which the activities generating the right to offset were carried out, is also admitted.

IFRS-EU do not explicitly set out the accounting treatment of tax credits for investments, and consequently, deciding whether deductions for investments fall under the scope of IAS 12 Income Taxes (in which case the credits would be recognised as a reduction in the income tax expense) or IAS 20 Accounting for Government Grants and Disclosure of Government Assistance (in which case the deductions would be recognised initially in deferred income, then under other operating income as the financed assets were depreciated), is an issue which requires judgement.

The Company's directors consider that the deductions fall under the scope of IAS 12, taking into account that they were not linked to compliance with any requirement other than reinvestment in assets computable for tax purposes. In order to eliminate the differences in criteria between both sets of accounting principles, and considering that the accounting treatment applied in the accounts prepared under IFRS-EU is equally applicable under Spanish GAAP, the directors of Euskaltel, S.A. decided during the year to recognise deductions related to investments in fixed assets as a reduction in the income tax expense, which is consistent with the criteria used in the preparation of the financial statements under IFRS-EU for 2012, 2013 and 2014, which the Company made available to the markets in preparation for its stock flotation, and which was also used when preparing the consolidated annual accounts for 2015.

Consequently, comparative information has been corrected in accordance with prevailing accounting principles. The impact of this change in criteria on comparative information is as follows:

	<u>31.12.13</u>
Reserves	72,179
Valuation adjustments	(64,381)
Profit for the year	
Income tax	<u>(7,798)</u>
	<u><u>-</u></u>

Consequently, the balance sheet, income statement, statement of changes in equity, statement of cash flows and notes for 2015 include comparative figures for 2014 which, except for the adjustment for the change in criteria referred to in the preceding paragraph, formed part of the annual accounts approved by shareholders at the annual general meeting held on 1 June 2015.

As a result of the stock flotation and the acquisition of R Cable, the Company has incurred substantial non-recurring expenses which are shown in the income statement for 2015 and which affect the comparability of the financial information. Details of these non-recurring expenses are as follows:

	2015	2014
Incentives plan (notes 12 and 15.5)	30,705	7,832
Extraordinary personnel remuneration (note 15.3)	3,365	-
Cancellation of derivatives and financing (note 15.5)	10,556	-
Stock flotation expenses (notes 1, 11 and 15.4)	6,558	-
R Cable acquisition costs (notes 1, 6 and 15.4)	5,477	-
	<u>56,661</u>	<u>7,832</u>

### 2.3. Critical issues regarding the valuation and estimation of uncertainties

Preparation of the annual accounts requires certain estimates and judgements concerning the future. These are evaluated constantly and based on historical experience and other factors, including expectations of future events and, where applicable, the justified opinion of renowned experts.

In the event that the final outcome of the estimates differed from the amounts initially recognised, or information that would modify these estimates became available, the effects of any changes in the initial estimates are accounted for in the period they are known.

The estimates and judgements that present significant risk of a material adjustment to the carrying amounts of assets and liabilities in the subsequent reporting period are as follows:

#### a) Capitalisation of tax credits

Deferred tax assets are recognised for all unused tax loss carryforwards, deductible temporary differences and available deductions to the extent that it is probable that sufficient taxable income will be available against which these assets can be utilised. In order to determine the amount of the deferred tax assets to be recognised, estimates are made of the amounts and dates on which future taxable profits will be obtained and the reversal period of temporary differences.

#### b) Useful lives and impairment of non-current assets

The Company determines the estimated useful lives and related amortisation and depreciation charges of assets based on the actual decline in value due to operation and use. The sector in which it carries out its activities is susceptible to technical obsolescence of its facilities, and consequently, estimates made must be reviewed periodically, and at least at each year end. The existence of circumstances which could indicate that the carrying amount of the Company's property, plant and equipment and intangible assets may not be recoverable, is also evaluated.

#### c) Impairment of investments in Group companies

Analysis of the recoverable amount of investments in Group companies requires the use of highly subjective assumptions and accounting estimates.

### 2.4. Presentation currency

The annual accounts are expressed in thousands of Euros rounded off to the nearest thousand.

## 2.5. Grouping of items

To facilitate understanding, certain items in the balance sheet, income statement, statement of changes in equity and statement of cash flows have been aggregated, details of which are included in the relevant notes to the annual accounts.

## NOTE 3.- Distribution of profit

The distribution of Company profits and reserves for the year ended 31 December 2014, approved by the shareholders at their annual general meeting held on 1 June 2015, was as follows:

<b>Basis of application</b>	
Profit for the year	44,334
	<u>44,334</u>
<b>Distribution</b>	
Legal reserve	4,433
Voluntary reserves	33,800
Prior years' losses	6,101
	<u>44,334</u>

Distributable profit is the amount reflected in the annual accounts for the year, without considering the effect of the change in criteria referred to in note 2.2. which increased the income tax expense by Euros 7,551 thousand.

At the annual general meeting held on 26 June 2015, the shareholders agreed to distribute an extraordinary dividend:

<b>Basis of application</b>	
Profit for the year	36,783
Voluntary reserves	119,286
Share premium	50,964
	<u>207,033</u>
<b>Distribution</b>	
Dividends	<u>207,033</u>

The proposed distribution of profit for the year ended 31 December 2015 is as follows:

Legal reserve	678
Other reserves	6,103
	<u>6,781</u>

## NOTE 4.- Accounting principles

### 4.1. Intangible assets

#### a) Computer software

Costs related to the acquisition and development of computer software are recognised at cost of acquisition or production and are amortised on a straight-line basis over their estimated useful lives of between 3 and 5 years.

Computer software maintenance costs are charged as expenses when incurred.

#### b) Licences

Licences for the use of radio space are carried at cost less accumulated amortisation and any recognised accumulated impairment. Amortisation is calculated on a straight-line basis over the concession period.

#### c) Other intangible assets

Other intangible assets include incremental and specific costs related to contracts in which customers undertake to remain with the Company for a specified period of time, and are amortised on a straight-line basis over the specified period.

#### d) Impairment

The Company evaluates and determines impairment losses and reversals of impairment losses on intangible assets based on the criteria described in note 4.3.

### 4.2. Property, plant and equipment

Property, plant and equipment are recognised at cost of acquisition or production, less accumulated depreciation and any recognised accumulated impairment losses.

The value of work performed by the entity and capitalised is calculated taking into account direct and indirect costs attributable to those assets.

Costs incurred to extend, modernise or improve property, plant and equipment are only recorded as an increase in the value of the asset when the capacity, productivity or useful life of the asset is increased and it is possible to ascertain or estimate the carrying amount of the assets that have been replaced in inventories.

Recurring maintenance costs are recognised in the income statement when incurred.

Property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives, based on the actual decline in value due to operation and use.

The estimated average useful lives of property, plant and equipment are as follows:

Buildings	50
Civil engineering	50
Cablings	18-40
Network equipment	10-18
Client equipment	2-15
Other installations, equipment and furniture	6-7
Other property, plant and equipment	5-8

The majority of property, plant and equipment reflects investments to roll-out the Company's telecommunications network throughout the Basque Country.

The Company reviews the useful lives of the assets, as well as their consideration as under construction or operating, and makes any necessary adjustments at each reporting date. Nonetheless, based on the expected use of the Company's assets, their residual value is not estimated to be significant at the reporting date.

When the carrying amount of an asset is higher than its estimated recoverable amount, its value is immediately reduced to its recoverable amount in accordance with the criteria in note 4.3. Impairment losses, or reversals of impairment losses if the circumstances in which they were recognised no longer exist, are recognised as an expense or income, respectively, in the income statement.

Finance costs that are directly attributable to the acquisition or construction of assets which will not be available for use for at least a year are included in the cost of the asset when the expenses related to the asset have been incurred, interest has been accrued and the steps necessary to prepare the assets for their intended use are being taken. Capitalisation of borrowing costs is suspended when construction of the assets is interrupted, except when the interruption is considered necessary to make the asset operational.

#### 4.3. Impairment losses on non-financial assets

The Company evaluates whether there are indications of possible impairment losses on non-financial assets subject to amortisation or depreciation to verify whether the carrying amount of these assets exceeds the recoverable amount. The recoverable amount is the higher of the fair value less costs to sell and the value in use.

Recoverable amount is determined for each individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit (CGU) to which the asset belongs.

Impairment losses for CGU's reduce the value of the assets comprising the CGU, pro rata with their carrying amounts. The carrying amount of each asset may not be reduced below the highest of its fair value less costs of disposal, its value in use and zero.

At the end of each reporting period the Company assesses whether there is any indication that an impairment loss recognised in prior periods may no longer be applicable or may have decreased. Impairment losses are only reversed if there has been a change in the estimates used to calculate the recoverable amount of the asset.

Impairment losses are recognised in the income statement.

A reversal of an impairment loss is recognised in the income statement. The increased carrying amount of an asset attributable to a reversal of an impairment loss may not exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised.

A reversal of an impairment loss for a CGU is allocated to the non-current assets of each unit, pro rata with the carrying amounts of those assets. The carrying amount of an asset may not be increased above the lower of its recoverable amount and the carrying amount that would have been disclosed, net of amortisation or depreciation, had no impairment loss been recognised.

After an impairment loss or reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset is adjusted in future periods based on its new carrying amount.

However, if the specific circumstances of the assets indicate an irreversible loss, this is recognised directly in losses on the disposal of fixed assets in the income statement.

#### **4.4. Inventories**

Inventories are initially measured at the lower of cost (whether cost of acquisition or production) and net realisable value, and any related impairment losses or reversals are recognised in the income statement.

Cost is determined using the weighted average cost method. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale.

#### **4.5. Financial assets**

##### **a) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

These financial assets are initially carried at fair value, including directly attributable transaction costs, and subsequently measured at amortised cost, recognising accrued interest at the effective interest rate. Nevertheless, trade receivables falling due in less than one year are carried at their nominal amount on both initial recognition and subsequent measurement, provided that the effect of not discounting the cash flows is immaterial.

The impairment loss is calculated as the difference between the carrying amount of the asset and the present value of the estimated future cash flows. Impairment losses are recognised and reversed in profit or loss. Balances receivable are derecognised when they are no longer expected to be recovered.

##### **b) Investments in Group companies**

Investments in Group companies and associates are initially recognised at cost, which is equivalent to the fair value of the consideration given, including, in the case of investments in associates, transaction costs incurred. After initial recognition, they are measured at cost less any accumulated impairment.

If there is objective evidence that the carrying amount is not recoverable, the amount of the impairment loss is measured as the difference between the carrying amount and the recoverable amount, the latter of which is understood as the higher of the fair value less costs to sell and the present value of estimated future cash flows from the investment. Impairment losses are recognised and reversed in profit or loss.



c) Derecognition of financial assets

A financial asset is derecognised from the balance sheet when all the risks and rewards of ownership are substantially transferred.

**4.6. Cash and cash equivalents**

Cash and cash equivalents include cash on hand and demand deposits in financial institutions and other short-term, highly liquid investments with original maturity of less than three months.

**4.7. Own shares**

The acquisition of equity instruments of the Company is recognised separately at cost of acquisition as a reduction in equity, regardless of the reason for the purchase. No gain or loss is recognised on transactions involving own equity instruments.

The subsequent redemption of Company shares entails a capital reduction equivalent to the par value of the shares. Any positive or negative difference between the purchase price and the par value of the shares is debited or credited to reserves.

Transaction costs related to own equity instruments are accounted for as a reduction in equity, net of any tax effect.

**4.8. Share-based payment transactions**

Services received in cash-settled share-based payment transactions which require compliance with a certain period of tenure, are recognised in the income statement during that period. These services are initially measured at the fair value of the liability at the date the requirements for their recognition are met.

The liability is subsequently measured until settlement at its fair value at each reporting date, and any changes in value during the year are taken to profit or loss. Changes in value that raise the provision are recognised with a charge to personnel expenses, whereas revaluation adjustments are recorded under finance costs.

**4.9. Financial liabilities**

Financial liabilities are initially recognised at fair value, adjusted for directly attributable transaction costs, and subsequently carried at amortised cost using the effective interest method. Nevertheless, trade payables falling due in less than one year without a contractual interest rate are carried at their face value on both initial recognition and subsequent measurement, provided the effect of not discounting flows is not significant.

A financial liability, or part of a financial liability, is derecognised when the Company has complied with the attached obligation. Any difference between the carrying amount of the financial liability and the consideration given is taken to profit and loss.

#### **4.10. Hedge accounting**

Derivative financial instruments which qualify for hedge accounting are initially measured at fair value, plus any transaction costs that are directly attributable to the acquisition.

At the inception of the hedge the Company formally designates and documents the hedging relationships and the objective and strategy for undertaking the hedges. Hedge accounting is only applicable when the hedge is expected to be highly effective at the inception of the hedge and throughout the period for which the hedge was designated. A hedge is considered to be highly effective if at inception and during its life, changes in fair value or cash flows attributable to the hedged risk are prospectively expected to be offset almost entirely by changes in the fair value or cash flows of the hedging instrument, and that, retrospectively, gains or losses on the hedging transaction have been within the range of 80% and 125% with respect to those of the hedged item.

The Company provisionally recognises the portion of the gain or loss on the measurement at fair value of a hedging instrument that is determined to be an effective hedge in income and expense recognised in equity, which is then transferred to the income statement in the year or years in which the hedge affects profit or loss. Cash flows from the hedging instrument are recognised under the same income statement heading as the hedged item.

Hedge accounting is discontinued when the hedging instrument expires, is sold, is exercised, if the hedge no longer qualifies for hedge accounting or the Company revokes the designation. In these cases, the cumulative gain or loss on the hedging instrument that has been recognised in valuation adjustments is not recorded in profit or loss until the forecast transaction occurs.

#### **4.11. Provisions and contingent liabilities**

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

#### **4.12. Revenue recognition**

The main revenues generated by the Company are those related to individual or combined offerings of telephone, Pay TV, broadband and mobile telephone services.

In the case of combined offerings, the need to individually treat the different components of the bundle is analysed in order to allocate the revenue to each component.

Fixed-line and prepaid mobile telephone revenue is recognised when the services are provided.

Revenue from fixed rates with predetermined talk times is recognised on a straight-line basis over the contractual period.

Regular charges for network use (telephone, internet and Pay TV services) are recognised in the income statement over the contractual period.

For amounts collected in advance in respect of prepaid mobile telephone services, the unused amount is recognised as a liability until it has been consumed or the contractual obligations cancelled.

Revenue from leased equipment and other services is recognised in the income statement when the service is rendered.

Revenue from the sale of equipment to customers is recognised when the risks and rewards of ownership have been transferred, which normally takes place when the asset is delivered.

#### **4.13. Leases**

Leases in which the lessor retains substantially all the risks and rewards incidental to ownership are classified as operating leases. Lease payments under operating leases are recognised as an expense on a straight-line basis over the lease term.

#### **4.14. Foreign currency transactions**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the transaction date. Foreign currency gains and losses resulting from the settlement of transactions and translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currency are recognised in the income statement.

#### **4.15. Related party transactions**

Transactions between related parties are initially recognised at fair value. Transactions are subsequently measured in accordance with applicable accounting standards.

#### **4.16. Income tax**

The income tax expense or tax income is recognised in the income statement each year, calculated based on the pre-tax profits, adjusted for permanent differences with fiscal criteria. If the profit is associated with an income or expense recognised directly in equity, the tax expense or tax income is also recognised against equity.

Deferred tax assets and unused tax credits in respect of loss carryforwards are only capitalised when their future realisation is reasonably assured. Deferred tax liabilities are recognised in all cases.

Tax credits in respect of all items, including loss carryforwards, are recognised at the tax rate prevailing at the end of the year they are generated, and adjusted, if modified, at the tax rate prevailing at the reporting date.

#### **4.17. Environmental issues**

Expenses derived from protecting and improving the environment are recognised as an expense in the period in which they are incurred. Property, plant and equipment modified or acquired to minimise the environmental impact of its activity and protect and improve the environment are recognised as an increase in property, plant and equipment.

## NOTE 5.- Financial risk management

The Company's activities are exposed to credit risk, liquidity risk, and market risk, the latter of which includes currency and interest rate risk.

The Company uses financial risk evaluation and mitigation methods suited to its activity and scope of operations, which are sufficient to adequately manage risks.

A summary of the main risks affecting the Company, and the measures in place to mitigate their potential affect, is as follows:

a) Credit risk

Credit risk is the risk of financial loss to which the Company is exposed in the event that a customer or counterparty to a financial instrument fails to discharge a contractual obligation. This risk is concentrated in receivables.

The Company considers customer credit risk to be mitigated by the application of different policies, and the high level of dispersion of receivables. Among the different policies and specific practices are the customer acceptance policy, continual monitoring of customer credit, which reduces the possibility of default on the main receivables, and collection management.

Cash and cash equivalents reflect the amounts available with financial institutions that have high credit ratings.

b) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it has enough liquidity to settle its debts as they fall due, in both normal and stressed conditions, without incurring unacceptable losses or compromising its reputation.

The Company adjusts the maturities of its debts to its capacity to generate cash flows to settle them.

To do this, the Company has implemented a seven-year financing plan with annual reviews and regular analyses of its financial position, which includes long-term projections, together with daily monitoring of bank balances and transactions.

Although the Company's working capital, defined as the difference between current assets and current liabilities (maturing in less than 12 months in both cases), is negative, this is mainly because of the way the business operates, resulting in the average collection period being shorter than the average payment period, which is common practice in the sector in which the Company operates.

c) Market risk, currency risk and interest rate risk

Market risk is the risk that changes in prices could affect the Company's revenue or the value of its financial instruments. The objective of managing market risk is to control exposure to this risk, within reasonable parameters, and optimise returns.

The Company's ambit of operations barely exposes it to currency or price risks, which may arise from occasional purchases in foreign currency of insignificant amounts.

Interest rate risks arises on variable-rate loans from financial institutions and related parties, which expose the Company to fluctuations in future cash flows.

The Company regularly revises its interest rate hedging policy. Under this policy, the need to contract interest rate hedges is assessed.

The Company settles interest on a monthly basis, which allows it to closely monitor the performance of interest rates in the financial market.

For the year ended 31 December 2015, had interest rates risen by 100 basis points, with other variables remaining constant, profit (after tax) would have fallen by Euros 2,765 thousand (Euros 2,475 thousand for the year ended 31 December 2014).

## NOTE 6.- Investments in Group companies and associates

On 27 November 2015 the Company acquired a 30% interest in R Cable y Telecomunicaciones Galicia, S.A. and 100% of the share capital of Rede Brigantium, S. L., (hereinafter Rede Brigantium), the holder of the remaining 70% stake in R Cable. With these acquisitions, the Company directly or indirectly holds the entire share capital of R Cable (see note 1), making it one of the leading operators with convergent offerings in northern Spain. The combination of Euskaltel, S.A. and R Cable will result in better access to and bargaining power over products, services and content, sharing of systems and technologies, optimisation of contractual relations with suppliers and harmonisation of growth strategies.

Details of the financial information of R Cable and Rede Brigantium at 31 December 2015 are as follows:

	R Cable	Rede Brigantium
Capital	40,144	55,628
Share premium	26,698	66,838
Reserves and other equity holder contributions	36,796	67,439
Profit/(loss) for the year	13,007	(344)
Grants	33,456	-
	<u>150,101</u>	<u>189,561</u>
Results from operating activities	<u>44,436</u>	<u>(364)</u>

The cost of acquiring the interests in Rede Brigantium, S. L. and R Cable amounted to Euros 894,497 thousand. Costs related to the acquisition amounted to Euros 5,477 thousand and are recognised under other operating expenses in the income statement.

At 31 December 2014, the investments in Rede Brigantium, S.L. and R Cable were pledged to secure compliance with the Company's financing obligations (see note 13).

Rede Brigantium, S. L. and R Cable y Telecomunicaciones Galicia, S.A. are not listed on the stock exchange.

The Company also has investments in associates, none of which are listed on the stock exchange, corresponding to a 25% direct interest in Andornet, domiciled in Andorra and involved in the telematic distribution of data to third parties, and a 20% direct interest in Hamaika Telebista, domiciled in Bilbao and engaged in promoting the creation of local television stations that broadcast in the Basque language (Euskera). In 2015 the Company sold its interest in Andornet, S.A.

## NOTE 7.- Intangible assets

Details of intangible assets and movement are as follows:

	31.12.14	Additions	Disposals	31.12.15
<b>Cost</b>				
Industrial property	103	-	-	103
Computer software	58,617	9,292	-	67,909
Licences	2,674	-	-	2,674
Other intangible assets	10,764	9,006	(8,478)	11,292
	<u>72,158</u>	<u>18,298</u>	<u>(8,478)</u>	<u>81,978</u>
<b>Accumulated amortisation</b>				
Industrial property	(87)	(16)	-	(103)
Computer software	(41,025)	(6,667)	-	(47,692)
Licences	-	(74)	-	(74)
Other intangible assets	(5,820)	(7,676)	8,478	(5,018)
	<u>(46,932)</u>	<u>(14,433)</u>	<u>8,478</u>	<u>(52,887)</u>
<b>Impairment</b>	<u>(2,674)</u>	-	2,674	-
<b>Carrying amount</b>	<u>22,552</u>	<u>3,865</u>	<u>2,674</u>	<u>29,091</u>
	31.12.13	Additions	Disposals	31.12.14
<b>Cost</b>				
Industrial property	97	6	-	103
Computer software	50,907	7,895	(185)	58,617
Licences	2,674	-	-	2,674
Other intangible assets	10,330	7,885	(7,451)	10,764
	<u>64,008</u>	<u>15,786</u>	<u>(7,636)</u>	<u>72,158</u>
<b>Accumulated amortisation</b>				
Industrial property	(73)	(14)	-	(87)
Computer software	(35,886)	(5,324)	185	(41,025)
Licences	-	-	-	-
Other intangible assets	(4,993)	(8,278)	7,451	(5,820)
	<u>(40,952)</u>	<u>(13,616)</u>	<u>7,636</u>	<u>(46,932)</u>
<b>Impairment</b>	<u>(2,674)</u>	-	-	<u>(2,674)</u>
<b>Carrying amount</b>	<u>20,382</u>	<u>2,170</u>	-	<u>22,552</u>

In 2015 the Company reversed the impairment of the administrative concession as a result of the decision to roll-out the 4G network.

The cost of fully amortised intangible assets in use at 31 December 2015 totals Euros 31,332 thousand (Euros 27,636 thousand at 31 December 2014).

The Group has contracted sufficient insurance policies to cover the risks to which its intangible assets are exposed.

At 31 December 2015 personnel expenses totalling Euros 2,326 thousand (Euros 3,206 thousand at 31 December 2014) have been capitalised as intangible assets.

## NOTE 8.- Property, plant and equipment

Details of property, plant and equipment and movement in 2015 are as follows:

	31.12.14	Additions	Disposals	Transfers	31.12.15
<b>Cost</b>					
Land and buildings	133,757	-	-	130	133,887
Civil engineering	259,654	-	-	2,134	261,788
Cablings	271,972	-	-	1,294	273,266
Network equipment	355,260	-	-	4,912	360,172
Client equipment	262,549	-	-	12,959	275,508
Other installations, equipment and furniture	147,241	3	-	212	147,456
Under construction	6,354	28,022	-	(22,254)	12,122
Other property, plant and equipment	21,990	-	(275)	613	22,328
	<u>1,458,777</u>	<u>28,025</u>	<u>(275)</u>	<u>-</u>	<u>1,486,527</u>
<b>Accumulated depreciation</b>					
Land and buildings	(20,498)	(4,663)	-	-	(25,161)
Civil engineering	(57,941)	(5,347)	-	-	(63,288)
Cablings	(134,572)	(9,752)	-	-	(144,324)
Network equipment	(242,192)	(21,017)	-	-	(263,209)
Client equipment	(168,034)	(13,894)	-	-	(181,928)
Other installations, equipment and furniture	(74,717)	(9,528)	-	-	(84,245)
Other property, plant and equipment	(17,086)	(1,020)	275	-	(17,831)
	<u>(715,040)</u>	<u>(65,221)</u>	<u>275</u>	<u>-</u>	<u>(779,986)</u>
<b>Carrying amount</b>	<u>743,737</u>	<u>(37,196)</u>	<u>-</u>	<u>-</u>	<u>706,541</u>

Details of property, plant and equipment and movement in 2014 are as follows:

	31.12.13	Additions	Disposals	Transfers	31.12.14
<b>Cost</b>					
Land and buildings	133,576	-	(9)	190	133,757
Civil engineering	258,302	-	-	1,352	259,654
Cablings	268,875	-	(4)	3,101	271,972
Network equipment	345,903	-	(669)	10,026	355,260
Client equipment	251,641	-	(52)	10,960	262,549
Other installations, equipment and furniture	145,702	-	(193)	1,732	147,241
Under construction	10,415	26,424	(2,629)	(27,856)	6,354
Other property, plant and equipment	25,585	-	(4,090)	495	21,990
	<u>1,439,999</u>	<u>26,424</u>	<u>(7,646)</u>	<u>0</u>	<u>1,458,777</u>
<b>Accumulated depreciation</b>					
Land and buildings	(15,842)	(4,658)	2	-	(20,498)
Civil engineering	(52,614)	(5,327)	-	-	(57,941)
Cablings	(123,877)	(10,696)	1	-	(134,572)
Network equipment	(219,703)	(23,103)	614	-	(242,192)
Client equipment	(154,446)	(13,599)	11	-	(168,034)
Other installations, equipment and furniture	(65,557)	(9,353)	193	-	(74,717)
Other property, plant and equipment	(19,962)	(1,156)	4,032	-	(17,086)
	<u>(652,001)</u>	<u>(67,892)</u>	<u>4,853</u>	<u>-</u>	<u>(715,040)</u>
<b>Carrying amount</b>	<u>787,998</u>	<u>(41,468)</u>	<u>(2,793)</u>	<u>-</u>	<u>743,737</u>

During the year ended 31 December 2015 borrowing costs and internal expenses amounting to Euros 230 thousand and Euros 2,771 thousand, respectively, (Euros 215 thousand and Euros 2,515 thousand, respectively, in 2014) have been capitalised.

The cost of fully depreciated property, plant and equipment in use at 31 December 2015 is Euros 280,902 thousand (Euros 248,567 thousand at 31 December 2014).

At 31 December 2015 and 2014, sufficient insurance policies have been taken out to cover the risks to which property, plant and equipment are exposed.



## NOTE 9.- Financial assets

### 9.1. Classification by category

Details of the Company's financial assets are as follows:

	Loans and receivables		Investments in Group companies		Available-for-sale financial assets		Total	
	31.12.15	31.12.14	31.12.15	31.12.14	31.12.15	31.12.14	31.12.15	31.12.14
<b>Non-current</b>								
Equity instruments (note 6)	-	-	894,497	3	855	855	895,352	858
Loans extended								
Group companies and associates	301,543	5	-	-	-	-	301,543	5
Related parties	-	2,686	-	-	-	-	-	2,686
Third parties	3,168	2,505	-	-	-	-	3,168	2,505
Other non-current assets	260	278	-	-	-	-	260	278
	<u>304,971</u>	<u>5,474</u>	<u>894,497</u>	<u>3</u>	<u>855</u>	<u>855</u>	<u>1,200,323</u>	<u>6,332</u>
<b>Current</b>								
Trade receivables	40,847	39,329	-	-	-	-	40,847	39,329
Investments	79	3,991	-	-	-	-	79	3,991
Cash and cash equivalents	1,423	10,650	-	-	-	-	1,423	10,650
	<u>42,349</u>	<u>53,970</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>42,349</u>	<u>53,970</u>

Loans to Group companies include the loan extended to R Cable on 27 November 2015. This loan earns annual interest of 7% and is repayable in a single sum upon maturity on 27 November 2022. This loan has been pledged to secure repayment of financing extended to the Company. The Company's bank accounts have also been pledged as a guarantee (see note 13).

The carrying amount of financial liabilities at amortised cost does not differ significantly from their fair value.

### 9.2. Impairment

The Company calculates the provision for impairment of trade and other receivables using information available on the recovery of balances.

Details of the ageing of unimpaired trade balances past due are as follows:

Past due	31.12.15	31.12.14
From 0 to 30 days	2,326	3,445
From 31 to 90 days	669	959
From 91 to 180 days	1,070	274
From 181 to 365 days	1,615	548
	<u>5,680</u>	<u>5,226</u>
<b>Not past due</b>		
Invoiced	14,642	12,362
Pending invoice	20,525	21,741
	<u>35,167</u>	<u>34,103</u>
	<u>40,847</u>	<u>39,329</u>

Details of the provision for impairment of trade and other receivables is as follows:

	31.12.15	31.12.14
Gross balance	52,969	53,024
Impairment	(12,122)	(13,695)
	<u>40,847</u>	<u>39,329</u>

Movement in the provision for impairment of trade and other receivables is as follows:

	2015	2014
Opening balance	13,695	16,383
Charge	2,229	2,014
Write-offs	(3,802)	(4,702)
Closing balance	<u>12,122</u>	<u>13,695</u>

## NOTE 10.- Inventories

Details are as follows:

	31.12.15	31.12.14
Terminals and equipment		
Mobile telephones	917	1,421
Decoders	328	206
Material for subcontractors	1,648	1,716
Other inventories	74	80
	<u>2,967</u>	<u>3,423</u>
Impairment	(1,031)	(1,110)
	<u>1,936</u>	<u>2,313</u>

The Company has taken out sufficient insurance policies to cover the risks to which its inventories are exposed.

## NOTE 11.- Equity

### 11.1. Capital

At 31 December 2014 subscribed capital was represented by 6,326,890 registered shares of Euros 60 par value each, with the same rights and obligations, and subscribed and fully paid.

At their annual general meeting held on 1 June 2015, the shareholders decided to split the number of outstanding shares in the proportion of 20 new shares for each old share, and reduce their par value from Euros 60 per share to Euros 3 per share. As a result, the number of new shares outstanding amounted to 126,537,800 of Euros 3 par value each. At the aforementioned annual general meeting, it was also decided to modify the system of representation of the shares by converting the former registered shares into book entries.

On 16 June 2015, and in the context of the Company's admission to trading, the shareholders of Euskaltel, S.A. agreed to make an initial public offering (IPO) of 80,408,930 shares, representing 63.55% of share capital, increasable to a maximum of 88,449,823 shares, representing 69.90% of share capital, if the purchase option (green shoe) extended by the selling shareholders to the global coordinators, and aimed solely at qualified investors, were exercised. On the same date, the shareholders authorised the board of directors to carry out a derivative acquisition of own shares until the admission to trading date.

The derivative acquisition of own shares involved awarding shares free of charge to Company employees in an amount equivalent to two salary payments, and reinvesting 50% of the remuneration, net of withholdings, received by beneficiaries of the incentive plans as they reach maturity, in shares (see note 12). The reinvestment in shares was not contemplated in the agreements initially reached with the beneficiaries, rather, this was done voluntarily at their own request as a demonstration of their commitment to the Company. The awarding of shares free of charge to Euskaltel, S.A. employees was a unilateral decision taken by its shareholders after the annual accounts for 2014 were approved.

Details of own shares acquired in relation to the transactions described above are as follows:

	<u>Number of shares</u>	<u>% ownership</u>	<u>Price in Euros</u>	<u>Amount</u>
Earmarked for:				
Share plan beneficiaries	1,160,040	0.92%	9.50	11,020,380
Employees	<u>282,085</u>	<u>0.22%</u>	9.50	<u>2,679,808</u>
	<u><b>1,442,125</b></u>	<u><b>1.14%</b></u>		<u><b>13,700,188</b></u>

Own shares were acquired within the framework of the IPO agreed by the Company's shareholders, and purchased under the same terms as the remaining investors. Shares acquired by the Company and immediately paid for by the plan beneficiaries amounted to Euros 11,020 thousand.

Own shares awarded free of charge to employees were charged to personnel expenses (see note 15.3).

At their annual general meeting held on 12 November 2015, the shareholders authorised the board of directors to increase share capital within 5 years up to half of the share capital existing at the agreement date, with the power to exclude the preferential subscription right up to a limit of 20% of capital at the time of delegation.

By virtue of this authorisation, the board of directors increased share capital by Euros 75,923 through the issue of 25,307,560 new shares of Euros 3 par value each, with exclusion of the preferential subscription right. This capital increase, which was used to partially finance the acquisition of R Cable, was subscribed in full at an issue of Euros 10.08 per share. The impact of this transaction on the Company's equity is as follows:

	<u>Number of shares</u>	<u>Capital</u>	<u>Share premium</u>	<u>Total</u>
Capital increase	25,307,560	75,923	179,178	255,101
Share issue costs				4,733
Tax effect				<u>(1,325)</u>
				3,408
				<u><b>251,693</b></u>

The new shares were floated on the Barcelona, Bilbao, Madrid and Valencia stock exchanges on 26 November 2015.

Details of shareholders at 31 December 2015 are as follows:

	31.12.2015		31.12.2014	
	Number of shares	% ownership	Number of shares	% ownership
Kutxabank Group (*)	38,087,977	25.08%	3,157,118	49.90%
Corporación Financiera Alba, S.A. (**)	15,186,055	10.00%	-	-
Rest	98,571,328	64.92%	3,169,772	50.10%
	<b>151,845,360</b>	<b>100.00%</b>	<b>6,326,890</b>	<b>100.00%</b>

(\*) Includes the shares of Kutxabank, S.A. and Araba Gertu, S.A.

(\*\*) Through its solely-owned subsidiary Alba Europe, S.a.r.l

## 11.2. Share premium

In accordance with prevailing legislation, the share premium is a freely-distributable reserve, provided that equity exceeds share capital.

## 11.3. Reserves and prior years' profit

Details of this caption are as follows:

	31.12.15	31.12.14
Reserves		
Legal reserve	36,967	32,534
Voluntary reserves	(3,350)	129,818
Unused profits	0	(6,101)
	<b>33,617</b>	<b>156,251</b>

The legal reserve has been appropriated in compliance with article 274 of the Spanish Companies Act, which requires that companies transfer 10% of profits for the year to a legal reserve until this reserve reaches an amount equal to 20% of share capital. Until the legal reserve exceeds this limit, it may only be applied to offset losses if no other reserves are available.

## 11.4. Own shares

At 31 December 2015, the Company held 139,806 own shares acquired at a weighted average cost of Euros 10.22 per share.

## NOTE 12.- Share-based payment transactions

In 2014 and 2013 the Company awarded certain incentives to members of the management committee, board members and other key employees. These incentives took the form of investment plans (hereinafter, the plans). The plan participants were, in economic terms, equivalent to shareholders, making a profit if the value of the Company rose, and assuming the risk of losing their investment if the value of the Company fell. The plans were aimed at attracting the involvement and support of a motivated management team focused on achieving the Company's business plan, and at motivating and retaining those it considered key to the Company's operations.

The plans gave participants a share in any rise in value of the Company's shares from the date the plan was launched to 31 December 2025, with the possibility of extending the plan for a further 5 years at the request of the board of directors. However, the plan's maturity would be brought forward if, among other circumstances, the Company was floated on the stock exchange.

Beneficiaries' participation in the plan was conditional on payment of certain amounts in respect of an initial price of Euros 4,336 thousand, partially financed through loans that accrued interest at the legal rate. At 31 December 2014, loans extended in relation to share-based payments amounted to Euros 3,132 thousand, of which Euros 2,686 thousand was recognised under non-current investments.

The Company was floated on 1 July 2015, an event not foreseen at the 2014 reporting date and which was decided by the board of directors after the close of the 2014 financial year. Consequently, all commitments had to be recognised, and the deadlines for settling the obligations were reduced significantly.

Movement in incentive plan liabilities is as follows:

	2015	2014
Balances at 01.01	12,168	2,837
Charges (note 15.6)	30,705	7,832
Contributions	-	1,499
Loan repayments	(3,132)	-
Payments	(39,741)	-
Balances at 31.12	-	12,168

## NOTE 13.- Financial liabilities

### 13.1. Classification by category

Details of financial liabilities classified by category are as follows:

	Debts and payables		Financial liabilities at fair value		Total	
	31.12.15	31.12.14	31.12.15	31.12.14	31.12.15	31.12.14
<b>Non-current</b>						
Loans received	1,352,922	194,517	-	-	1,352,922	194,517
Derivatives	-	-	-	6,226	-	6,226
Other financial liabilities	602	12,206	-	-	602	12,206
	<u>1,353,524</u>	<u>206,723</u>	<u>-</u>	<u>6,226</u>	<u>1,353,524</u>	<u>212,949</u>
						-
<b>Current</b>						
Loans received	1,137	48,819	-	-	1,137	48,819
Loans	-	387	-	-	-	387
Suppliers	44,187	38,670	-	-	44,187	38,670
Asset purchase payables	19,089	20,079	-	-	19,089	20,079
Salaries payable	2,366	3,683	-	-	2,366	3,683
	<u>66,779</u>	<u>111,638</u>	<u>-</u>	<u>-</u>	<u>66,779</u>	<u>111,638</u>

The Company was extended a series of loans in prior years which fall due between January 2016 and June 2020. These loans are pegged to Euribor plus a spread. In order to mitigate the variability of interest payments, the Company contracted financial swaps for an accumulated notional of Euros 150,000 thousand, with a fair value of Euros 6,226 thousand at 31 December 2014.

Average interest accrued on loans extended in 2007 was 2.70%, and 5.21% on financing received in 2012 and 2013.

As a result of the agreements reached during the stock flotation process, the Company negotiated two loans of Euros 235 million each (tranches A-1 and B-1) and a revolving credit facility of Euros 30 million to repay loans extended in prior years early, finance the extraordinary dividend referred to in note 3 and cover the expenses related to the admission to trading of the Company's shares. At the 2015 reporting date, no amount has been drawn down from the revolving credit facility.

For the acquisition of R Cable y Telecomunicaciones Galicia, S.A.(see note 1), the Company borrowed two additional tranches (tranches A-2 and B-2) of Euros 300 million each, and an institutional loan (tranche B-3), underwritten by four financial institutions, also for Euros 300 million.

Interest on the new financing is pegged to Euribor plus a spread calculated by dividing the Group's consolidated net debt by consolidated EBITDA (the coefficient), both of which are defined in the loan clauses. Early repayment of the loans may be demanded if the coefficient exceeds the parameters established. Early repayment of the loan may also be demanded if there is a change in control, understood as the acquisition of more than 50% of shares with voting rights.

A summary of the main characteristics of the loans at the reporting date are as follows:

Tranche	Interest	Nominal	Maturity
A-1	2.500%	235,000	30-06-21
B-1	3.175%	235,000	30-06-22
A-2	2.500%	300,000	30-06-21
B-2	3.175%	300,000	30-06-22
B-3	4.750%	300,000	27-11-22
Credit facility	(a)	30,000	30-06-22

(a) Not drawn down at year end

Tranches B-1, B-2 and B-3 are repayable in a single sum as they fall due. Tranches A-1 and A-2 are repayable according to the following schedule:

	No. of six-month periods	(1)
<b>Six-monthly maturity</b>		
Period 30-06-17 to 30-06-19	4	5%
Period 30-06-19 to 30-12-19	2	10%
Period 30-06-20 to 30-12-20	2	15%
30 June 2021	1	30%

(1) Repayment percentage calculated based on the nominal of the loans repaid on the last day of each six-month period included in the period.

Details of repayments made on non-current loans with financial institutions are as follows:

2 years	3 years	4 years	5 years	> 5 years	Total
97,070	94,663	145,789	192,209	1,043,262	1,572,993

The Company may not distribute extraordinary dividends or redeem own shares if the coefficient exceeds 4 after the extraordinary dividend distribution. However, the financing contract stipulates that there shall be no restrictions on the payment of dividends with profit from ordinary activities.

When the financing became available, the Company signed pledges on certain investments in Group companies (see note 6), and loans extended and bank accounts (see note 9). It also signed a pledge on the shares of a potential corporate restructuring, or alternatively, on the Company's network.

The fair values of loans and payables do not differ significantly from their carrying amount.

### 13.2. Suppliers

Details of the average payment period referred to in the Spanish Institute of Accounting and Auditing's Resolution of 29 January 2016 are as follows:

	2015
Average supplier payment period (in days)	40.21
Transactions paid ratio	44.56
Transactions payable ratio	14.81
Total payments made (thousands of Euros)	238,872
Total payments payable (thousands of Euros)	40,880

The average payment period is the time between delivery of the goods or provision of the services by the supplier and payment of the transaction in accordance with the methodology described in article 5 of the Resolution. According to the Resolution, disclosure of comparative balances is not required in the notes to the annual accounts in the first year of mandatory application.

## NOTE 14.- Taxes

### 14.1. Balances with public entities

At 31 December 2015 and 2014 balances with public entities are as follows:

	2015	2014
Value added tax	1,888	4,145
Social Security	401	390
Withholdings and payments on account	394	386
Other liabilities	940	533
	<u>3,623</u>	<u>5,454</u>

The Company has open to inspection all main applicable taxes for the years still open to inspection.



## 14.2. Income tax

A reconciliation of net income and expenses for the year with the taxable income is as follows:

	2015				2014		
	Profit and loss	Reserves	Recognised income and expense	Total	Profit and loss	Recognised income and expense	Total
Income and expenses for the year	6,781	(3,408)	4,483	7,856	36,783	(3,906)	32,877
Income tax	(3,169)	1,325	(1,743)	(3,587)	(13,152)	1,519	(11,633)
Profit before tax	9,950	(4,733)	6,226	11,443	49,935	(5,425)	44,510
Permanent differences	4,198	-	-	4,198	94	-	94
Temporary differences:	(8,483)	-	-	(8,483)	(1,108)	-	(1,108)
Offset of tax loss carryforwards	-	-	-	-	(44,102)	-	(44,102)
Taxable income	<u>5,665</u>	<u>(4,733)</u>	<u>6,226</u>	<u>7,158</u>	<u>4,819</u>	<u>(5,425)</u>	<u>(606)</u>

The relationship between the income tax expense and accounting profit for the year is as follows:

	2015				2014		
	Profit and loss	Reserves	Recognised income and expense	Total	Profit and loss	Recognised income and expense	Total
Income and expenses for the year	9,950	(4,733)	6,226	11,443	49,935	(5,425)	32,877
Tax at 28%	2,786	(1,325)	1,743	3,204	13,982	(1,519)	12,463
Permanent differences	1,175	-	-	1,175	26	-	26
Prior year adjustments	(647)	-	-	(647)	(115)	-	(115)
Deductions for the current year	(145)	-	-	(145)	(741)	-	(741)
	<u>3,169</u>	<u>(1,325)</u>	<u>1,743</u>	<u>3,587</u>	<u>13,152</u>	<u>(1,519)</u>	<u>11,633</u>

Details of deferred tax assets and liabilities by type of asset and liability are as follows:

	31.12.13	Source	Reversal	31.12.14	Source	Reversal	Other	31.12.15
<b>Deferred tax assets</b>								
Provision for bad debts	204	133	-	337	-	(51)	-	286
Share-based bonus plan	-	2,193	-	2,193	-	(2,193)	-	-
Restructuring provision	513	-	(513)	0	-	-	-	-
Hedging transactions	249	1,492	-	1,741	-	(1,741)	-	-
Other assets	1,085	259	(234)	1,110	2	(135)	(860)	117
	2,051	4,077	(747)	5,381	2	(4,120)	(860)	403
Tax loss carryforwards	21,194	-	(12,358)	8,836	-	-	(1,626)	7,210
Deductions on tax due	137,388	-	(605)	136,783	142	(258)	1,054	137,721
	<u>160,633</u>	<u>4,077</u>	<u>(13,710)</u>	<u>151,000</u>	<u>144</u>	<u>(4,378)</u>	<u>(1,432)</u>	<u>145,334</u>
<b>Deferred tax liabilities</b>								
Sales in instalments	-	(2,079)	-	(2,079)	-	-	2,079	-
	<u>160,633</u>	<u>1,998</u>	<u>(13,710)</u>	<u>148,921</u>	<u>144</u>	<u>(4,378)</u>	<u>647</u>	<u>145,334</u>

Other corresponds to differences between estimated income tax and income tax declared.

The income tax expense is calculated as follows:

	<u>2015</u>	<u>2014</u>
<b>Current tax</b>		
Taxable income at 28%	1,586	1,349
Deductions	(261)	(1,349)
Prior year adjustments	<u>-</u>	<u>(53)</u>
	1,325	(53)
<b>Deferred tax</b>		
Source and reversal of temporary differences	2,375	243
Change in deductions	116	12,962
Prior year adjustments	<u>(647)</u>	<u>-</u>
	<u><u>3,169</u></u>	<u><u>13,152</u></u>

The Company calculates its income tax in accordance Regional Law 11/2013 of 5 December 2013. Tax loss carryforwards and unused deductions at 1 January 2014 are applicable over a period of 15 years.

Details of tax loss carryforwards and unused deductions are as follows:

	<u>Taxable income</u>	<u>Deductions</u>	<u>Applicable</u>
<b>Balances at 01.01.14</b>	75,662	140,235	
Applied in 2014	(49,907)	(791)	
Applied in 2015	<u>-</u>	<u>(116)</u>	
	25,755	139,328	2028
Generated in 2014 and not applied	-	200	2029
Generated in 2015 and not applied	<u>-</u>	<u>1,442</u>	2030
	<u><u>25,755</u></u>	<u><u>140,970</u></u>	

Euros 137,721 thousand of the aforementioned deductions, which mainly correspond to deductions for investments in new fixed assets and activities in priority programmes, have been capitalised at 31 December 2015 (Euros 136,783 thousand at 31 December 2014). The Company has capitalised tax loss carryforwards of Euros 25,755 thousand which were generated in 2011. The Company has no unrecognised tax loss carryforwards.

The Company expects to apply tax loss carryforwards and tax credits for deductions amounting to Euros 3,746 thousand in its 2016 income tax return.

The capitalisation of tax credits is based on annual recoverability analyses carried out by the Company. The business plans of Euskaltel, S.A. show that the Company will have sufficient future taxable income against which tax credits capitalised at year end can be utilised.

## NOTE 15.- Income and expenses

### 15.1. Revenues

The Company's activity primarily includes: the provision of combined broadband, Pay TV, mobile and fixed-line telephone services to residential customers, freelancers ("Small Office / Home Office - SOHOs"), small and medium-sized enterprises (SMEs), large accounts, the public sector and the wholesale market.

For internal management purposes, the Company differentiates between the following types of customers:

- Residential
- Business
- Wholesale
- Other

Details of revenues are as follows:

	2015	2014
Residential	202,369	196,190
Business		
SOHOs	37,745	35,551
SMEs	17,626	18,537
Large accounts	36,814	39,295
Wholesale	24,318	24,730
Other	8,884	6,858
<b>Total</b>	<b>327,756</b>	<b>321,161</b>
work performed by the entity and capitalised	(5,097)	(5,721)
Other operating income	(367)	(331)
<b>Revenues</b>	<b>322,292</b>	<b>315,109</b>

#### **Residential**

The Company offers customers in this category a combination of fixed-line and mobile telecommunication services, as well as other added-value services which it renders through its fibre optic network and the virtual mobile operator agreement. These customers receive combined offers of broadband access, Pay TV and fixed-line and mobile telephone services which are billed as a bundle at competitive prices.

#### **Business**

Customers in this category - SOHOs, SMEs and large accounts, including the public sector - also receive fixed-line and mobile telecommunication services. In the case of SMEs and large accounts, our sales team is able to offer integrated, tailor-made services to financial institutions, large companies, healthcare providers and public entities.

- SOHOs: We have a specific commercial package for these types of customers, which include businesses with less than 10 employees. The services we provide include technical support, online support and electronic mail. As in the residential segment, we offer a wide range of combined packages such as broadband access, Pay TV and fixed-line and mobile telephone.

- **SMEs:** We offer a broad array of solutions adapted to businesses with between 10 and 40 employees. Our services include broadband access with speeds of up to 350 Mbps, symmetrical fibre access with speeds of up to 1 Gbps, MPLS access, fixed-line/mobile convergence, IP Switch and advanced IT services.
- **Large accounts:** Our large accounts include public sector customers and large companies. Our large accounts require technically complex solutions that demand tailor-made responses, including fibre access with speeds of up to 1 Gbps, MPLS access, fixed-line/mobile convergence, IP Switch, cloud firewalls and virtual data centres. We offer these types of services through a dedicated sales team that includes engineers who participate in the life cycle of the project (pre-sales, implementation and after sales service).

### **Wholesale**

We offer communication services including line access, and voice and data services to other operators in the telecommunications sector which use our infrastructure and installations for providing services to their customers. Part of the revenues generated in the wholesale market come from the Company's main direct competitors, to which we provide services such as SDH (Synchronous Digital Hierarchy) line access, Ethernet and Dark Fibre technologies, voice services (which allow distributors to complete the termination of calls originating or ending in our territory) and enabling services, which are based on our BSS networks and mobile backhaul network. We also offer services related to the placement and resale of voice services. Finally, as a result of the agreements with the Catalonia Automobile Association (RACC) we offer mobile telephone services in this region under the brand "RACC Móvil".

### **Other**

This corresponds to the sale of electronic material and equipment to third parties which provide installation services.

## **15.2. Supplies**

Details are as follows:

	<b>2015</b>	<b>2014</b>
<b>Merchandise used</b>		
Purchases	19,710	18,898
Change in inventories	456	886
	<u>20,166</u>	<u>19,784</u>
<b>Subcontracted work</b>		
Interconnection expenses	42,125	41,501
Other supplies	8,878	11,236
	<u>51,003</u>	<u>52,737</u>
<b>Impairment of merchandise</b>	(79)	(997)
	<u>71,090</u>	<u>71,524</u>

## **15.3. Personnel expenses**

Details are as follows:

	<b>2015</b>	<b>2014</b>
Salaries and wages	18,990	24,352
Extraordinary personnel remuneration (notes 2 and 11.1)	3,365	-
Employee benefits expense (other employee benefits expense)	4,592	5,966
Total	<u>26,947</u>	<u>30,318</u>

Extraordinary personnel remuneration includes an amount of Euros 2,680 thousand in share-based bonuses (see note 11.1).

The average headcount, distributed by category, is as follows:

	2015	2014
Senior management	33	35
Management	35	41
Other professionals	275	424
	<u>343</u>	<u>500</u>

The distribution by gender of the Company's headcount at 31 December 2015 and 2014 is as follows:

	2015			2014		
	Male	Female	Total	Male	Female	Total
Senior management	26	7	33	29	5	34
Management	26	10	36	24	13	37
Other professionals	117	156	273	124	157	281
	<u>169</u>	<u>173</u>	<u>342</u>	<u>177</u>	<u>175</u>	<u>352</u>

During 2014, agreements were reached with strategic partners in the fields of information systems (with the French multinational GFI) and network management and maintenance (with the Chinese multinational ZTE). Through these agreements, know-how has been shared and Euskaltel employees from these areas of activity have been hired by the above companies.

At the date these annual accounts were authorised for issue, the board of directors of the Company was comprised of 6 men and 3 women (7 men and 3 women at the end of the prior year).

#### 15.4. Other operating expenses

Details are as follows:

	2015	2014
Advertising	8,338	7,196
Repairs and maintenance	26,471	18,955
Services provided by third parties	34,870	22,322
Other external services and utilities	10,443	9,954
Taxes	4,643	3,028
Losses, impairment and changes in trade provisions	2,229	2,014
	<u>86,994</u>	<u>63,469</u>

In 2015 the Company incurred the following non-recurring expenses:

	2015
R Cable acquisition costs (note 6)	5,477
Stock flotation expenses	6,558
Total	<u>12,035</u>

## 15.5. Net finance cost

Details are as follows:

	2015	2014
<b>Finance income</b>		
Third parties	190	36
Group companies and associates	1,995	-
	<u>2,185</u>	<u>36</u>
<b>Finance costs</b>		
Other	(18,962)	(14,378)
Hedging derivatives	(6,349)	(1,224)
Changes in the valuation of share-based payments (note 12)	(30,705)	(7,832)
	<u>(56,016)</u>	<u>(23,434)</u>
<b>Exchange losses</b>	(34)	(9)
<b>Impairment and gains/(losses) on disposal of financial instruments</b>	(40)	143
	<u><u>(53,905)</u></u>	<u><u>(23,264)</u></u>

The costs of cancelling debts and derivatives amounted to Euros 10,556 thousand.

## NOTE 16.- Commitments

### 16.1. Sale/purchase commitments

At the reporting date, the Company has purchase commitments for the following items and amounts, all of which are related to its everyday operations and are expected to materialise in the coming year:

	2015	2014
Intangible assets	61	182
Property, plant and equipment	3,944	8,800
Inventories	1,869	1,697
	<u><u>5,874</u></u>	<u><u>10,679</u></u>

### 16.2. Operating lease commitments

The Company mainly rents locations for its node equipment under operating leases. These contracts have a term of between 10 and 30 years, which is considered significantly lower than the economic life of the buildings in which the equipment is located.

Future minimum payments under operating leases are as follows:

	2015	2014
Less than one year	2,133	2,140
One to five years	9,678	9,844
Over five years	12,920	14,666
	<u><u>24,731</u></u>	<u><u>26,650</u></u>

The operating lease expense recognised in the income statement for the period ended 31 December 2015 amounts to Euros 4,171 thousand (Euros 4,266 thousand for the same period in 2014).

## NOTE 17.- Related party transactions

### 17.1. Transactions and balances with key personnel

Details of transactions with key Company personnel are as follows:

	2015		2014	
	Board members	Senior management	Board members	Senior management
Salaries and wages	762	4,461	663	5,909
Share-based payments	7,359	23,346	2,194	5,638
Personnel remuneration through shares	-	352	-	-
Other remuneration	6	85	-	-
	<b>8,093</b>	<b>28,244</b>	<b>2,856</b>	<b>11,547</b>

At 31 December 2014, loans extended to members of the board of directors and other key personnel amounted to Euros 650 thousand and Euros 2,035 thousand, respectively.

The Company has no pension or life insurance obligations with current or former board members, or with other members of senior management.

### 17.2. Transactions and balances with other related parties

Details of transactions and balances with significant shareholders and Group companies are as follows:

	2015			2014
	Significant shareholders	Group companies	Total	Significant shareholders
Sales	9,506	57	9,563	9,498
Services rendered	(2,357)	(45)	(2,402)	(410)
Finance income	2	1,995	1,997	1
Finance costs	(9,535)	-	(9,535)	(8,654)
	<b>(2,384)</b>	<b>2,007</b>	<b>(337)</b>	<b>435</b>

Details of outstanding collections and payments related to transactions with significant shareholders and Group companies are as follows:

	31.12.15		31.12.14	
	Current	Non-current	Current	Non-current
<b>Key shareholders</b>				
Current account	-	-	8,900	-
Loans extended	73	(186,051)	(17,744)	(115,125)
<b>Group companies</b>				
Receivables	-	301,541	-	-
	<b>73</b>	<b>115,490</b>	<b>(8,844)</b>	<b>(115,125)</b>

The directors of the Company have not carried out any transactions other than ordinary business or applying terms that differ from market conditions with the Company or any other Group company.

### 17.3. Conflicts of interest

At the 2015 reporting date no member of the Company's board of directors or their related parties, as defined in the Spanish Companies Act, has communicated any direct or indirect conflict of interest with the Company.

## NOTE 18.- Other information

The firm auditing the annual accounts of the Company has invoiced the following net fees for professional services during the years ended 31 December 2015 and 2014:

	2015	2014
Audit services	40	54
Other assurance services	160	57
Other services	90	55
	<b>290</b>	<b>166</b>

Other assurance services and other services includes those related to the issuance of comfort letters, limited reviews, audits of financial statements prepared under IFRS-EU and other services related to the stock flotation and the acquisition of R Cable y Telecomunicaciones Galicia, S.A.

## NOTE 19.- Environmental information

The Company considers the environmental impact of its products and services right from the design stage, and seeks to minimise this impact through efficient and effective ways of promoting responsible use.

Since 1999 the Company has had an Environmental Management System which complies with European Regulation 1221/2009 (EMAS III) and the UNE-EN ISO 14001: 2004. As a result of this commitment to excellence in environmental management, the Company has had its 2014 Environmental Impact Declaration validated by a recognised independent party, in accordance with EMAS regulation.

The Company has drawn up an environmental master plan for 2014-2016 that sets out the strategy and programmes and initiatives to be implemented and developed for managing environmental impact, in line with the Basque Environmental Strategy for Sustainable Development 2002-2020 and the Framework Environmental Programme of the Autonomous Community of the Basque Country, promoted by the Basque Government.

The Company, committed to the fight against climate change, prepared a plan for reducing greenhouse gas emissions in 2015. The Company has broadened this commitment by calculating its carbon footprint based on ISO 14064 guidelines and preparing the greenhouse gas emissions report for 2015. As part of its commitment to transparency, at the end of 2015, Euskaltel applied for registration in the Ministry for Agriculture, Food and the Environment's Carbon Footprint Registry.

The Company is a member of the Basque Ecodesign Center, an entity with headquarters in the Basque Country and the fruit of collaboration between private sector companies and the Basque Government. The purpose of this centre is to design and execute innovative ecodesign projects. In the context of this collaboration, in 2015 the Company continued to apply the methodology established for calculating its carbon footprint and analysing the life cycle of its products.



## **NOTE 20.- Guarantees**

The Company has to submit certain guarantees as part of its everyday commercial activity, for concession and spectrum tenders derived from legal obligations through its participation in the development of the telecommunications sector, for network roll-out licences from public administrations, and to comply with its long-term contractual obligations with service providers.

The Company has extended guarantees to safeguard the working conditions of employees hired by the companies with which the agreements mentioned in note 15.3 were reached.

As a result of the Company's financing, pledges on certain assets have been extended (see note 13).

The Company does not estimate that the guarantees extended would give rise to any additional liabilities in the financial statements.



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## Directors' Report 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

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## 1.- Business and economic environment and regulatory framework

### Introduction

In 2015 a series of events took place in the Company that led to relevant changes in its shareholder, corporate and balance sheet structures.

At the meeting held on 3 February 2015 the board of directors of Euskaltel, S.A. agreed, among other matters, to explore the possibility of floating the Company's shares on the Spanish stock market. This kick started a process that concluded in the admission to trading of the Company's shares on the Madrid, Barcelona, Bilbao and Valencia stock exchanges on 1 July 2015 for a total of 80,408,930 shares at a price of Euros 9.50 per share.

This flotation resulted in a change in shareholder structure, with some shareholders withdrawing completely and others seeing their investment reduced, as the Company went from having few shareholders with substantial investments to numerous shareholders with more diversified investments.

Euskaltel thus became a listed company, assuming the regulatory requirements associated with its new status.

In October 2015 Euskaltel and the shareholders of R Cable y Telecomunicaciones Galicia, S.A. (R Cable) entered into a share-purchase agreement for the entirety of R Cable's shares, whereby Euskaltel would acquire control of R Cable through the purchase of 100% of the share capital of Rede Brigantium, S.L., the owner of shares representing 70% of the share capital of R Cable, and the purchase of the remaining 30% from Abanca Corporación Industrial y Empresarial, S.L.U. (Abanca).

In November 2015 the Spanish Competition Authority (CNMC) authorised Euskaltel to acquire exclusive control of R Cable y Telecomunicaciones Galicia, S.A.

On 27 November 2015 the Company completed the direct and indirect acquisition of the entire share capital of R Cable y Telecomunicaciones Galicia, S.A.

Both the stock flotation and the acquisition of R Cable resulted in changes to the Company's balance sheet structure. In June 2015 the Company obtained loans and a revolving credit facility totalling Euros 470 million, which were used to refinance existing debt of Euros 232 million, pay an extraordinary dividend of Euros 207 million and cover certain payments relating to the stock flotation process and expenses derived from refinancing itself. The acquisition of R Cable, for an ultimate price of Euros 1,190 million, including the company's net financial debt, was financed by Euskaltel through the expansion of existing lines of bank credit by Euros 600 million, a tranche of institutional debt of Euros 300 million, the issuance of new shares for Euros 255 million and funds available in cash.

### Overview of the business

FY 2015 saw a change in the trend of our business. It is the first year since 2012 that we have experienced a growth in revenue, which rose by 2.28% to Euros 322.29 million.

It was in 2014 that we began to see the first shoots of recovery in the residential market, with growth of 0.4% on the prior year. This was seen as a potential turning point that has been confirmed this year.

Apart from a notable improvement in the macroeconomic environment, we consider key to this recovery the confirmation of our commercial strategy in recent years for the residential market and SOHO segment, the main goal of which was to secure new customers for high-value 3P and 4P packages and focus on cross-selling and up-selling with a view to maximising customer lifetime value within our existing customer base.

Our profitability has increased on the back of the recovery in revenue, and our position as a sector leader has been ratified in cash conversion ratio terms.

In the analysis of our results for 2015 we cannot ignore the numerous extraordinary events that occurred during the year. These have given rise to non-recurring impacts that we consider should be isolated as they affect the comparability of the Company's results for 2015 with those of 2014. As a result of the stock flotation and the acquisition of R Cable, the Company incurred significant expenses that are reflected in the income statement. Details are as follows:

	<u>2015</u>	<u>2014</u>
Incentive plan (*)	30,705	7,832
Extraordinary personnel remuneration	3,365	-
Cancellation of derivatives and financing	10,556	-
Stock flotation expenses	6,558	-
R Cable acquisition expenses	5,477	-
	<u>56,661</u>	<u>7,832</u>

(\*) See details in Note "2015: settlement of incentive plans for directors and executive board members accrued as a result of the Company's stock flotation", in section 5 (Economic-Financial Situation and Key Business Indicators) of this directors' report.

The following table shows details of the Company's key business indicators, identifying actual data for 2015 and those we have labelled "adjusted", which eliminate the impact of the non-recurring expenses described in the previous paragraph.

<u>€m</u>	<u>2015 Adjusted vs</u>				
	<u>2015</u>	<u>2015 Adjusted (**)</u>	<u>2014</u>	<u>2014</u>	<u>2014%</u>
<b>Total Revenue</b>	<b>327.8</b>	<b>327.8</b>	<b>321.2</b>	<b>6.6</b>	<b>2.1%</b>
Residential	202.4	202.4	195.7	6.7	3.4%
Business	92.2	92.2	93.4	(1.2)	-1.3%
Wholesale & Other	24.3	24.3	25.2	(0.9)	-3.6%
Other (*)	8.9	8.9	6.9	2.0	29.5%
<b>Ebitda</b>	<b>142.7</b>	<b>158.1</b>	<b>155.9</b>	<b>2.3</b>	<b>1.5%</b>
<i>Ebitda Margin</i>	<i>43.5%</i>	<i>48.2%</i>	<i>48.5%</i>	<i>-0.3 pp</i>	
<b>OpFCF</b>	<b>95.9</b>	<b>111.3</b>	<b>113.6</b>	<b>(2.3)</b>	<b>-2.0%</b>
<i>Conversion rate</i>	<i>67.2%</i>	<i>70.4%</i>	<i>72.9%</i>	<i>-2.5 pp</i>	
<b>Net income</b>	<b>6.8</b>	<b>49.1</b>	<b>(**)42.4</b>	<b>6.7</b>	<b>15.8%</b>
<b>Net Financial Debt</b>	<b>1,369.1</b>		<b>236.9</b>	<b>1,132.2</b>	

(\*) Profit neutral operations  
(\*\*) Excluded costs related to the IPO process, debt cancellation and the acquisition of R Cable.

<b>Adjustments</b>	<b>2015</b>	<b>2014</b>
Ebitda	15.4	0.0
Net Finance cost	41.3	7.8
Tax effect	(14.4)	(2.2)
	<u>42.3</u>	<u>5.6</u>

We continue to perceive as relevant that our cash flow conversion rates set us apart from other European companies with the same characteristics. In the year ended 31 December 2015, for each euro generated in adjusted EBITDA, we converted Euros 0.70 into cash flow.

This superior cash flow conversion is primarily a consequence of our proprietary, next generation fibre network and our business strategy, which allow us to focus our capital investments on maintenance and attracting customers rather than on new, capital-intensive projects.

## Macroeconomic Environment

After years of severe economic crisis in Spain, 2015 saw the consolidation of a turnaround in the macroeconomic situation. The Spanish economy continued the pattern of growth that started in 2014 (1.4%), with a rise of 3.2% in 2015 (source: Spanish Statistics Institute - INE), with somewhat lower increases of 2.7% and 2.3% expected for 2016 and 2017, respectively (source: IMF, World Economic Outlook Database, January 2016). According to all economic report forecasts, the Spanish economy peaked in the fourth quarter of 2015, then began to dip. While GDP per capita remains below the EU average, Spain has seen improvements of 1.2% in 2014 and 4% in 2015.

The Basque Country has experienced many of the same recent economic trends as Spain; however, given its highly industrialised economy, and the fact that it is one of the most affluent regions in Spain, it has proved to be more resilient than the broader country, with Basque GDP outstripping Spanish GDP in four out of the last six years. The Basque Country is also consolidating its recovery, with GDP growing 1.4% in 2014 and 2.8% in 2015 (source: Eustat). The Basque corporate sector is also showing signs of stabilisation, with the harmonised business confidence index increasing by 12.2% in 2014 and 7.3% in 2015. In addition, after several years of negative growth in the number of companies on the Social Security register, the Basque Country has seen net additions of 620 companies in 2014 and 638 in 2015 (source: Spanish Ministry of Employment and Social Security).

## Industrial Environment

The Spanish telecommunications market underwent a major transformation between 2011 and 2015 in order to adjust to the challenging macroeconomic environment. The main trends that impacted the market are the following:

- **Convergence and pricing pressure:** The Spanish telecommunications market has most recently been characterised by a rapid transition towards convergence of fixed-line and mobile services, with operators bundling services such as broadband, Pay TV, mobile and fixed-line telephony services into integrated offerings. In October 2012, Telefónica introduced heavily-discounted convergent offerings under the quadruple-play offer commercially known as “Fusión”. As a result, prices in the Spanish telecommunications market dropped significantly with a rapid shift to convergence as other operators followed Telefónica's example. The proportion of the market represented by 3P/4P bundles increased from 13% in 2012 to 50% in 2014 and 57% by mid-2015.
- **Consolidation:** Over the past three years, the Spanish market has been characterised by consolidation, primarily driven by mobile-centric operators acquiring fibre operators. As a result, the top three operators accounted for 77% of the market in 2012 and 84% in 2014, due to the effect of the incorporation of Ono and Jazztel, and 85% in the second quarter of 2015. The reduction in the number of operators is favouring both investments and a more rational competitive behaviour, as infrastructure investments require price discipline to achieve target returns.
- **Increasing importance of high-speed internet:** Spain is one of the largest broadband markets in Europe, with approximately 13.1 million broadband subscriptions at 30 November 2015 (source: CNMC). In terms of high-speed broadband access (lines capable of providing at least 30Mbps), the Spanish market is underpenetrated. However, the market has seen growth in recent years, with fibre, including cable and FTTx, representing 41% of the Spanish market in November 2015 (compared to 29% in 2014), and FTTH increasing considerably between 2012 and 2015, from 2.9% to 22.5% of Spanish fixed-line broadband subscribers (source: CNMC).

## Regulatory Environment

The Spanish telecommunications market is subject to changes implemented by its regulatory body, the CNMC.

In November 2015 the CNMC approved a draft law covering the Spanish wholesale broadband market in which it proposes that Telefónica should open up its fibre network in all of Spain except for cities in which at least three operators are present. There are currently 34 municipalities that comply with this competition requirement, reaching 26% of the population: Alicante, Almería, Badalona, Barcelona, Cornellà de Llobregat, Granollers, Hospitalet de Llobregat, Sant Adrià de Besòs, Santa Coloma de Gramenet, Cerdanyola del Vallès, Burgos, Córdoba, Granada, Huelva, Lérida, Alcalá de Henares, Alcorcón, Coslada, Fuenlabrada, Getafe, Leganés, Madrid, Móstoles, Parla, Pinto, Torrejón de Ardoz, Málaga, Seville, Mislata, Tavernes Blanques, Valencia, Vigo, Valladolid and Zaragoza. In the remaining municipalities, Telefónica will have to offer the alternative operators access to its fibre optic network - without the 30 Mbps limit - at a price that allows them to match Telefónica's offerings.

In January 2016 Telefónica and Mediapro reached an agreement through which the operator acquires football rights that will give it exclusive control of all league (Liga) matches for the next three seasons, except in bars, and all UEFA Champions League matches. The CNMC will have to determine whether this content is subject to the commitments undertaken by Telefónica as part of its authorisation to acquire DTS (Canal+), in which case the remaining operators would have the opportunity to access them.

## 2.-Commercial activity and customer relations

### 2.1 Commercial activity

#### a) Residential Market

During the year ended 31 December 2015 we continued our strategy of directing our new and existing customer bases towards convergent bundles with the highest added value. This strategy, in line with that of the prior year, has brought our portfolio of customers on 3P or 4P contracts to 65% of the total at year end, compared to 55.3% for these high added-value customers at the 2014 close. In this regard, residential customers had net positive growth, with a 11.47% increase in the number of products contracted, bringing the number of products sold in this segment of the market to almost a million.

Improvements in mobile telephony, the possibility of financing purchases of mobile devices and the launching of the 4G service have all contributed to the healthy performance in this area. This is also seen in fixed-line customers with a mobile service, rising from 273,906 products in 2014 to 367,886 in 2015, and in the higher percentage of customers with mobile devices (49.1% in 2014 vs 66.4% in 2015).

We have also seen growth in the number of broadband customers (1.76% up on 2014) and television customers (5.78% up on the prior year), despite the significant impact of not being able to offer football coverage for the 2015-2016 season.

As a result, the product/customer ratio rose from 3.0 in 2014 to 3.4 in 2015.

Although our commercial strategy is clearly focused on the management and sale of convergent product packages, below is a brief description of the main characteristics of the actions carried out for the different services that make up these packages:

#### MOBILE

Throughout 2015 we continued adapting to our customers' growing needs for greater and faster internet browsing on their mobile devices. We achieved this through Euskaltel WiFi, which became Euskaltel's biggest launch in 2015. Since March, Euskaltel WiFi has enabled our customers to connect to the internet in the streets of the Basque Country using their mobile and tablet devices through more than 128,000 WiFi hotspots.



Euskaltel WiFi came into being as an exclusive idea for our customers. By the end of 2015 we had more than 150,000 WiFi hotspots and we will continue to expand our coverage throughout 2016. Euskaltel WiFi is, and will continue to be, an innovative, and revolutionary service, and one that sets us apart.

Accompanying the re-launch of the mobile service is our policy of increasing the data allowances included in our plans and roll-out of the 4G service. Once 4G networks became consolidated and coverage reached more than 80% of the Spanish population, we launched our 4G service in October in such a way that customers did not have to do anything or change cards, automatically incorporating it into plans in which users can enjoy reasonable browsing experiences (from 1.5 GB). Furthermore, we made the Family plan (*Tarifa Family*), which is a multi-line plan, more flexible by offering customers specific, optional 4G modules to add to whatever lines they wish.

In October we also launched a new mobile browsing service that allows customers to continue browsing at high speed after using up the limit included in their plan. This service, together with the possibility of using the same plan on several devices, offers our customers more possibilities to continue browsing at high speed.

## INTERNET

As part of our commitment to enhancing our customers' internet experience at home, we have increased connection speeds in such a way that 82% of our customers now enjoy speeds in excess of 50 Mbps, which is seven times faster than the average ADSL speed. Furthermore, almost 40% of our customers enjoy speeds of over 150 Mbps, making the Basque Country the region of Spain with the fastest broadband speed, and one of the fastest in Europe.

In June 2015 we repositioned our broadband offering with four new options: 15 Mbps, 50 Mbps, 150 Mbps and 350 Mbps.

In addition, convinced of the exponential growth of devices that use WiFi networks in the home, we have evolved our internet connectivity equipment portfolio by releasing a new WiFi cable modem that allows our users to reach connection speeds of up to 350 Mbps. We have also sold additional equipment such as specific advanced routers, repeaters and PLCs to adapt home WiFi networks to the needs of our users.

## TELEVISION

During 2015 we made a strategic commitment to continue underpinning our television offering with the most technologically advanced services.

In addition to the services launched in 2014, Videoclub and Edonon (Multi-screen TV), we now have a new recording service. Recording is one of the services most requested by our customers, who want to be able to watch their favourite programmes and series whenever they want, not just when they are broadcast.

We have also evolved Edonon, thanks to which our customers can watch television wherever they want, on their tablets, computers or mobiles, as long as they have a WiFi connection. This service now incorporates new functionalities that make it even better to use for our customers, such as viewing content already started from the beginning (start over), pausing a live programme (timeshift), listing the episodes of a series in viewing order, searching for channels by genre and, of course, recording.

In addition to launching new services, we have also continued to enrich our content offering by incorporating two compelling new channels, Canal de Estrenos de Cine (new film releases) and Canal de Series (series), aimed at film lovers who wish to see the latest cinema releases and those who enjoy the latest in popular and critically-acclaimed television series. Other channels have also been added to the offering, such as Somos and Extreme Sports, and the Videoclub has been expanded to allow customers to choose from a wide variety of viewing options, from the latest film releases to adult and free content.

### b) Business Market

The business segment has responded positively to our strategy of maximising bundles and 3P and 4P offerings. The number of business customers has risen from the prior year to 47,684, while the number of products contracted by these companies is up 13.5% on the end of 2014 (162,844 compared to 143,472).



There have been various developments in offerings which we have used to achieve these results. In May we launched a new convergent services bundle aimed at businesses called Euskaltel PRO. This solution covers the global needs of the small business segment through a high-performance connectivity solution (voice and broadband), which also includes a series of added-value services for small companies such as convergent fixed-line/mobile voice, e-mail and calls.

This year also saw the launch of the Team plan (*Tarifa Equipo*), a multi-line plan aimed at businesses with several employees, with unlimited calls and 2 GB of data for each line at an unbeatable price.

In the medium term, our aim is to become the leading information security provider for the SME market. In the business market, we have channelled our efforts into improving our security products offering: We launched our protection against denial of service attacks service to complement our perimeter security services offering, in which the Cloud Firewall was rated best product by our customers. We also have agreements with Panda allowing us to offer an antivirus service for mobile devices.

As part of another medium-term objective for the business market, outsourced corporate services, we are continuing to consolidate our data centre services with the support of our proprietary CPD Tier 4 infrastructures.

In order to provide our customers with management tools for improving productivity, we have reached an agreement with IBM to integrate their Remote Mobile Device Management service (MaaS360) in our catalogue of products. This service allows customers to maintain complete control over their range of mobile devices, and amongst its many features are a permanently updated inventory,

and the ability to control permitted applications or remotely delete all corporate content on the device in the event of loss or theft.

## 2.2 Customer relations

Throughout 2015 we have focused on getting to know our customers better and generating value propositions adapted to their particular needs and situations. Segmented up-selling and cross-selling initiatives are directed at new customers with a view to generating greater customer satisfaction and loyalty.

Backed by a bigger and better multi-channel approach (with a focus on online resources), the most suitable products for each situation are presented and the responses of each case processed to enrich our customer knowledge and enhance the value proposition.

At the same time, proactive and reactive steps are taken to retain customers and adapt their situation to their new realities, and products are adjusted to strike the best balance between performance and price.

The number of residential customers who choose internet as a means of communicating with Euskaltel rose by 26% in 2015, gaining ground over telephone support and points of sale, although telephone still remains the first choice. Activity on these platforms has fallen thanks to self-management (Web and IVR) and the 10% drop in repeat queries compared to 2014, and customer satisfaction ratings are in excess of 9/10. The number of unresolved complaints has fallen slightly in 2015, as has the time spent on addressing them. Attention was also focused during the year on boosting the commercial side of telephone support platforms, resulting in 22% sales growth compared to 2014.

Progress on the Online First initiative was ongoing throughout the year, and in December, it became our customers' channel of choice for communicating with Euskaltel. 55% of our customers (active) have a common web user to access Euskaltel's main services, while the number of customers accessing the self-management web is up 26% on 2014. As a result, total access volume rose by 45%, in other words, more customers access more often, as a result of focusing on providing the channel with self-management and query functionalities and enhancing the user experience.

Additionally, efforts have been made to generate new residential customer sales volume through this channel, resulting in 19% growth compared to 2014 and which now accounts for 17% of total sales.

### 3.- Operations

One of the basic cornerstones of our business strategy is to have the most advanced network possible, giving our customers access to the best services and maximising their user experience. The main Operations projects in 2015 were as follows:

a) WiFi Kalean

The aim behind this project, launched at the end of 2014, is for Euskaltel customers to avail of free WiFi in as many places as possible. In March 2015 this was rolled out at street level (Community) with 120,00 hotspots. During 2016 the number of hotspots to this network, which is accessed by around 75,000 lines daily, will be increased to an estimated 160,000.

b) Launch of 4G and roll-out of the proprietary LTE network

In October, we launched our 4G service for mobile customers, through Orange's network (our host). In the coming years, this service will be enhanced with the roll-out of a proprietary LTE network across the Basque Country. Euskaltel holds administrative concessions for two blocks of frequencies in the 2.6 GHz bandwidth, which will reduce interconnection costs. At the end of 2015, 8 stations were active.

c) Roll-out in new homes

In 2015, the roll-out of the proprietary fixed line was relaunched with the aim of facilitating connection to 51,000 homes over the next 4 years. By the end of 2015, connection had been made available to over 10,000 homes. The majority of homes were in areas with active nodes already in our network.

d) Roll-out in industrial estates

Apart from the homes mentioned above, 8 industrial estates were included for new FTTH technology roll-out under the proprietary fixed-network plan, 2 of which were in service by the end of 2015.

Additionally, a further 29 industrial estates are earmarked for roll-out, with speeds of over 100 Mbps through an FTTH-GPON network. Aid was obtained for this project from the Secretary of State for Telecommunications and the Information Society under the programme for next generation broadband expansion.

e) Voice over Internet Protocol (VoIP)

Throughout 2015 we have carried out migration projects from the current fixed-voice platforms to new platforms that support VoIP services and position Euskaltel's network for the challenges of the future.

f) Broadband

We have expanded and adapted our broadband network so that our customers can enjoy speeds of up to 350 Mbps. By the end of 2015 around 80% of our residential broadband customer base had speeds in excess of 50 Mbps.

g) Television

In 2015 we launched a new 4K decoder project with added-value TV functionalities (OTT, VoD etc.). This decoder is due to enter service in the first few months of 2016.

We also launched various projects which will allow our customers to enjoy greater capabilities:

- Cloud recording: The possibility of recording TV content. Entry into service in September 2015.
- StartOver: this allows an event which has already started but not finished to be watched from the beginning. Project launched in 2015 and available in the first quarter of 2016.
- TimeShift: this allows the viewer to pause a live broadcast and continue watching at a later stage. Project launched in 2015 and available in the first quarter of 2016.

#### h) Other projects

- Implementation of an internet attack incident platform (ARBOR), which provides a detection and migration tool for denial of service attacks. The project has two areas of application, the proprietary network and services to large account customers. This platform went live in May 2015.
- Online channel:
  - ✓ Our after sales web: activated in March for residential customers and November for businesses.
  - ✓ New architecture, mobile apps and improvements geared towards increasing customer use of our Online Channel as a more efficient vehicle for dealings and queries than calls to our Call Centre.
- Investors' website brought online to cover the requirements and obligations derived from the stock flotation and investor relations.

## 4.- People

A healthy organisation attends to and maximises the labour resources of its employees, including the physical working environment, training, personal productivity tools, sufficient autonomy in their job, adequate social support, flexible timetables etc. so that people can perform optimally without compromising their health and well-being.

A healthy organisation also assumes that the good psychosocial well-being of its employees is central to achieving its own objectives. To attain this, it systematically makes planned and proactive efforts to improve the physical and emotional well-being of its employees by maximising the personal resources of its employees.

The more and better the labour resources offered by an organisation, and the more personal resources employees have at their disposal, the better the positive psychological state of its employees in relation to their work, and the better they will perform.

Consequently, healthy organisations must appropriately manage the personal and labour resources of their employees, and aim to generate 'virtuous circles' that provide benefits to all.

To accomplish this, an Organisation, Human Resource and Quality Management Plan has been drawn up which contains a Motivation and Alignment Programme, a People Programme and an Organisation Programme, in the form of groups of instrumental plans tasked with implementing all the initiatives contained in the three lines of action: Confidence, Individual Performance and Collective Performance

#### a) Motivation and Alignment Programme (Confidence)

The main aim of this programme is to build up the confidence of our people as a basis for raising motivation and commitment. It was thus necessary to re-establish an ambience of social peace in a framework of stable labour relations in order to reach a new collective labour agreement that was acceptable to the majority of the Company's employees.

Finally, in 2015 this new collective agreement was achieved, and unanimously accepted by all trade unions in the Company and the workers' committee. This agreement resulted in the III Euskaltel Collective Labour Agreement, valid until 2018, with marked conditions from both an economic (salary increases linked to the Company's results), and quality of life (with emphasis on work/life balance and equality) perspective. This is an innovative agreement, suited to the new chapter of the Company, that generates stability and promotes social peace for the coming years.

Furthermore, the fact that all employees are now shareholders of the Company after receiving an extraordinary bonus in Company shares equivalent to two month's salary, coinciding with the stock flotation, has aided greatly in improving the working atmosphere and raising the level of commitment

b) People Programme (Individual Performance)

As mentioned in the introduction to this section, a healthy organisation attends to and maximises the labour resources of its employees, including the physical working environment, training, personal productivity tools, sufficient autonomy in their job, adequate social support, flexible timetables etc. so that people can perform optimally without compromising their health and well-being.

In addition to all the measures related to the undertakings in the new collective labour agreement such as salary conditions, flexible timetables, teleworking, work/life balance, equality, etc. the following lines of action taken in 2015 within the scope of this programme also deserve a mention:

- *Equality and work/life balance plan.* The Work/Life Balance Plan has been revised and new initiatives incorporated, such as the possibility of a temporary transfer to the nearest work centre to the family home in summer, and greater flexibility in unpaid leave for employees who participate in fostering programmes for children from Chernobyl, the Sahara etc. in summer.
- *Integration of disabled people.* Development of the Family plan (*Plan Familia*) for employees with disabled family members and the Emergence plan (*Plan Aflora*), designed to bring to the fore unrecognised disabilities in people already employed in Euskaltel.
- *Training and Qualification of Euskaltel professionals.* During 2015 a total of 20,055 hours' training was given, corresponding to 232 training initiatives affecting 99% of the workforce. The level of satisfaction with training received during the year was 4.98/6, while efficiency, which measures the transfer of learning to the workplace, was 4.71/6 (average rating of the total training plan), and 99% of training initiatives covered the targets established.
- *Mentoring.* Initiatives aimed at junior management to boost their people leadership and management skills.
- *Rotations and Promotions.* During 2015, 49 positions were covered by internal rotations, five of which were management positions through internal promotions.
- *Welcome procedure.* In-depth review of the welcome procedure for new employees and interns.
- *Professional training analysis.* Active participation in a task force promoted by the Basque government's Department of Work, Industry and Professional Training and Confebask (Basque employer's association), charged with coordinating the needs and interests of the industry in relation to professional training.
- *Corporate voluntary work.* Activities related to promoting and assisting NGOs in which our employees participate.
- *Educational cooperation.* During 2015, we accepted 15 students for work practice.
- *Emotional barometer.* At the end of 2015, an emotional pilot survey was carried out to measure the level of engagement of Company employees, and a psychosocial risk assessment process was launched.
- *Health.* Voluntary annual medical check-ups were offered to Company employees and a survey conducted of the level of satisfaction with medical insurance. OHSAA 18001 certification for our Occupational Health and Safety Management Systems was renewed for three years.

c) Organisation programme (Collective Performance)

In 2015, our Integral Management System was upgraded to implement the risk management system for the prevention of crime, which was audited and certified at year end by Aenor. It should be noted that Euskaltel is the first company in the Basque Country and the first telecommunications operator in Spain to receive this certification.

## 5.- Economic-financial situation and key business indicators

There was a flurry of activity at Euskaltel during 2015, resulting in relevant changes in its corporate, shareholder and balance sheet structures. The most relevant milestones were as follows:

#### April 2015: conversion and adaptation of our financial statements to international standards (IFRS)

In response to the new requirements of a potential stock floatation, we decided to adapt our financial reporting from Spanish GAAP to international accounting principles (IFRS).

Despite not being legally obliged to do so, as we were not a group of consolidated companies prior to being floated, we deemed it necessary to adopt international reporting standards to facilitate comparison with similar international companies, and enhance transparency and understanding for domestic and international investors.

We converted the accounts for 2012, 2013 and 2014, and since then, have reported under international standards. As a result of the acquisition of R Cable y Telecomunicaciones Galicia, S.A., the accounts to be presented under international accounting principles (IFRS as adopted by the EU) will be those corresponding to the consolidated Group.

#### June 2015: signing of a new syndicated financing agreement

As a result of the agreements reached during the stock floatation process, the Company negotiated two new loans of Euros 235 million each (tranches A-1 and B-1) and a revolving credit facility of Euros 30 million to repay loans extended in prior years early, finance the extraordinary dividend payable to shareholders existing before the initial public offering (IPO) and cover the expenses related to the admission to trading of the Company's shares.

This new financing has stretched the average term of financing to 5.8 years and reduced the average effective cost of borrowing to 1.8%, compared to 4.6 years and 5.5% with the previous financing.

#### June 2015: Split of outstanding shares in the proportion 20 x 1

At 31 May 2015 subscribed capital was represented by 6,326,890 registered shares of Euros 60 par value each, with the same rights and obligations, and subscribed and fully paid.

At their annual general meeting held on 1 June 2015, the shareholders decided to split the number of outstanding shares in the proportion of 20 new shares for each old share, and reduce their par value from Euros 60 per share to Euros 3 per share. As a result, the number of new shares outstanding amounted to 126,537,800 of Euros 3 par value each. At the aforementioned annual general meeting, it was also decided to modify the system of representation of the shares by converting the former registered shares into book entries.

#### June 2015: payment of an ordinary dividend to existing shareholders

In the context of floating the Company on the stock exchange, the board of directors conducted an analysis to determine the most optimum balance sheet structure to maximise the Company's value upon flotation. This analysis determined that a debt structure ratio of between 3:1 and 4:1 of Financial Debt:EBITDA (without considering extraordinary M&A transactions) to be an appropriate balance and an optimised cost of the resources employed for the Group's activity. At the annual general meeting held on 26 June 2015, the shareholders agreed to distribute an extraordinary dividend of Euros 207 million to shareholders existing before the stock flotation.

#### July 2015: Initial Public Offering of shares and conversion into a company listed on the Spanish stock exchanges

On 16 June 2015, and in the context of the Company's admission to trading, the shareholders of Euskaltel, S.A. agreed to make an initial public offering (IPO) of 80,408,930 shares, representing 63.55% of share capital, increasable to a maximum of 88,449,823 shares, representing 69.90% of share capital, if the purchase option (green shoe) extended by the selling shareholders to the global coordinators, and aimed solely at qualified investors, were exercised.

On 1 July 2015, the shares were released on the Bilbao, Madrid, Barcelona and Valencia stock exchanges, at a price of Euros 9.50 per share. The total volume of shares sold amounted to 88,449,823, equivalent to 69.9% of share capital, once the entire greenshoe option had been exercised in the days immediately after admission to trading.

On the same date, the shareholders authorised the board of directors to carry out a derivative acquisition of own shares until the admission to trading date. The derivative acquisition of own shares involved awarding shares free of charge to Company employees in an amount equivalent to two month's salary, and reinvesting 50% of the remuneration, net of withholdings, received by beneficiaries of the incentive plans upon maturity, in shares. Own shares were acquired within the framework of the IPO agreed by the Company's shareholders, and purchased under the same terms as the remaining investors.

#### October 2015: awarding of a credit rating by Moody's and Standard & Poor's

As part of the Company's strategy to increase its visibility in the financial markets, in both debt and capital terms, in September and October the Standard & Poor's and Moody's ratings agencies reviewed our business plan and financial solvency. As a result of this work by these internationally renowned agencies, we were awarded credit ratings of BB- (S&P) and B1 (Moody's).

According to both agencies, Euskaltel's principal strengths lie in its considerable cash generating capacity, a stable market, and healthy growth prospects, with a sound, sustainable business plan for the coming years.

#### November 2015: signing of a new syndicated financing agreement for the purchase of R Cable y Telecomunicaciones de Galicia, S.A.

For the acquisition of R Cable y Telecomunicaciones Galicia, S.A., the Company borrowed two additional tranches (tranches A-2 and B-2) to those signed in May, of Euros 300 million each, and an institutional loan (tranche B-3), underwritten by four financial institutions, also for Euros 300 million.

The main new feature of this banking syndication was the institutional debt tranche of Euros 300 million (TLB-3), underwritten by four financial institutions and successfully syndicated among domestic and international institutional funds under the terms offered to the market. The underwriters received subscription offers from institutional investors, and demand far outstripped double the tranche offered.

The syndication of the TLB-3 tranche represented the final milestone in the Euros 900 million borrowing process to finance the acquisition of R Cable and refinance its debt. This involved (i) raising both tranches of the loans signed on 5 October last by Euros 300 million each, and (ii) the TLB-3 institutional loan tranche of Euros 300 million referred to in the previous paragraph.

Interest on the new financing is pegged to Euribor plus a spread calculated by dividing the Group's consolidated net debt by consolidated EBITDA (the coefficient), both of which are defined in the loan clauses. A summary of the main characteristics of the loans at the reporting date are as follows:

Tranche	Interest	Nominal	Maturity
A-1	2.500%	235,000	30/06/2021
B-1	3.175%	235,000	30/06/2022
A-2	2.500%	300,000	30/06/2021
B-2	3.175%	300,000	30/06/2022
B-3	4.750%	300,000	27/11/2022
Credit facility	(a)	30,000	30/06/2022
(a) <i>Not drawn down at year end</i>			

Tranches B-1, B-2 and B-3 are repayable in a single sum as they fall due. Tranches A-1 and A-2 are repayable according to the following schedule:

	No. of six-month periods	(1)
Six-monthly maturity		
Period 30-06-17 to 30-06-19	4	5%
Period 30-06-19 a 30-12-19	2	10%
Period 30-06-20 a 30-12-20	2	15%
30 June 2021	1	30%
(2) <i>Repayment percentage calculated based on the nominal of the loans repaid on the last day of each six-month period included in the period.</i>		

#### November 2015: capital increase

At their annual general meeting held on 12 November 2015, the shareholders authorised the board of directors to increase share capital within 5 years up to half of the share capital existing at the agreement date, with the power to exclude the preferential subscription right up to a limit of 20% of capital at the time of delegation.

By virtue of this authorisation, the board of directors increased share capital by Euros 75,923 through the issue of 25,307,560 new shares of Euros 3 par value each, with exclusion of the preferential subscription right. This capital increase, which was used to partially finance the acquisition of R Cable, was subscribed in full at an issue of Euros 10.08 per share. The new shares were floated on the Barcelona, Bilbao, Madrid and Valencia stock exchanges on 26 November 2015.

#### November 2015: Acquisition of R Cable Telecomunicaciones de Galicia, S.A.

On 27 November 2015 the Company acquired a 30% interest in R Cable y Telecomunicaciones Galicia, S.A. and 100% of the share capital of Rede Brigantium, S. L., the holder of the remaining 70% stake in R Cable y Telecomunicaciones Galicia, S.A. With these acquisitions, the Company directly or indirectly holds the entire share capital of R Cable y Telecomunicaciones Galicia, S.A., with the aim of consolidating itself as the leading operator in convergent offerings in northern Spain, and making the Company stronger, more efficient, with shared synergies and capacity for growth. The combination of Euskaltel, S.A. and R Cable y Telecomunicaciones Galicia, S.A. will result in better access to and bargaining power over products, services and content, sharing of systems and technologies, optimisation of contractual relations with suppliers and harmonisation of growth strategies.

The cost of acquiring the interests in Rede Brigantium, S. L. and R Cable y Telecomunicaciones Galicia, S.A. amounted to Euros 894,497 thousand. Costs related to the acquisition amounted to Euros 5,477 thousand and are recognised under other operating expenses in the income statement.

#### 2015: Settlement of the incentives plan for senior management and executive directors, accrued as a result of the Company's flotation on the stock exchange

The total amount accrued on incentive plans for the Company's stock flotation ultimately amounted to Euros 42.87 million. Considering the initial contributions of Euros 4.33 million made by the plan participants, the total gross return on the investments amounted to Euros 38.54 million.

After tax (around Euros 23.8 million) and associated finance costs (Euros 0.2 million), the total liquid return amounted to Euros 14.5 million.

The participants and beneficiaries of the plans voluntarily opted to reinvest most of the returns in own shares of the Company. At the 2015 reporting date, a total of Euros 13.53 million had been reinvested in shares, corresponding to 1,409,475 shares, or 0.93% of the Company's share capital. The shares were acquired as they were released on the stock market (Euros 11.02 million, corresponding to 1,160,040 shares at Euros 9.50 per share), and coinciding with the capital increase carried out in November (Euros 2.51 million, corresponding to 249,435 shares at Euros 10.08 per share). The reinvestments have a 360-day lock up restriction on the transfer of ownership of the shares, which expires on 1 July 2016.

Details of the matters discussed in the paragraphs above, and how the plan affects the different groups involved, are as follows:



(Thousands of Euros)

	<b>TOTAL</b>	<b>Chairman</b>	<b>Management team</b>	<b>Other executives</b>	<b>Directors</b>
Overall amount	42,873	9,692	28,730	3,013	1,438
Contributions	(4,338)	(975)	(2,480)	(633)	(250)
<b>Gross return</b>	<b>38,535</b>	<b>8,717</b>	<b>26,250</b>	<b>2,380</b>	<b>1,188</b>
<b>Tax withholdings, rest of tax costs + financial + other</b>	<b>(23,967)</b>	<b>(5,273)</b>	<b>(16,031)</b>	<b>(1,475)</b>	<b>(1,188)</b>
<b>Liquid return (mostly committed to reinvestment in Euskaltel, S.A. shares)</b>	<b>14,568</b>	<b>3,444</b>	<b>10,219</b>	<b>905</b>	<b>0</b>
<u>Amount already invested in Euskaltel shares</u>	<u>13,534</u>	<u>3,444</u>	<u>9,185</u>	<u>905</u>	<u>0</u>
<i>Number of shares</i>	1,409,475	357,222	957,003	95,250	0
<i>% of share capital</i>	0.928%	0.235%	0.630%	0.063%	0.0%

The aforementioned Euros 38.5 million of the incentives plan forms part of the costs associated with the stock flotation, which, although largely accrued in the first quarter of 2015 and thus after the distribution of the extraordinary dividend (June 2015) mentioned previously, was taken into account when determining the extraordinary dividend payment, and the best estimate of the effect of the stock flotation expenses on equity was left on the Company's balance sheet as undistributed equity. This was done so that the Company's equity remained unaffected by these expenses.

## Key performance indicators (KPIs)

The following tables show some of our operating and financial KPIs for the period examined.

<b>Residential</b>			
<b>KPI</b>	<b>Unit</b>	<b>2014</b>	<b>2015</b>
Homes passed	#	869,900	879,219
<i>Household coverage</i>	%	85%	86%
Residential subs	#	296,023	296,157
<i>o/w fixed services</i>	#	279,212	276,959
<i>as % of homes passed</i>	%	32.1%	31.5%
<i>o/w mobile only subs</i>	#	16,811	19,198
<i>o/w 1P (%)</i>	%	17.8%	17.3%
<i>o/w 2P (%)</i>	%	26.9%	17.6%
<i>o/w 3P (%)</i>	%	35.0%	35.4%
<i>o/w 4P (%)</i>	%	20.3%	29.6%
Total RGUs	#	896,077	998,871
RGUs / sub	#	3.0	3.4
Residential churn fixed customers	%	14.8%	14.9%
Global ARPU fixed customers	€/month	53.78	55.92
Fixed Voice RGUs	#	279,691	277,449
<i>as % fixed customers</i>	%	100.2	100.2
BB RGUs	#	217,726	221,573
<i>as % fixed customers</i>	%	78.0%	80.0%
TV RGUs	#	124,754	131,963
<i>as % fixed customers</i>	%	44.7%	47.6%
Postpaid lines	#	273,906	367,886
Postpaid customers	#	153,939	203,114
<i>as % fixed customers (only mobile excluded)</i>	%	49.1%	66.4%
<i>Mobile lines / customer</i>	#	1.8	1.8

2015 saw the re-launch of the proprietary fixed-line network roll-out to facilitate connection for 51,000 homes over the next 4 years. This year connection was made available to more than 10,000 new homes.



Residential customers had net positive growth, with a 11.47% increase in the number of products contracted, bringing the number of products sold in this segment of the market to almost a million.

Improvements in mobile telephony, the possibility of financing purchases of mobile devices and the launching of the 4G service have all contributed to the healthy performance in this area. This is also seen in fixed-line customers with a mobile service, rising from 273,906 products in 2014 to 367,886 in 2015, and in the higher percentage of customers with mobile devices (49.1% in 2014 vs 66.4% in 2015).

We have also seen growth in the number of broadband customers (1.76% up on 2014) and television customers (5.78% up on the prior year), despite the significant impact of not being able to offer football coverage for the 2015-2016 season.

As a result, the product/customer ratio rose from 3.0 in 2014 to 3.4 in 2015.

The higher percentage of customers with a mobile telephone and the associated loyalty effect has allowed us to maintain the churn rates at levels similar to the prior year, despite the negative impact, in terms of loss of customers, of not being able to offer football since August.

ARPU has grown by Euros 2.14 (+3.98%) in 2015. Sales policies vis-à-vis mobile telephones, higher-added value services (upgrading) and additional services to existing customers (up-selling) have contributed to this growth. Of particular note has been the rise in 3P and 4P customers, which rose from 55.3% of the total customer base in 2014 to 65.0% in 2015.

Soho			
KPI	Unit	2014	2015
Subs	#	47,038	47,684
o/w 1P (%)	%	32.7%	29.1%
o/w 2P (%)	%	26.1%	18.2%
o/w 3P (%)	%	31.1%	38.4%
o/w 4P (%)	%	10.2%	14.2%
Total RGUs	#	143,472	162,844
RGUs / sub	#	3.1	3.4
Global ARPU Fixed customers	€/month	65.0	65.7

Commercial strategy in the Business market is in line with that of the Residential segment. The growth in customers, despite not being able to offer football since August 2015, coupled with product initiatives and upgrading and up-selling policies, have contributed to improving all year-on-year indicators. There has been 13.5% growth in products sold and 1% recovery in ARPU, compared to 2014.

#### Selected financial data

	Unit	2014	2015
<b>Total revenues</b>	<b>€m</b>	<b>321.2</b>	<b>327.8</b>
Y-o-y change	%		2.0%
o/w residential	€m	195.7	202.4
Y-o-y change	%		3.4%
o/w Business	€m	93.4	92.2
Y-o-y change	%		-1.3%
o/w Wholesale and Other	€m	25.2	24.3
Y-o-y change	%		-3.6%
o/w Other Profit Neutral Revenues	€m	6.9	8.9
Y-o-y change	%		29.2%
<b>Adjusted EBITDA</b>	<b>€m</b>	<b>155.9</b>	<b>158.1</b>
Y-o-y change	%		1.5%
Margin	%	48.5%	48.2%
<b>Capital expenditures</b>	<b>€m</b>	<b>(42.2)</b>	<b>(46.9)</b>
Y-o-y change	%		11.0%
% total revenues	%	-13.1%	-14.3%
<b>Operational Free Cash Flow</b>	<b>€m</b>	<b>113.6</b>	<b>111.3</b>
Y-o-y change	%		-2.1%
% EBITDA	%	72.9%	70.4%
<b>Net income</b>	<b>€m</b>	<b>36.8</b>	<b>6.8</b>
<b>Net income per share</b>	<b>€/share</b>		<b>0.05</b>
<b>Cash Flow per share</b>	<b>€/share</b>		<b>0.86</b>

Residential revenues grew by 3.4% in 2015 compared to the prior year. This is due an improvement in the ARPU (Euros 55.92 in 2015, an increase of Euros 2.14 on 2014) and the growth in products contracted by customers (from 3.0 to 3.4). For mobile customers, this increase has been 49,175 with a ratio of 1.8 lines per customer.

Business revenue amounted to Euros 92.2 million, down -1.2% on the same period in the prior year. This is largely attributable to the decline in revenues from SMEs and large accounts in 2014 due to austerity measures in companies, and pressure on prices from the competition. This difference has been falling monthly however, with positive year-on-year growth rates in the last quarter of 2015. Business segment performance (SOHO) has been positive in 2015, with revenue growth of Euros 1.8 million compared to 2014, a rise of 5.0%.

Wholesale and other revenues fell as expected, by -3.6%, due mainly to the impact of regulatory changes on operator revenue at the end of 2014.

Adjusted EBITDA, which does not include the effect of costs related to the stock flotation or the acquisition of R Cable, amounted to Euros 158.1 million in 2015, an increase of 1.5% on 2014, with a revenue margin of 48.2%. These results show the success of managing operating costs and the efficiency measures implemented in prior years.

Investments during the year came to Euros 46.9 million, a Euros 4.7 million increase on the prior year. This rise is explained by relevant projects carried out or started at Euskaltel in 2015. The plan to facilitate connection to 51,000 houses and industrial estates, the migration to VoIP platforms, the repositioning of broadband speeds, the WiFi Klean project, the new functionalities of the television service, and the initial roll-out of the proprietary 4G network have all contributed to this growth. These are projects involving technological, customer-oriented innovations which will allow them to enjoy the best services and us to increase our commercial offering and revenues in the coming years.

Operating cash flow, defined as the difference between EBITDA and investments, has remained stable compared to 2014, with a conversion rate of over 70%.

## Comparison of results for the years ended 31 December 2014 and 2015

### a) Revenues

Revenues for the year ended 31 December 2015 amounted to Euros 322,292 thousand compared to Euros 315,109 thousand for the year ended 31 December 2014, an increase of Euros 7,183 thousand or 2.3%.

This increase is due to a substantial upturn in the macroeconomic environment and is confirmation of our recent years' residential and SOHO commercial strategy aimed at winning new customers in the 3P and 4P high-value packages and focusing on cross-selling and up-selling.

b) Other income

Revenues for the year ended 31 December 2015 amounted to Euros 367 thousand compared to Euros 331 thousand for the year ended 31 December 2014, a negligible variation in absolute terms.

c) Work performed by the entity and capitalised

Work performed by the entity and capitalised for the year ended 31 December 2015 amounted to Euros 5,097 thousand compared to Euros 5,721 thousand for the year ended 31 December 2014, a drop of Euros 624 thousand or 10.9%. During 2014, agreements were reached with strategic partners in the fields of information systems (with the French multinational GFI) and network management and maintenance (with the Chinese multinational ZTE). Through these agreements, two instances of outsourcing have taken place involving the transfer of Euskaltel employees from these areas of activity. Although there was an increase in the number of household connections and a greater volume of new products and services, this caption has fallen due to the transfer of the workers mentioned. Previously, these employees performed internal work eligible for capitalisation, but are now invoiced by these companies and the investment is recognised directly.

d) Supplies

Supplies for the year ended 31 December 2015 amounted to Euros 71,090 thousand compared to Euros 71,524 thousand for the year ended 31 December 2014, a decrease of Euros 434 thousand or 0.6%. This reduction is basically due to the lower cost of content, mainly football in the last quarter of the year, and the competitive contract we have with our host that has largely offset the higher interconnection costs associated with the notable increase in mobile telephone lines during the year and the greater consumption of mobile data per line.

e) Personnel expenses

Personnel expenses for the year ended 31 December 2015 amounted to Euros 26,947 thousand compared to Euros 30,318 thousand for the year ended 31 December 2014, a decrease of Euros 3,371 thousand or 11.1%. This decline is due to the reduction in headcount related to the outsourcing of activities to GFI and ZTE, mentioned previously.

f) Other operating expenses

Other operating expenses for the year ended 31 December 2015 amounted to Euros 86,994 thousand compared to Euros 63,649 thousand for the year ended 31 December 2014, an increase of Euros 23,345 thousand or 36.7%. This rise is due to the aforementioned outsourcing and the significant, non-recurring costs incurred as a result of the stock flotation and the acquisition of R Cable.

g) Depreciation, amortisation and impairment

Depreciation, amortisation and impairment for the year ended 31 December 2015 amounted to Euros 77,455 thousand, compared to Euros 81,219 thousand for the year ended 31 December 2014, a decrease of Euros 3,764 thousand or 4.6%. This decline is largely due to the reversal of the provision for licences after the decision to roll out the 4G network.

h) Results from operating activities

As a result of the above, results from operating activities for the year ended 31 December 2015 fell by Euros 9,344 thousand to Euros 63,855 thousand, compared to Euros 73,199 thousand for the year ended 31 December 2014. The main reason for this drop are the non-recurring expenses of Euros 15.4 million incurred as a result of

the stock flotation and the acquisition of R Cable. Isolating this effect, results from operating activities would have been Euros 79,255 thousand, or 8.27% up on the prior year.

i) Net finance costs

Net finance costs for the year ended 31 December 2015 amounted to Euros 53,905 thousand compared to Euros 23,264 thousand for the year ended 31 December 2014, an increase of Euros 30,641 thousand, or 131.7%. This increase is basically attributable to the following:

- Expenses recognised during the year and related to the incentives plan for senior management, the board of directors and other key employees came to Euros 30,705 thousand compared to Euros 7,832 thousand for the year ended 31 December 2014.
- Costs of cancelling derivatives and financing amounted to approximately Euros 10,556 thousand.
- Despite debt rising from Euros 236.9 million at 31 December 2014 to Euros 1,369.1 million at 31 December 2015 (as a result of all the events described in section 5), borrowing costs have fallen due to the drop in average interest rates compared to the prior year. It should also be noted that a substantial part of debt in 2015 is attributable to the acquisition of R Cable at the end of November.

j) Income tax

Income tax for the year ended 31 December 2015 came to Euros 3,169 thousand, compared to Euros 13,152 thousand for the year ended 31 December 2014. This reduction is due to lower profit before tax on account of the aforementioned non-recurring expenses.

k) Profit for the period

As a result of the above, profit for the period ended 31 December 2015 fell by Euros 30,002 thousand to Euros 6,781 thousand, compared to Euros 36,783 thousand for the year ended 31 December 2014. As mentioned previously, profit for the year has been severely impacted by the non-recurring expenses of the stock flotation, the acquisition of R Cable and the repayment of debt. If we isolate the impact of non-recurring expenses for the past two years, net profit would have been Euros 49.1 million in 2015 and Euros 42.4 million in 2014, an increase of 15.8% in the last year.

## 6.- Corporate governance and social responsibility

### 6.1. Corporate governance

In 2014 and 2015 we consolidated our actions with regard to corporate governance, implementing changes that enable us to assert that we work in a company that clearly promotes transparency and implements the good governance recommendations generally accepted in international markets, applying advanced business management ideas even beyond what would be strictly applicable under prevailing legislation.

These changes include the appointment of independent advisors, the creation of consultative committees within the board of directors (Audit and Control and Appointments and Remuneration for now, as the Company's by-laws and the regulations of the board permit other options), the launch of a corporate defence programme, with an ethical conduct channel that encourages the flow of information with absolute confidentiality, and the creation of an internal audit management team, whose functions are to provide assurance and advisory services with a systematic approach in compliance with the 2014-2016 Plan targets.

The Company has adapted its corporate governance to best practices.

## 6.2. Board of directors

Our board of directors is responsible for overseeing the Company and establishing our strategic, accounting, organisational and financial policies, among others. In accordance with Spanish legislation, the regulations of the board, and our by-laws, the chairperson of the board and, if applicable, the vice-chairperson, who acts as chair if the chair is absent or incapacitated, are elected from the members of the board of directors. The secretary and, if applicable, the vice-secretary of the board do not necessarily have to be board members. The board of directors is charged with calling general meetings of shareholders and applying any resolutions adopted by the shareholders.

The board of directors meets at least quarterly. Our by-laws and the regulations of the board stipulate that the majority (half plus one) of the members of the board (whether present in person or duly represented by another member of the board) constitutes a quorum. Unless otherwise stated in legislation or our by-laws, the resolutions of the board are approved by an absolute majority of the members present at a meeting, whether in person or duly represented. In the event of a tied vote, the chair has a casting vote.

### a) Consultative committees of the board

In compliance with our by-laws and the regulations of the board, our board of directors has an Audit and Control Committee and an Appointments and Remuneration Committee which are governed by the "Audit and Control Committee Regulations" and the "Appointments and Remuneration Committee Regulations", respectively.

#### *Appointments and Remuneration Committee*

The composition, duties and rules of the Appointments and Remuneration Committee is governed by our Appointments and Remuneration Committee Regulations.

The committee comprises a minimum of three and a maximum of five external directors (i.e. proprietary and independent). The majority of the Committee's members are independent directors. The Committee elects a chair from among the independent directors sitting on the Committee, with the chair having the casting vote in the event of a tied vote. The Committee appoints a secretary, who may be one of its members or the secretary or vice-secretary of the board.

The members of the Appointments and Remuneration Committee are appointed for a maximum of four years, and may be re-elected one or more times for maximum periods of four years. The chair's tenure is for a maximum of four years, and they may not be re-elected until one year has elapsed, without prejudice to remaining a member of the Appointments and Remuneration Committee. The secretary of the Committee's tenure is for a maximum of four years, and they may be re-elected one or more times for maximum periods of four years.

The Appointments and Remuneration Committee is charged, inter alia, with the following:

- advising the board of directors on the most appropriate make up of its committees in terms of size and the balance between the different types of directors;
- establishing and reviewing the criteria to be followed for the composition of the board and the selection of its candidates, defining its functions, capacities and competences, as well as determining the time and dedication necessary to carry out its duties properly;
- ensuring that whoever assumes the post of director satisfies, in all respects, the requisites of reputation, suitability, solvency, adequacy, experience, qualification, training, availability and dedication as regards their function and that they not are affected, directly or indirectly, by any incompatibility, prohibition, conflict or opposition of interests as regards the interests of the Company, when proposing candidates for the board;
- examining and organising the succession of the chair of the board and the Company's CEO and, if applicable, proposing candidates for the board of directors in order that succession be conducted in an orderly, planned fashion;

- submitting candidates for the appointment, promotion or cessation of executives, as well as proposals for reviewing and modifying the organisation structure and the allocation of responsibilities in the Company;
- informing the board of directors of the selection, appointment and remuneration of directors and senior executives of the Company and its Group;
- periodically reviewing the Company's policy of remunerating senior executives and proposing modifications and updates to the board of directors;
- ensuring compliance with the Company's remuneration policy and providing information on documents which require board approval.

The Appointments and Remuneration Committee meets between two and four times a year, and when its chair deems necessary.

#### *Audit and Control Committee*

The composition, duties and rules of the Audit and Control Committee are governed by our Audit and Control Committee Regulations.

Our Audit and Control Committee Regulations require that the Audit and Control Committee have a minimum of three and a maximum of five members, all of whom must be external directors. At least two members of the Audit and Control Committee must be independent directors and their appointment shall take into account their knowledge and experience in accounting, audit or both.

The chair of the Audit and Control Committee is elected by the committee from among its independent directors, who are elected for a maximum of four years, and they may only be re-elected one year after their tenure has ended, without prejudice to remaining a member of the Audit and Control Committee. The secretary of the Committee may be one of the members of the Committee or the secretary or vice-secretary of the board of directors.

The Audit and Control Committee is charged, inter alia, with the following:

- analysing the financial statements after the end of each year, examining the draft audit opinion, discussing the annual accounts and the audit report with the auditors, and presenting their recommendations to the board of directors before the annual accounts are authorised for issue based on the conclusions of the aforementioned activities;
- informing the shareholders at their annual general meeting on matters relating to the points proposed by the shareholders for their attention;
- supervising the internal audit and risk management services, as well as analysing the internal control systems with the external auditors to identify possible significant weaknesses;
- knowing, understanding and taking due account of the Company's financial reporting processes and internal control systems;
- establishing appropriate relations with the external auditor in order to receive information on issues that could compromise their independence, for analysis by the Committee, as well as any information related to the audit process;
- examining, before presentation, the financial reporting to be presented to the pertinent market regulators;
- providing information on transactions that could entail a conflict of interest;

The Audit and Control Committee meets between two and four times a year, before financial and risk management reports are presented to third parties, and as the chair deems necessary.

### **6.3. Our social responsibility approach**

Our social responsibility policy is based on the concept of sustainability, where Euskaltel, as a socially-responsible company, seeks to balance its Mission and Vision-driven corporate objectives with the expectations of its stakeholders, taking into account the economic, social and environmental aspects of its commitment to the economic and social development of the community in which it renders its services. Annually, and as part of its transparency undertaking to stakeholders, Euskaltel prepares its Corporate Responsibility Report,

following the methodology based on the Global Reporting Initiative (GRI) 2006 for sustainability reports, and the GRI Sector Supplement for the telecommunications sector (2003).

Economic strategy is centred on maximising the value of its customer base, taking advantage of its leading position in the Basque Country, customer loyalty, its proprietary fibre optic network - which does not require any additional significant investment - and high brand value to consolidate market share and contribute to growth. Euskaltel is focused on increasing the penetration of convergent services bundles in order to raise average revenue per user (ARPU) and reduce churn. Mobility is key to this strategy and Euskaltel's goal is to offer its customers high-speed access anywhere through its fibre network, WiFi hotspots and the roll-out of its 4G network.

The cornerstone of the Company's strategy is that the incorporation of risk management in business decisions is essential for creating value for stakeholders and for developing a strategy that seeks long-term success and sustainability for both the company and the environment. One of these risks is environmental risk.

Euskaltel strives to effectively integrate environmental risk management into its management system, on the assumption that environmental protection concerns all people and activities and is a key issue for corporate sustainability. An environmental master plan has been drawn up and is employed as the principal tool.

This master plan is aligned and responds to Euskaltel's different internal and external undertakings, including those directly related to the environment, such as:

- UNE-EN ISO 14001: Environmental Management System. Requisites.
- EMAS III: EU Eco-Management and Audit Scheme
- Global Pact (10 principles).

Our social activity is twofold: internally, through people management, and society-wise, through institutional and sponsorship activity. We are aware that one of the pillars underpinning the sustainability of our business is our people. Their knowledge, competencies and skills are key to guaranteeing corporate competitiveness. Euskaltel, faithful to its foundation criteria, remains committed to the stability and continuity of its people. 100% of our workforce are on fixed, indefinite, full-time contracts.

Loyal to its vision, Euskaltel considers that its institutional and sponsorship activities are a tool for realising its undertaking as a company with strong territorial ties, in order to remain a caring, committed company with a clear vocation, and to from a part of the technological progress of the Basque Country, its natural market.

## 7.- Financial risks

Our activities are exposed to credit risk, liquidity risk, and market risk, the latter of which includes currency and interest rate risk.

We use financial risk evaluation and mitigation methods suited to our activity and scope of operations, which are sufficient to adequately manage risks.

A summary of the main financial risks affecting us, and the measures in place to mitigate their potential affect, is as follows:

### a) Credit risk

Credit risk is the risk of financial loss to which we are exposed in the event that a customer or counterparty to a financial instrument fails to discharge a contractual obligation. This risk is mainly concentrated in receivables.

The probability of customer credit risk materialising is mitigated by the application of different policies, and the high level of dispersion of receivables. Among the different policies and specific practices are the customer acceptance policy, continual monitoring of customer credit, which reduces the possibility of default on the main receivables, and collection management.

Cash and cash equivalents reflect the amounts available with financial institutions that have high credit ratings.

b) Liquidity risk

Liquidity risk is the risk that we will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets. Our approach to managing liquidity risk is to ensure, as far as possible, that it has enough liquidity to settle its debts as they fall due, in both normal and stressed conditions, without incurring unacceptable losses or compromising its reputation.

We adjust the maturities of our debts to our capacity to generate cash flows to settle them. To do this, we have implemented a seven-year financing plan with annual reviews and regular analyses of our financial position, which includes long-term projections, together with daily monitoring of bank balances and transactions.

Although our working capital, defined as the difference between current assets and current liabilities (maturing in less than 12 months in both cases), is negative, this is mainly because of the way the business operates, resulting in the average collection period being shorter than the average payment period, which is common practice in the sector in which we operate.

c) Market risk

Market risk is the risk that changes in prices could affect our revenue or the value of our financial instruments. The objective of managing market risk is to control exposure to this risk, within parameters we consider reasonable, and optimise returns.

Our scope of operations barely exposes us to currency or price risks, which may arise from occasional purchases in foreign currency of insignificant amounts.

Interest rate risks arise on variable-rate loans from financial institutions and related parties, which expose us to fluctuations in future cash flows.

We regularly revise our interest rate hedging policy. Under this policy, we assess the need to contract interest rate hedges.

We settle interest on a monthly basis, which allows us to closely monitor the performance of interest rates in the financial market.

For the year ended 31 December 2015, had interest rates risen by 100 basis points, with other variables remaining constant, profit (after tax) would have fallen by Euros 2,765,000 (Euros 2,475,000 for the year ended 31 December 2014).



## 8.- Share price

### 8.1. Share price



Since the Company was floated on the stock exchange, its share price has risen by +21.89%. The Ibex 35 however dropped by -11.38% during the same period.

The share prices of other comparable telecommunications operators during the period July-December 2015 fluctuated by between -27.3% and +2%.

### 8.2 Volume of trading

#### Volume of shares traded July to December 2015

<u>Period (1-Jul/31-Dec)</u>	<u>Volume of shares</u>	<u>Average daily</u>
Ordinary trading	50,616,370	386,385
Block trading	79,421,386	606,270
	<b>130,037,756</b>	<b>992,655</b>

#### Trading days peak and trough for the period

<u>Date</u>	<u>Close</u>	<u>Volume of shares</u>
1-Jul-15	10.05 €	16,695,817
20-Aug-15	11.00 €	11,080

## 9.- Outlook and events after the reporting period

The signs of recovery in economic activity, and more specifically, the forecast growth in revenues announced by the main players in the telecommunications sector, lead us to believe that a sustained recovery is highly likely, which will raise our current operating revenues.

In addition, forecast improvements from the complementary strengths being discovered and implemented as a result of incorporating the knowledge and experience of R Cable Telecomunicaciones de Galicia, S.A. people, mean we can expect a period of expansion and development with excellent prospects of profitability for our shareholders.

Focusing on 2016, projects which commenced in 2015 and which are still producing results, together with those in the pipeline for next year, particularly as regards expansion to new houses and industrial areas and technological developments designed to improve our services and mobile solutions, will enable us to surpass all relevant economic indicators achieved in 2015.

Finally, no significant events after the 2015 reporting period have arisen.

## 10.- Acquisition of own shares

At 31 December 2015 we held 139,806 own shares. During the year a total of 2,031,891 shares were acquired, and 1,892,085 were sold or delivered.

The acquisition of own shares is part of the liquidity contract that Euskaltel signed on 17 September 2015 with Norbolsa, Sociedad de Valores, S.A. (Norbolsa), to manage its own share portfolio.

Under this contract, Norbolsa will trade Euskaltel shares on the Spanish securities markets with a view to achieving the following:

- a) Favour liquidity in transactions.
- b) Share price stability.

The liquidity contract has a duration of 12 months, and is tacitly renewable for a further 12 months. 125,000 shares have been earmarked for the securities account associated with the contract, and Euros 1,375,000 for the cash account.

This contract is based on the liquidity contract model included in Spanish National Securities Market Commission Circular 3/2007 of 19 December 2007 on liquidity contracts, so that it will be accepted as market practice.

## 11.- R+D+i

### R&D activities

Euskaltel pays particular attention to research and development as these are the foundations on which service offerings to the market will be built in the near future. With a vocation of constant innovation in the market, an effort must be made in this regard. The research and development projects in which Euskaltel is involved are based on emerging technologies that are not yet a commercial reality and for which no business case yardsticks exist, but which have great potential.

The fundamental objectives are twofold: firstly, get to know and familiarise ourselves with the new technology and its possible applications, and, secondly get to know, through the project consortium, an ecosystem of companies with which to build a possible business case in the near future.

Throughout 2015, Euskaltel actively participated in a series of R&D projects centred mainly on the following:

- Health and tele-assistance (EBIZI)
- Smart cities and community WiFi (EMENHIR)
- Knowledge of television use (NORU)

For each of these projects a consortium of various field-related companies was set up, which included Technology Centres of the Basque Science, Technology and Innovation Network. These three projects in 2015 were part of the official research and development programmes promoted by the Basque Government through SPRI.

## Innovation activities

Euskaltel focuses its technological innovation activity on the development of new systems and processes and the creation of new telecommunications products and services.

The projects for developing new systems and processes cover the design and development of tools in Euskaltel's integral management system, which allow us to manage each aspect of offering telecommunication services, and which involves the incorporation of new technology and functionalities of customer management and service systems, internal support and operations, and different marketing and sales processes for the company.

Work during the year involved developing customer marketing, sales and service systems (developed in the CRM to incorporate new functionalities and services, improving our web channel as a platform for communication and interaction with our customers, progress in sales information systems, etc.); business support systems (automation and improvement of product migration systems, improvements in logistics processes associated with customer order management, migration of our geographical information system, progress in billing systems etc.) and improvements in network diagnostics (monitoring of equipment at customers).

In relation to our products and services, we strive to promote the development of the information society, working to offer users the most advanced telecommunications solutions on the market through directly managed proprietary networks, and taking advantage of all the service possibilities that new technologies have to offer.

Work during the year involved developing new products and services (new digital television, new corporate solutions for customers, and broadband service requirements etc.), new processes and innovations in products and services (new VoIP solution, Euskaltel WiFi, launch of 4G/LTE etc.) and new strategic projects for the future (integration of services in the digital home etc.).

## 12.- Average supplier payment period

Details of the average payment period referred to in the Spanish Institute of Accounting and Auditing's Resolution of 29 January 2016 are as follows:

	2015
Average supplier payment period (in days)	40.21
Transactions paid ratio	44.56
Transactions payable ratio	14.81
Total payments made (thousands of Euros)	238,872
Total payments payable (thousands of Euros)	40,880

The average payment period is the time between delivery of the goods or provision of the services by the supplier and payment of the transaction in accordance with the methodology described in article 5 of the Resolution.

## 13.- Annual Corporate Governance Report

The 2015 Annual Corporate Governance Report, which forms part of the directors' report, was approved by the board of directors of Euskaltel, S.A. on 24 February 2016 and is available on the Company's website ([www.euskaltel.com](http://www.euskaltel.com)) and that of the Spanish National Securities Market Commission ([www.cnmv.es](http://www.cnmv.es)).

Derio, 24 February 2016

In compliance with prevailing legislation, the directors of Euskaltel, S.A. have authorised for issue the annual accounts (comprising the balance sheet, income statement, statement of changes in equity, statement of cash flows and notes) and the directors' report of the Company for the period ended 31 December 2015.

The directors declare that they have signed each of the above-mentioned documents in their own hand, and in witness thereof sign below

Signed:

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**Mr. Alberto García Erauzkin**  
(Chairman)

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**Mr. José Ángel Corres Abasolo**  
(Vice-chairman)

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**Ms. Alicia Vivanco González**  
(Board member)

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**Mr. Alfonso Basagoiti Zavala**  
(Board member)

---

**Mr. Javier Fernández Alonso**  
(Board member)

---

**Ms. Bridget Cosgrave**  
(Board member)

---

**Mr. Richard Alden**  
(Board member)

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**Ms. Belén Amatriaín Corbi**  
(Board member)

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**Mr. Iñaki Alzaga Etxeita**  
(Board member)



**Consolidated Annual Accounts  
and Directors' Report  
for the year  
ended 31 December 2015**

**(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)**

## **Independent Auditor's Report on the Consolidated Annual Accounts**

(Translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

To the Shareholders of  
Euskaltel, S.A.

### **Report on the Consolidated Annual Accounts**

We have audited the accompanying consolidated annual accounts of Euskaltel, S.A. (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated balance sheet at 31 December 2015 and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and consolidated notes.

#### *Directors' Responsibility for the Consolidated Annual Accounts*

The Directors are responsible for the preparation of the accompanying consolidated annual accounts in such a way that they give a true and fair view of the consolidated equity, consolidated financial position and consolidated financial performance of Euskaltel, S.A. and subsidiaries in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and other provisions of the financial reporting framework applicable to the Group in Spain, and for such internal control that they determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated annual accounts based on our audit. We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. This legislation requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated annual accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of the consolidated annual accounts by the Company's Directors in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated annual accounts taken as a whole.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the accompanying consolidated annual accounts give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of Euskaltel, S.A. and subsidiaries at 31 December 2015 and of their consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union, and other provisions of the financial reporting framework applicable in Spain.

**Report on Other Legal and Regulatory Requirements**

The accompanying consolidated directors' report for 2015 contains such explanations as the Directors of Euskaltel, S.A. consider relevant to the situation of the Group, its business performance and other matters, and is not an integral part of the consolidated annual accounts. We have verified that the accounting information contained therein is consistent with that disclosed in the consolidated annual accounts for 2015. Our work as auditors is limited to the verification of the consolidated directors' report within the scope described in this paragraph and does not include a review of information other than that obtained from the accounting records of Euskaltel, S.A. and subsidiaries.

KPMG Auditores, S.L.

*(Signed on original in Spanish)*

Enrique Asla García

25 February 2016

## EUSKALTEL, S.A. AND SUBSIDIARIES

### Consolidated Balance Sheet at 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

ASSETS	Notes	31.12.2015	31.12.2014
<b>NON-CURRENT ASSETS</b>		<b>2,184,772</b>	<b>921,542</b>
Goodwill	5	591,442	-
Intangible assets	6	184,317	22,552
Property, plant and equipment	7	1,243,778	743,737
Financial assets	8	7,516	6,332
Deferred tax assets	13	157,719	148,921
<b>CURRENT ASSETS</b>		<b>97,622</b>	<b>56,785</b>
Inventories	9	3,532	2,313
Trade and other receivables	8	63,906	39,329
Current tax assets		3,602	-
Other current assets		3,211	4,493
Cash and cash equivalents	8	23,371	10,650
<b>TOTAL ASSETS</b>		<b>2,282,394</b>	<b>978,327</b>
EQUITY AND LIABILITIES	Notes	31.12.2015	31.12.2014
<b>EQUITY</b>			
Capital and reserves	10	702,569	652,037
Capital		455,536	379,613
Share premium		207,604	79,390
Retained earnings		40,858	193,034
(Own shares)		(1,429)	-
Other comprehensive income		(64)	(4,547)
Equity attributable to equity holders of the Parent		702,505	647,490
Non-controlling interests		419	-
		702,924	647,490
<b>NON-CURRENT LIABILITIES</b>		<b>1,439,009</b>	<b>212,949</b>
Non-current payables	12	1,353,009	212,949
Provisions		1,711	-
Other non-current liabilities	12	8,007	-
Deferred tax liabilities	13	76,282	-
<b>CURRENT LIABILITIES</b>		<b>140,461</b>	<b>117,888</b>
Current payables	12	1,231	49,206
Trade and other payables	12	121,545	58,749
Provisions		1,059	-
Other current liabilities		16,626	9,933
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>2,282,394</b>	<b>978,327</b>

Derio, 24 February 2015



## EUSKALTEL, S.A. AND SUBSIDIARIES

### Consolidated Income Statement for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	Notes	2015	2014
Revenues	14	343,259	315,109
Work performed by the entity and capitalised	6 & 7	5,793	5,721
Supplies	14	(77,220)	(71,524)
Other operating income		431	331
Personnel expenses	14	(28,593)	(30,318)
Other operating expenses	14	(93,614)	(64,612)
Amortisation and depreciation	6 & 7	(85,446)	(81,508)
Impairment	6	2,137	-
RESULTS FROM OPERATING ACTIVITIES		66,747	73,199
Finance income		192	179
Finance costs		(56,391)	(23,443)
NET FINANCE COST	14	(56,199)	(23,264)
Profit before income tax		10,548	49,935
Income tax	13	(3,311)	(13,152)
PROFIT FOR THE YEAR	10	7,237	36,783
Profit for the year attributable to equity holders of the Parent		7,241	36,783
Profit for the year attributable to non-controlling interests		(4)	-
		7,237	36,783
Earnings per share		0.06	0.29

Derio, 24 February 2016

## EUSKALTEL, S.A. AND SUBSIDIARIES

### Consolidated Statement of Comprehensive Income for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	Notes	2015	2014
a) Consolidated profit for the year	13	<u>7,237</u>	<u>36,783</u>
Items to be reclassified to the income statement			
b) Income and expense recognised directly in consolidated equity	13	<u>(88)</u>	<u>(4,787)</u>
Cash flow hedges		(123)	(6,649)
Tax effect		35	1,862
c) Amounts transferred to the consolidated income statement	13	<u>4,571</u>	<u>881</u>
Cash flow hedges		6,349	1,224
Tax effect		(1,778)	(343)
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<u><b>11,720</b></u>	<u><b>32,877</b></u>
Attributable to equity holders of the Parent		11,724	32,877
Attributable to non-controlling interests		<u>(4)</u>	<u>-</u>
		<u><b>11,720</b></u>	<u><b>32,877</b></u>

## EUSKALTEL, S.A. AND SUBSIDIARIES

### Consolidated Statement of Changes in Equity for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	Equity attributable to equity holders of the Parent						Non-controlling interests	Total
	Registered capital	Share premium	Retained earnings	Own shares	Other comprehensive income	Sub-total		
Closing balance 2013	379,613	79,390	156,251	-	-641	614,613	-	614,613
Other comprehensive income	-	-	36,783	-	(3,906)	32,877	-	32,877
Closing balance, 2014	379,613	79,390	193,034	-	(4,547)	647,490	-	647,490
Other comprehensive income			7,241		4,483	11,724	(4)	11,720
Transactions with shareholders								
<i>Acquisition of subsidiaries</i>	-	-	-	-	-	-	423	423
<i>Own shares</i>	-	-	60	(1,429)	-	(1,369)	0	(1,369)
<i>Capital increases</i>	75,923	179,178	(3,408)	-	-	251,693	0	251,693
<i>Dividends</i>	-	(50,964)	(156,069)	-	-	(207,033)	0	(207,033)
Closing balance, 2015	455,536	207,604	40,858	(1,429)	(64)	702,505	419	702,924

Derio, 24 February 2016

## EUSKALTEL, S.A. AND SUBSIDIARIES

### Consolidated Statement of Cash Flows for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	2015	2014
<b>Profit for the year before tax</b>	<b>10,548</b>	<b>49,935</b>
<b>Adjustments for</b>	<b>141,798</b>	<b>105,501</b>
Amortisation and depreciation	85,446	81,508
Impairment	2,249	1,018
Impairment and gains/(losses) on disposals of fixed assets	(2,137)	(289)
Impairment and gains/(losses) on disposals of financial instruments	-	(143)
Finance income	(151)	(36)
Finance costs	56,357	23,434
Exchange losses	34	9
Other gains/losses	-	-
Other income and expenses	-	-
<b>Changes in operating assets and liabilities</b>	<b>(8,843)</b>	<b>(12,581)</b>
Inventories	445	886
Trade and other receivables	(3,531)	(4,044)
Other current assets	-	180
Trade and other payables	(5,757)	(9,780)
Other current liabilities	-	177
<b>Other cash flows used in operating activities</b>	<b>(58,232)</b>	<b>(16,497)</b>
Interest paid	(18,683)	(14,148)
Interest received	192	36
Income tax paid	-	(2,385)
Other non-current assets and liabilities	(39,741)	-
<b>Cash flows from operating activities</b>	<b>85,271</b>	<b>126,358</b>

## EUSKALTEL, S.A. AND SUBSIDIARIES

### Consolidated Statement of Cash Flows for the year ended 31 December 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

(Expressed in thousands of Euros)

	<u>2015</u>	<u>2014</u>
<b>Payments for investments</b>	<b>(873,511)</b>	<b>(37,582)</b>
Acquisition of subsidiaries, net of cash and cash equivalents	(819,224)	-
Intangible assets	(20,353)	(15,786)
Property, plant and equipment	(33,934)	(20,600)
Other financial assets	-	(1,196)
<b>Proceeds from sale of investments</b>	<b>3,559</b>	<b>335</b>
Group companies and associates	-	171
Property, plant and equipment	-	-
Other financial assets	3,559	164
<b>Cash flows used in investing activities</b>	<b><u>(869,952)</u></b>	<b><u>(37,247)</u></b>
<b>Proceeds from and payments for equity instruments</b>	<b>253,732</b>	<b>-</b>
Issue of equity instruments	255,102	-
Acquisition of own equity instruments	(1,370)	-
<b>Proceeds from and payments for financial liability instruments</b>	<b>543,670</b>	<b>(84,750)</b>
Issue of:	1,353,487	23,353
Loans and borrowings	1,353,487	23,353
Repayment of:	(602,784)	(108,103)
Loans and borrowings	(602,784)	(108,103)
Dividends and interest on other equity instruments paid	(207,033)	-
Dividends	(207,033)	-
<b>Cash flows from/(used in) financing activities</b>	<b><u>797,402</u></b>	<b><u>(84,750)</u></b>
Cash and cash equivalents at beginning of year	10,650	6,289
Cash and cash equivalents at year end	23,371	10,650
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b><u>12,721</u></b>	<b><u>4,361</u></b>

Derio, 24 February 2016

## **EUSKALTEL, S.A. AND SUBSIDIARIES**

### **NOTES TO THE CONSOLIDATED ANNUAL ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2015**

**(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)**

#### **NOTE 1.- General information**

Euskaltel, S.A. (hereinafter the Company) was incorporated with limited liability on 3 July 1995. Its first product was launched on the market on 23 January 1998. Its registered office is located in Derio (Bizkaia) and its products are primarily marketed and sold in the Basque Country.

The Company's statutory and principal activity since incorporation has been the rendering, management, installation, operation and marketing and sale of telecommunications networks and services in accordance with prevailing legislation, as well as the marketing and sale of goods required to carry out these services. The Company's main facilities are located at the Bizkaia technology park.

On 1 July 2015 the Company's shares were admitted to trading on the Barcelona, Bilbao, Madrid and Valencia stock exchanges.

On 27 November 2015 the Company acquired the entire share capital of R Cable y Telecomunicaciones Galicia, S.A. (hereinafter R. Cable) (see note 5), an entity incorporated in A Coruña on 1 August 1994 whose principal activity is the rendering of services similar to those of the Company, in Galicia. R Cable is the leading telecommunications operator in Galicia, with access to an extensive fibre optic network, and provides mobile telephone services through an agreement with a virtual mobile operator.

#### **NOTE 2.- Basis of presentation**

##### **2.1. True and fair view**

The accompanying consolidated annual accounts have been prepared on the basis of the accounting records of Euskaltel, S.A. and of the consolidated entities. The consolidated annual accounts for 2015 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU), and other applicable provisions in the financial reporting framework, to give a true and fair view of the consolidated equity and consolidated financial position of Euskaltel, S.A. and subsidiaries (the Group) at 31 December, and the consolidated results of operations and changes in consolidated equity and cash flows of the Group for the year then ended.

The Company applied International Financial Reporting Standards as adopted by the European Union (IFRS-EU) for the first time when preparing its financial statements for 2012 in the context of the stock flotation mentioned in the previous note.

The directors of the Parent consider that the consolidated annual accounts for 2015, authorised for issue on 24 February 2016, will be approved with no changes by the shareholders at their annual general meeting.

## 2.2. Comparative information

As a result of the acquisition of R Cable, Euskaltel, S.A. has prepared its consolidated annual accounts in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU), and the consolidated annual accounts for the year ended 31 December 2015 are the first which present the combined assets, liabilities, income, expenses and cash flows of the new Group.

The consolidated balance sheet, consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and the notes thereto for 2015 include comparative figures for the prior year.

As a result of the stock flotation and the acquisition of R Cable, Euskaltel, S.A. has incurred substantial non-recurring expenses which are shown in the income statement for 2015 and which affect the comparability of the financial information. Details of these non-recurring expenses are as follows:

	2015	2014
Incentives plan (notes 11 and 14.5)	30,705	7,832
Extraordinary personnel remuneration (note 14.3)	3,365	-
Cancellation of derivatives and financing (note 14.5)	10,556	-
Stock flotation expenses (notes 1, 10 and 14.4)	6,558	-
R Cable acquisition costs (notes 1, 5 and 14.4)	5,477	-
	<u>56,661</u>	<u>7,832</u>

## 2.3. Critical issues regarding the valuation and estimation of uncertainties

Preparation of the consolidated annual accounts in accordance with IFRS-EU requires certain estimates and judgements concerning the future. These are evaluated continuously and are based on historical experience and other factors, including expectations of future events and, where applicable, the justified opinion of renowned experts.

In the event that the final outcome of the estimates differed from the amounts initially recognised, or information that would modify these estimates became available, the effects of any changes in the initial estimates are accounted for in the period they are known.

The estimates and judgements that present significant risk of a material adjustment to the carrying amounts of assets and liabilities in the subsequent reporting period are as follows:

### a) Capitalisation of tax credits

Deferred tax assets are recognised for all available deductible temporary differences, tax loss carryforwards and deductions to the extent that it is probable that the companies comprising the Group will obtain sufficient taxable income against which these assets can be utilised. In order to determine the amount of the deferred tax assets to be recognised, estimates are made of the amounts and dates on which future taxable profits will be obtained and the reversal period of temporary differences.

### b) Useful lives and impairment of non-current assets

The Group determines the estimated useful lives and related amortisation and depreciation charges of assets based on the actual decline in value due to operation and use. The sector in which the Group carries out its activities is susceptible to technical obsolescence of its facilities, and consequently, estimates made must be reviewed periodically, and at least at each year end. The existence of circumstances which could indicate that the carrying amount of the Group's property, plant and equipment and intangible assets may not be recoverable, is also evaluated.

c) Impairment of goodwill

The acquisition of R Cable has resulted in goodwill whose recoverable amount must be reviewed annually. Analysis of the recoverable amount requires the use of highly subjective assumptions and accounting estimates.

**2.4. Presentation currency**

The consolidated annual accounts are expressed in thousands of Euros rounded off to the nearest thousand.

**2.5. Standards and interpretations issued and not applied**

In May 2014 the International Accounting Standards Board (IASB) issued IFRS 15, which will regulate the recognition of revenue from contracts with customers. This new standard, effective for periods beginning on or after 1 January 2018, will replace the requirements currently established in IAS 18 Revenue, IAS 11 Construction Contracts, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers and SIC-31 Revenue – Barter Transactions Involving Advertising Services. The Group is implementing a plan which will allow it to calculate the impact of applying this new standard.

On 13 January 2016 IFRS 16 Leases was issued, effective for periods beginning on or after 1 January 2019 and a replacement for IAS 17. Under the new requirements, and with certain exceptions, lessees must recognise a right-of-use asset at the present value of the future lease payments, and a lease liability. The Group has entered into contracts which transfer the right-of-use of certain assets. These contracts could potentially be affected by IFRS 16 if control over a specific asset for a specified period were contemplated, which would give rise to new assets and liabilities on the Group's consolidated balance sheet.

## **NOTE 3.- Accounting principles**

**3.1. Subsidiaries**

Subsidiaries are entities over which the Company, either directly or indirectly, exercises control. The Company controls an entity when it is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary.

The income, expenses and cash flows of subsidiaries are included in the consolidated annual accounts from the date of acquisition, which is the date on which the Group obtains effective control of the subsidiaries. Subsidiaries are no longer consolidated once control is lost.

Intragroup balances and transactions and any unrealised gains or losses are eliminated on consolidation.

The subsidiaries' accounting policies have been adapted to Group accounting policies for like transactions and events in similar circumstances.



### 3.2. Business combinations

Business combinations are recognised using the acquisition method, which is applied from the date the Group obtains control of the acquiree. At that date, the assets acquired and liabilities assumed are generally recognised at fair value. Liabilities assumed include any contingent liabilities that represent present obligations arising from past events for which the fair value can be reliably measured. Indemnification assets assumed by the seller are measured using the same criteria applicable to the liability subject to indemnification, taking into consideration any insolvency risk and any contractual limit on the indemnity amount.

The excess of the consideration given and the net identifiable assets acquired and liabilities assumed is recognised as goodwill.

If the values attributable to the assets and liabilities acquired at the date control is obtained have only been able to be determined provisionally, these are recognised at their estimated amounts at that date, and any adjustments made during the valuation period are recognised as if they had been known at the time control was obtained. Adjustments to provisional amounts entail modifying comparative figures. Adjustments to provisional amounts are only recognised when they correspond to facts and circumstances that existed at the acquisition date, which, had they been known, would have affected the recognised amounts. After this period, the initial measurement is only adjusted when correcting errors.

Contingent liabilities are recognised until settlement, cancellation or expiration at the higher of the initially recognised amount, less amounts which should be taken to consolidated profit or loss in accordance with revenue recognition criteria, and the amount resulting from provision measurement criteria.

### 3.3. Intangible assets

#### a) Goodwill

Goodwill is determined using the same criteria as for business combinations.

Goodwill is not amortised but is tested for impairment annually or more frequently where events or circumstances indicate that an asset may be impaired. Goodwill on business combinations is allocated to the cash-generating units (CGUs) or groups of CGUs which are expected to benefit from the synergies of the business combination. After initial recognition, goodwill is measured at cost less any accumulated impairment.

#### b) Computer software

Costs related to the acquisition and development of computer software are recognised at cost of acquisition or production and are amortised on a straight-line basis over their estimated useful lives of between 3 and 5 years.

Computer software maintenance costs are charged as expenses when incurred.

#### c) Licences

Licences for the use of radio space are carried at cost less accumulated amortisation and any recognised accumulated impairment. Amortisation is calculated on a straight-line basis over the concession period.

d) Other intangible assets

Other intangible assets include incremental and specific costs related to contracts in which customers undertake to remain with the Company for a specified period of time, and are amortised on a straight-line basis over the specified period.

This caption also includes the amount at which customer relations arising from the acquisition of R Cable (see note 5) have been recognised. These assets are measured at fair value and are amortised on a straight-line basis over their estimated useful lives of between 6 and 9 years.

e) Impairment

The Group evaluates and determines impairment losses and reversals of impairment losses on intangible assets based on the criteria described in note 3.5.

### 3.4. Property, plant and equipment

Property, plant and equipment are recognised at cost of acquisition or production, less accumulated depreciation and any recognised accumulated impairment losses.

The value of work performed by the entity and capitalised is calculated taking into account direct and indirect costs attributable to those assets.

Costs incurred to extend, modernise or improve property, plant and equipment are only recorded as an increase in the value of the asset when the capacity, productivity or useful life of the asset is increased and it is possible to ascertain or estimate the carrying amount of the assets that have been replaced in inventories.

Recurring maintenance costs are recognised in the consolidated income statement when incurred.

Property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives, based on the actual decline in value due to operation and use.

The estimated average useful lives of property, plant and equipment are as follows:

Buildings	50
Civil engineering	50
Cablings	18-40
Network equipment	10-18
Client equipment	2-15
Other installations, equipment and furniture	6-7
Other property, plant and equipment	5-8

The majority of property, plant and equipment reflects investments to roll-out the Company's telecommunications network throughout the Basque Country and Galicia.

The Company reviews the useful lives of the assets, as well as their consideration as under construction or operating, and makes any necessary adjustments at each reporting date. Nonetheless, based on the expected use of the Company's assets, their residual value is not estimated to be significant at the reporting date.

When the carrying amount of an asset is higher than its estimated recoverable amount, its value is immediately reduced to its recoverable amount in accordance with the criteria in note 3.5. Impairment losses, or reversals of impairment losses if the circumstances in which they were recognised no longer exist, are recognised as an expense or income, respectively, in the consolidated income statement.

Finance costs that are directly attributable to the acquisition or construction of assets which will not be available for use for a considerable length of time are included in the cost of the asset when the expenses related to the asset have been incurred, interest has been accrued and the steps necessary to prepare the assets for their intended use are being taken. Capitalisation of borrowing costs is suspended when construction of the assets is interrupted, except when the interruption is considered necessary to make the asset operational.

### **3.5. Impairment losses on non-financial assets**

The Group evaluates whether there are indications of possible impairment losses on non-financial assets subject to amortisation or depreciation to verify whether the carrying amount of these assets exceeds the recoverable amount. The recoverable amount is the higher of the fair value less costs to sell and the value in use. Nonetheless, the Group tests goodwill for impairment at least annually, irrespective of whether there is any indication of impairment.

Recoverable amount is determined for each individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit (CGU) to which the asset belongs.

Impairment losses for CGU's are allocated first to reduce the carrying amount of goodwill allocated to the unit and then to the other assets of the unit pro rata with their carrying amounts. The carrying amount of each asset may not be reduced below the highest of its fair value less costs of disposal, its value in use and zero.

At the end of each reporting period the Group assesses whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Impairment losses are only reversed if there has been a change in the estimates used to calculate the recoverable amount of the asset. Impairment of goodwill is not reversible.

Impairment losses are recognised in the consolidated income statement.

A reversal of impairment is recognised in the consolidated income statement. The increased carrying amount of an asset attributable to a reversal of impairment may not exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment been recognised.

A reversal of an impairment loss for a CGU is allocated to the non-current assets of each unit, except goodwill, pro rata with the carrying amounts of those assets. The carrying amount of an asset may not be increased above the lower of its recoverable amount and the carrying amount that would have been disclosed, net of amortisation or depreciation, had no impairment loss been recognised.

After an impairment loss or reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset is adjusted in future periods based on its new carrying amount.

However, if the specific circumstances of the assets indicate an irreversible loss, this is recognised directly in losses on the disposal of fixed assets in the consolidated income statement.

### **3.6. Inventories**

Inventories are initially measured at the lower of cost (whether cost of acquisition or production) and net realisable value, and any related impairment losses or reversals are recognised in the consolidated income statement.

Cost is determined using the weighted average cost method. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale.

### **3.7. Financial assets**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

These financial assets are initially carried at fair value, including directly attributable transaction costs, and subsequently measured at amortised cost, recognising accrued interest at the effective interest rate. Nevertheless, trade receivables falling due in less than one year are carried at their nominal amount on both initial recognition and subsequent measurement, provided that the effect of not discounting the cash flows is immaterial.

The impairment loss is calculated as the difference between the carrying amount of the asset and the present value of the estimated future cash flows. Impairment losses are recognised and reversed in consolidated profit or loss. Balances receivable are derecognised when they are no longer expected to be recovered.

A financial asset is derecognised from the consolidated balance sheet when all the risks and rewards of ownership are substantially transferred.

### **3.8. Cash and cash equivalents**

Cash and cash equivalents include cash on hand and demand deposits in financial institutions and other short-term, highly liquid investments with original maturity of less than three months.

### **3.9. Parent own shares**

The acquisition of equity instruments of the Parent by the Group is recognised separately at cost of acquisition as a reduction in equity, regardless of the reason for the purchase. No gain or loss is recognised on transactions involving own equity instruments.

The subsequent redemption of the Parent shares entails a capital reduction equivalent to the par value of the shares. Any positive or negative difference between the purchase price and the par value of the shares is debited or credited to reserves.

Transaction costs related to own equity instruments are accounted for as a reduction in equity, net of any tax effect.

### **3.10. Share-based payment transactions**

Services received in cash-settled share-based payment transactions which require compliance with a certain period of tenure, are recognised in the consolidated income statement during that period. These services are initially measured at the fair value of the liability at the date the requirements for their recognition are met.

The liability is subsequently measured until settlement at its fair value at each reporting date, and any changes in value during the year are taken to consolidated profit or loss. Changes in value that raise the provision are recognised with a charge to personnel expenses, whereas revaluation adjustments are recorded under finance costs.

### **3.11. Financial liabilities**

Financial liabilities are initially recognised at fair value, adjusted for directly attributable transaction costs, and subsequently carried at amortised cost using the effective interest method. Nevertheless, trade payables falling due in less than one year without a contractual interest rate are carried at their face value on both initial recognition and subsequent measurement, provided the effect of not discounting flows is not significant.

A financial liability, or part of a financial liability, is derecognised when the Group has complied with the attached obligation. Any difference between the carrying amount of the financial liability and the consideration given is taken to profit and loss.

### **3.12. Hedge accounting**

Derivative financial instruments which qualify for hedge accounting are initially measured at fair value, plus any transaction costs that are directly attributable to the acquisition.

At the inception of the hedge the Group formally designates and documents the hedging relationships and the objective and strategy for undertaking the hedges. Hedge accounting is only applicable when the hedge is expected to be highly effective at the inception of the hedge and throughout the period for which the hedge was designated. A hedge is considered to be highly effective if at inception and during its life, changes in fair value or cash flows attributable to the hedged risk are prospectively expected to be offset almost entirely by changes in the fair value or cash flows of the hedging instrument, and that, retrospectively, gains or losses on the hedging transaction have been within the range of 80% and 125% with respect to those of the hedged item.

The Group provisionally recognises the portion of the gain or loss on the measurement at fair value of a hedging instrument that is determined to be an effective hedge in other comprehensive income, which is then transferred to the consolidated income statement in the year or years in which the hedge affects profit or loss. Cash flows from the hedging instrument are recognised under the same consolidated income statement heading as the hedged item.

Hedge accounting is discontinued prospectively when the hedging instrument expires, is sold, is exercised, if the hedge no longer qualifies for hedge accounting or the Group revokes the designation. In these cases, the cumulative gain or loss on the hedging instrument that has been recognised in valuation adjustments is not recorded in profit or loss until the forecast transaction occurs.

### **3.13. Provisions and contingent liabilities**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

### **3.14. Employee benefits**

#### **a) Termination benefits**

Termination benefits are recognised at the earlier of when the Group can no longer withdraw an offer of those benefits and when it recognises any related restructuring costs.

For termination benefits payable as a result of an employee's decision to accept an offer of benefits, the time when the Group can no longer withdraw the offer of termination benefits is the earlier of when the employee accepts the offer and when a restriction on the Group's ability to withdraw the offer takes effect.

#### **b) Short-term employee benefits**

Short-term employee benefits comprise employee remuneration, other than termination benefits, that are expected to be settled in full before 12 months after the end of the reporting period in which the employees render the related services.

The Group recognises the expected cost of short-term employee benefits in the form of accumulating compensated absences when the employees render service that increases their entitlement to future compensated absences. In the case of non-accumulating compensated absences, the expense is recognised when the absences occur.

### **3.15. Revenue recognition**

The main revenues generated by the Group are those related to individual or combined offerings of telephone, Pay TV, broadband and mobile telephone services.

In the case of combined offerings, the need to individually treat the different components of the bundle is analysed in order to allocate the revenue to each component.

Fixed-line and mobile telephone revenue is recognised when the services are provided.

Revenue from fixed rates with predetermined talk times is recognised on a straight-line basis over the contractual period.

Regular charges for network use (telephone, internet and Pay TV services) are recognised in the consolidated income statement over the contractual period.

For amounts collected in advance in respect of prepaid mobile telephone services, the unused amount is recognised as a liability until it has been consumed or the contractual obligations cancelled.

Revenue from leased equipment and other services is recognised in the consolidated income statement when the service is rendered.

Revenue from the sale of equipment to customers is recognised when the risks and rewards of ownership have been transferred, which normally takes place when the asset is delivered.

### **3.16. Leases**

Leases in which the lessor retains substantially all the risks and rewards incidental to ownership are classified as operating leases. Lease payments under operating leases are recognised as an expense on a straight-line basis over the lease term.

### **3.17. Foreign currency transactions**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the transaction date. Foreign currency gains and losses resulting from the settlement of transactions and translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currency are recognised in the consolidated income statement.

### **3.18. Income tax**

The income tax expense or tax income is recognised in the consolidated income statement each year, calculated based on the pre-tax profits, adjusted for permanent differences with fiscal criteria. If the profit is associated with an income or expense recognised directly in equity, the tax expense or tax income is also recognised against equity.

Deferred tax assets and unused tax credits in respect of loss carryforwards are only capitalised when:

- their future realisation is considered probable;
- the temporary differences are related to investments in subsidiaries, associates and joint ventures providing the temporary differences will reverse in the foreseeable future and sufficient taxable income is expected to be generated against which the differences can be offset.

The Group recognises deferred tax liabilities in all cases except when:

- they arise from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable income.
- they are related to investments in subsidiaries, associates and interests in joint ventures over which the Group is able to control the timing of the reversal of the temporary difference and it is not probable that the temporary difference will reverse in the foreseeable future.

Tax credits in respect of all items, including loss carryforwards, are recognised at the tax rate prevailing at the end of the year they are generated, and adjusted, if modified, at the tax rate prevailing at the reporting date.

### **3.19. Environmental issues**

Expenses derived from protecting and improving the environment are recognised as an expense in the period in which they are incurred. Property, plant and equipment modified or acquired to minimise the environmental impact of its activity and protect and improve the environment are recognised as an increase in property, plant and equipment.

## NOTE 4.- Financial risk management

The Group's activities are exposed to credit risk, liquidity risk, and market risk, the latter of which includes currency and interest rate risk.

The Group uses financial risk evaluation and mitigation methods suited to its activity and scope of operations, which are sufficient to adequately manage risks.

A summary of the main risks affecting the Group, and the measures in place to mitigate their potential affect, is as follows:

### a) Credit risk

Credit risk is the risk of financial loss to which the Group is exposed in the event that a customer or counterparty to a financial instrument fails to discharge a contractual obligation. This risk is concentrated in receivables.

The Group considers customer credit risk to be mitigated by the application of different policies, and the high level of dispersion of receivables. Among the different policies and specific practices are the customer acceptance policy, continual monitoring of customer credit, which reduces the possibility of default on the main receivables, and collection management.

Cash and cash equivalents reflect the amounts available with financial institutions that have high credit ratings.

### b) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets. The Group's approach to managing liquidity risk is to ensure, as far as possible, that it has enough liquidity to settle its debts as they fall due, in both normal and stressed conditions, without incurring unacceptable losses or compromising its reputation.

The Group adjusts the maturities of its debts to its capacity to generate cash flows to settle them.

To do this, the Group has implemented a seven-year financing plan with annual reviews and regular analyses of its financial position, which includes long-term projections, together with daily monitoring of bank balances and transactions.

Although the Group's working capital, defined as the difference between current assets and current liabilities (maturing in less than 12 months in both cases), is negative, this is mainly because of the way the business operates, resulting in the average collection period being shorter than the average payment period, which is common practice in the sector in which the Group operates.

### c) Market risk, currency risk and interest rate risk

Market risk is the risk that changes in prices could affect the Group's revenue or the value of its financial instruments. The objective of managing market risk is to control exposure to this risk, within reasonable parameters, and optimise returns.



The Group's scope of operations barely exposes it to currency or price risks, which may arise from occasional purchases in foreign currency of insignificant amounts.

Interest rate risks arises on variable-rate loans from financial institutions and related parties, which expose the Group to fluctuations in future cash flows.

The Group regularly revises its interest rate hedging policy. Under this policy, the need to contract interest rate hedges is assessed.

The Group settles interest on a monthly basis, which allows it to closely monitor the performance of interest rates in the financial market.

For the year ended 31 December 2015, had interest rates risen by 100 basis points, with other variables remaining constant, consolidated profit (after tax) would have fallen by Euros 2,765 thousand (Euros 2,475 thousand for the year ended 31 December 2014).

## NOTE 5.- Business combinations

On 27 November 2015 the Company acquired a 30% interest in R Cable y Telecomunicaciones Galicia, S.A. and 100% of the share capital of Rede Brigantium, S. L., (hereinafter Rede Brigantium), the holder of the remaining 70% stake in R Cable. With these acquisitions, the Company directly or indirectly holds the entire share capital of R Cable (see note 1), making it one of the leading groups with convergent offerings in northern Spain. The combination of Euskaltel, S.A. and R Cable will result in better access to and bargaining power over products, services and content, sharing of systems and technologies, optimisation of contractual relations with suppliers and harmonisation of growth strategies.

The acquired business generated consolidated revenues and profit for the Group of Euros 20,966 thousand and Euros 456 thousand, respectively, between the acquisition date and the reporting date.

Had the acquisition taken place on 1 January 2015, the acquired business's contribution to consolidated revenues and profit for the year ended 31 December 2015 would have amounted to Euros 239,446 thousand and Euros 14,443 thousand, respectively.

Details of the calculation of goodwill are as follows:

	<u>Thousands of Euros</u>
Cash paid	894,497
Fair value of net assets acquired	<u>303,055</u>
Goodwill	<u><u>591,442</u></u>

Goodwill represents the value of the synergies that will arise from the combination of Euskaltel, S.A. and R Cable's businesses.

Costs related to the acquisition amounted to Euros 5,477 thousand and are recognised under other operating expenses in the consolidated income statement.

Details of the fair value of the main assets acquired are as follows:

<b>Assets</b>	
Brand	32,171
Customer relations	89,472
Other intangible assets	33,462
Property, plant and equipment	536,951
Current assets	107,880
Other assets	3,139
Deferred tax assets	12,432
	<u>815,507</u>
<b>Liabilities</b>	
Non-current payables	360,298
Current liabilities	71,981
Other liabilities	2,960
Deferred tax liabilities	76,790
	<u>512,029</u>
 Total net assets	 <u>303,478</u>
 Non-controlling interests	 <u>(423)</u>
Total net assets acquired	<u>303,055</u>
Cash paid	894,497
Cash and cash equivalents of the acquiree	75,273
Cash outflow for the acquisition	<u>819,224</u>

The main assets and liabilities at the date control was taken of R Cable y Telecomunicaciones Galicia, S.A.'s operations were calculated as follows:

- Brand: The fair value of this intangible asset was calculated by applying the relief-from-royalty method, the most significant parameters of which were a royalty of 1.25%, based on royalties observed in the sector, a discount rate of 9.6% and a perpetuity growth rate of 1.5%.
- Customer relations: these were measured using the Multi Excess Earnings Method (MEEM), which calculates the value of an asset as the sum of the excess future earnings discounted to their present value, after considering supporting asset charges. The key parameters used in measuring this intangible asset were the churn rate, the EBITDA attributable to each type of customer and a discount rate of 8.5%.
- Property, plant and equipment: this was measured using the depreciated replacement cost method.
- Non-current loans: these were measured based on the cost of financing comparable transactions taking into account the Group's refinancing transactions around the time of the R Cable takeover.

It has only been possible to determine the business combination provisionally as the fair values allocated as a result of the proximity of the transaction to year end have not yet been definitively reviewed. This valuation is being performed with the assistance of an independent expert. Consequently, the net identifiable assets have been recognised initially at their provisional amounts. Any adjustments made during the valuation period (which will not exceed the legally established period of twelve months from the date of acquisition) will be recognised as if they had been known at the acquisition date.

Goodwill has been allocated to the two cash-generating units comprising the Group's assets, located in the Basque Country and Galicia. An amount of Euros 32,171 thousand attributed to the valuation of the brand that arose on the acquisition of R Cable Telecomunicaciones Galicia, S.A., whose useful life is deemed indefinite, has been allocated to the Galicia CGU as it is a consolidated brand in that region. Consequently, on the valuation date it has not been possible to set a time limit for the period over which net cash flows are expected to be obtained.

For the purposes of impairment analysis, the fair value of the goodwill and the intangible assets of the brand have been determined based on their recoverable amount less costs to sell. In accordance with prevailing legislation, the best evidence of fair value less costs to sell of recently-acquired assets is the price paid in a transaction between independent parties adjusted for costs to sell and any changes in market conditions between the transaction date and the measurement date. In this regard, the recoverable amount less costs to sell has been determined considering the amounts paid on the date R Cable was acquired. (27 November 2015). No situations have arisen up to the date the consolidated annual accounts were authorised for issue that would indicate the need for any valuation adjustments.

## NOTE 6.- Intangible assets

Details of intangible assets and movement are as follows:

	31.12.14	Additions	Business combinations	Disposals	Transfers	31.12.15
<b>Cost</b>						
Industrial property	103	72	1,628	-	-	1,803
Computer software	58,617	9,558	21,957	(41)	1,057	91,148
Licences	2,674	-	3,219	-	-	5,893
Brands	-	-	32,171	-	-	32,171
Other intangible assets	10,764	10,723	96,130	(8,590)	(1,057)	107,970
	<u>72,158</u>	<u>20,353</u>	<u>155,105</u>	<u>(8,631)</u>	<u>-</u>	<u>238,985</u>
<b>Accumulated amortisation</b>						
Industrial property	(87)	(41)	-	-	-	(128)
Computer software	(41,025)	(7,404)	-	10	-	(48,419)
Licences	-	(91)	-	-	-	(91)
Brands	-	-	-	-	-	-
Other intangible assets	(5,820)	(8,700)	-	8,490	-	(6,030)
	<u>(46,932)</u>	<u>(16,236)</u>	<u>-</u>	<u>8,500</u>	<u>-</u>	<u>(54,668)</u>
<b>Impairment</b>	<u>(2,674)</u>	<u>-</u>	<u>-</u>	<u>2,674</u>	<u>-</u>	<u>-</u>
<b>Carrying amount</b>	<u>22,552</u>	<u>4,117</u>	<u>155,105</u>	<u>2,543</u>	<u>-</u>	<u>184,317</u>
	31.12.13	Additions	Business combinations	Disposals	Transfers	31.12.14
<b>Cost</b>						
Industrial property	97	6	-	-	-	103
Computer software	50,907	7,895	-	(185)	-	58,617
Licences	2,674	-	-	-	-	2,674
Other intangible assets	10,330	7,885	-	(7,451)	-	10,764
	<u>64,008</u>	<u>15,786</u>	<u>-</u>	<u>(7,636)</u>	<u>-</u>	<u>72,158</u>
<b>Accumulated amortisation</b>						
Industrial property	(73)	(14)	-	-	-	(87)
Computer software	(35,886)	(5,324)	-	185	-	(41,025)
Licences	-	-	-	-	-	-
Other intangible assets	(4,993)	(8,278)	-	7,451	-	(5,820)
	<u>(40,952)</u>	<u>(13,616)</u>	<u>-</u>	<u>7,636</u>	<u>-</u>	<u>(46,932)</u>
<b>Impairment</b>	<u>(2,674)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,674)</u>
<b>Carrying amount</b>	<u>20,382</u>	<u>2,170</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>22,552</u>

In 2015 the Company reversed the impairment of the administrative concession as a result of the decision to roll-out the 4G network.

The cost of fully amortised intangible assets in use at 31 December 2015 totals Euros 31,332 thousand (Euros 27,636 thousand at 31 December 2014).

The Group has contracted sufficient insurance policies to cover the risks to which its intangible assets are exposed.

At 31 December 2015 Group personnel expenses totalling Euros 2,592 thousand (Euros 3,206 thousand at 31 December 2014) have been capitalised as intangible assets.

## NOTE 7.- Property, plant and equipment

Details of property, plant and equipment and movement in 2015 are as follows:

	31.12.14	Additions	Business combinations	Disposals	Transfers	31.12.15
<b>Cost</b>						
Land and buildings	133,757	2	22,345	-	165	156,269
Civil engineering	259,654	426	231,762	-	2,466	494,308
Cablings	271,972	-	79,214	-	1,829	353,015
Network equipment	355,260	1,108	112,038	(34)	7,111	475,483
Client equipment	262,549	-	29,079	-	13,435	305,063
Other installations, equipment and furniture	147,241	28	53,969	(17)	295	201,516
Under construction	6,354	30,715	6,844	-	(25,914)	17,999
Other property, plant and equipment	21,990	38	1,700	(275)	613	24,066
	<u>1,458,777</u>	<u>32,317</u>	<u>536,951</u>	<u>(326)</u>	<u>-</u>	<u>2,027,719</u>
<b>Accumulated depreciation</b>						
Land and buildings	(20,498)	(4,736)	-	-	-	(25,234)
Civil engineering	(57,941)	(5,834)	-	-	-	(63,775)
Cablings	(134,572)	(10,231)	-	-	-	(144,803)
Network equipment	(242,192)	(23,088)	-	26	-	(265,254)
Client equipment	(168,034)	(14,188)	-	-	-	(182,222)
Other installations, equipment and furniture	(74,717)	(10,055)	-	8	-	(84,764)
Under construction	(17,086)	(1,078)	-	275	-	(17,889)
	<u>(715,040)</u>	<u>(69,210)</u>	<u>-</u>	<u>309</u>	<u>-</u>	<u>(783,941)</u>
<b>Carrying amount</b>	<u>743,737</u>	<u>(36,893)</u>	<u>536,951</u>	<u>(17)</u>	<u>-</u>	<u>1,243,778</u>

Details of property, plant and equipment and movement in 2014 are as follows:

	31.12.13	Additions	Business combinations	Disposals	Transfers	31.12.14
<b>Cost</b>						
Land and buildings	133,576	-	-	(9)	190	133,757
Civil engineering	258,302	-	-	-	1,352	259,654
Cablings	268,876	-	-	(4)	3,101	271,973
Network equipment	345,903	-	-	(669)	10,026	355,260
Client equipment	251,640	-	-	(52)	10,960	262,548
Other installations, equipment and furniture	145,702	-	-	(193)	1,732	147,241
Under construction	10,415	26,424	-	(2,629)	(27,856)	6,354
Other property, plant and equipment	25,585	-	-	(4,090)	495	21,990
	<u>1,439,999</u>	<u>26,424</u>	<u>-</u>	<u>(7,646)</u>	<u>-</u>	<u>1,458,777</u>
<b>Accumulated depreciation</b>						
Land and buildings	(15,842)	(4,658)	-	2	-	(20,498)
Civil engineering	(52,614)	(5,327)	-	-	-	(57,941)
Cablings	(123,877)	(10,696)	-	1	-	(134,572)
Network equipment	(219,703)	(23,103)	-	614	-	(242,192)
Client equipment	(154,446)	(13,599)	-	11	-	(168,034)
Other installations, equipment and furniture	(65,557)	(9,353)	-	193	-	(74,717)
Other property, plant and equipment	(19,962)	(1,156)	-	4,032	-	(17,086)
	<u>(652,001)</u>	<u>(67,892)</u>	<u>-</u>	<u>4,853</u>	<u>-</u>	<u>(715,040)</u>
<b>Carrying amount</b>	<u>787,998</u>	<u>(41,468)</u>	<u>-</u>	<u>(2,793)</u>	<u>-</u>	<u>743,737</u>

During the year ended 31 December 2015 borrowing costs and internal expenses amounting to Euros 230 thousand and Euros 3,202 thousand, respectively, (Euros 215 thousand and Euros 2,515 thousand, respectively, in 2014) have been capitalised.

The cost of fully depreciated property, plant and equipment in use at 31 December 2015 is Euros 280,902 thousand (Euros 248,567 thousand at 31 December 2014).

At 31 December 2015 and 2014, sufficient insurance policies have been taken out to cover the risks to which property, plant and equipment are exposed.

## NOTE 8.- Financial assets

### 8.1. Classification by category

Details of the Group's financial assets are as follows:

	Loans and receivables		Available-for-sale financial assets		Total	
	31.12.15	31.12.14	31.12.15	31.12.14	31.12.15	31.12.14
<b>Non-current</b>						
Equity instruments	-	3	1,816	855	1,816	858
Loans extended	5,179	5,196			5,179	5,196
Other non-current assets	521	278	-	-	521	278
	<u>5,700</u>	<u>5,477</u>	<u>1,816</u>	<u>855</u>	<u>7,516</u>	<u>6,332</u>
<b>Current</b>						
Trade receivables	63,906	39,329	-	-	63,906	39,329
Investments	532	3,991	-	-	532	3,991
Cash and cash equivalents	23,371	10,650	-	-	23,371	10,650
	<u>87,809</u>	<u>53,970</u>	<u>-</u>	<u>-</u>	<u>87,809</u>	<u>53,970</u>

The carrying amount of financial assets does not differ significantly from their fair value.

### 8.2. Impairment

Details of the ageing of unimpaired balances past due are as follows:

	31.12.15	31.12.14
<b>Past due</b>		
From 0 to 30 days	2,642	3,445
From 31 to 90 days	1,125	959
From 91 to 180 days	1,655	274
From 181 to 365 days	1,833	548
More than 365 days	-	-
	<u>7,255</u>	<u>5,226</u>
<b>Not past due</b>		
Invoiced	25,623	12,362
Pending invoice	31,028	21,741
	<u>56,651</u>	<u>34,103</u>
	<u>63,906</u>	<u>39,329</u>

Details of the provision for impairment of trade and other receivables is as follows:

	31.12.15	31.12.14
Gross balance	76,127	53,024
Impairment	(12,221)	(13,695)
	<u>63,906</u>	<u>39,329</u>

Movement in the provision for impairment of trade and other receivables is as follows:

	31.12.15	31.12.14
Opening balance	13,695	16,383
Charge	2,328	2,014
Write-offs	(3,802)	(4,702)
Closing balance	<u>12,221</u>	<u>13,695</u>

## NOTE 9.- Inventories

Details are as follows:

	31.12.15	31.12.14
Terminals and equipment		
Mobile telephones	1,353	1,421
Decoders	328	206
Material for subcontractors	1,648	1,716
Other inventories	1,234	80
<b>Total gross value</b>	<u>4,563</u>	<u>3,423</u>
Impairment	(1,031)	(1,110)
<b>Total</b>	<u>3,532</u>	<u>2,313</u>

The Group has taken out sufficient insurance policies to cover the risks to which its inventories are exposed.

## NOTE 10.- Equity

### 10.1. Share capital

At 31 December 2014 subscribed capital was represented by 6,326,890 registered shares of Euros 60 par value each, with the same rights and obligations, and subscribed and fully paid.

At their annual general meeting held on 1 June 2015, the shareholders decided to split the number of outstanding shares in the proportion of 20 new shares for each old share, and reduce their par value from Euros 60 per share to Euros 3 per share. As a result, the number of new shares outstanding amounted to 126,537,800 of Euros 3 par value each. At the aforementioned annual general meeting, it was also decided to modify the system of representation of the shares by converting the former registered shares into book entries.



On 16 June 2015, and in the context of the Company's admission to trading, the shareholders of Euskaltel, S.A. agreed to make an initial public offering (IPO) of 80,408,930 shares, representing 63.55% of share capital, increasable to a maximum of 88,449,823 shares, representing 69.90% of share capital, if the purchase option (greenshoe) extended by the selling shareholders to the global coordinators, and aimed solely at qualified investors, were exercised. On the same date, the shareholders authorised the board of directors to carry out a derivative acquisition of own shares until the admission to trading date.

The derivative acquisition of own shares involved awarding shares free of charge to Company employees in an amount equivalent to two salary payments, and reinvesting 50% of the remuneration, net of withholdings, received by beneficiaries of the incentive plans as they reach maturity, in shares (see note 11). The reinvestment in shares was not contemplated in the agreements initially reached with the beneficiaries, rather, this was done voluntarily at their own request as a demonstration of their commitment to the Company. The awarding of shares free of charge to Euskaltel, S.A. employees was a unilateral decision taken by its shareholders after the annual accounts for 2014 were approved.

Details of own shares acquired in relation to the transactions described above are as follows:

	Number of shares	% ownership	Price in Euros	Amount
Earmarked for:				
Share plan beneficiaries	1,160,040	0.92%	9.50	11,020,380
Employees	<u>282,085</u>	<u>0.22%</u>	9.50	<u>2,679,808</u>
	<u><b>1,442,125</b></u>	<u><b>1.14%</b></u>		<u><b>13,700,188</b></u>

Own shares were acquired within the framework of the IPO agreed by the Company's shareholders, and purchased under the same terms as the remaining investors. Shares acquired by the Company and immediately paid for by the plan beneficiaries amounted to Euros 11,020 thousand.

Own shares awarded free of charge to employees were charged to personnel expenses (see note 14.4).

At their annual general meeting held on 12 November 2015, the shareholders authorised the board of directors to increase share capital within 5 years up to half of the share capital existing at the agreement date, with the power to exclude the preferential subscription right up to a limit of 20% of capital at the time of delegation.

By virtue of this authorisation, the board of directors increased share capital by Euros 75,923 through the issue of 25,307,560 new shares of Euros 3 par value each, with exclusion of the preferential subscription right. This capital increase, which was used to partially finance the acquisition of R Cable, was subscribed in full at an issue of Euros 10.08 per share. The impact of this transaction on the Company's equity is as follows:

	Number of shares	Share capital	Share premium	Total
Capital increase	25,307,560	75,923	179,178	255,101
Share issue costs			4,733	4,733
Tax effect			(1,325)	(1,325)
			3,408	3,408
			<b>175,770</b>	<b>251,693</b>

The new shares were floated on the Barcelona, Bilbao, Madrid and Valencia stock exchanges on 26 November 2015.

Details of shareholders at 31 December 2015 are as follows:

	31.12.2015		31.12.2014	
	Number of shares	% ownership	Number of shares	% ownership
Kutxabank Group (*)	38,087,977	25.08%	3,157,118	49.90%
Corporación Financiera Alba, S.A. (**)	15,186,055	10.00%	-	-
Rest	98,571,328	64.92%	3,169,772	50.10%
	<b>151,845,360</b>	<b>100.00%</b>	<b>6,326,890</b>	<b>100.00%</b>

(\*) Includes the shares of Kutxabank, S.A. and Araba Gertu, S.A.

(\*\*) Through its solely-owned subsidiary Alba Europe, S.a.r.l

## 10.2. Capital management

The Group manages its capital with the aim of safeguarding its ability to continue operating as a going concern, so as to continue providing shareholder remuneration and benefiting other stakeholders, while maintaining an optimum capital structure to reduce the cost of capital.

To maintain and adjust the capital structure, the Group can adjust the amount of dividends payable to shareholders, reimburse capital, issue shares or dispose of assets to reduce debt.

The Group controls its capital/debt structure based on the Financial Debt:EBITDA ratio. The Group considers a ratio of between 3:1 and 4:1 to be an appropriate balance and an optimised cost of the resources employed for its activity. At present, and as a result of the recent acquisition described in note 5, the Group's ratios are above those mentioned, although cash flows expected to be generated by the Group's businesses will allow the optimum structure to be achieved in the medium term.

### 10.3. Share premium

In accordance with prevailing legislation, the share premium is a freely-distributable reserve, provided that equity exceeds share capital.

### 10.4. Retained earnings

Details of this caption are as follows:

	31.12.15	31.12.14
Reserves		
Legal reserve	36,967	32,534
Voluntary reserves	(3,351)	129,818
Unused profits	-	(6,101)
Profit for the year	7,241	36,783
	<u>40,857</u>	<u>193,034</u>

The legal reserve has been appropriated in compliance with article 274 of the Spanish Companies Act, which requires that companies transfer 10% of profits for the year to a legal reserve until this reserve reaches an amount equal to 20% of share capital. Until the legal reserve exceeds this limit, it may only be applied to offset losses if no other reserves are available.

### 10.5. Distribution of extraordinary dividends

At the annual general meeting held on 26 June 2015, the shareholders agreed to distribute an extraordinary dividend:

<b>Basis of application</b>	
Profit for the year	36,783
Voluntary reserves	119,286
Share premium	50,964
	<u>207,033</u>
<b>Distribution</b>	
Dividends (Euros 1.64 per share)	<u>207,033</u>

The proposed distribution of profit for the year ended 31 December 2015 is as follows:

Legal reserve	678
Other reserves	6,103
	<u>6,781</u>

### 10.6. Own shares

At 31 December 2015, the Group held 139,806 own shares acquired at a weighted average cost of Euros 10.22 per share.

## 10.7. Earnings per share

Basic earnings per share are calculated by dividing the profit for the year attributable to equity holders of the Parent by the weighted average number of ordinary shares outstanding during the year, excluding own shares.

Basic earnings per share are calculated as follows:

	2015	2014
Profit for the year attributable to the Parent	7,241	36,783
Weighted average number of ordinary shares outstanding	128,989,014	126,537,800
Basic earnings per share	0.06	0.29

The weighted average number of ordinary shares outstanding is determined as follows:

	2015	2014
Ordinary shares outstanding at 1 January (1)	126,537,800	126,537,800
Effect of own shares	(114,210)	-
Effect of capital increase	2,565,424	-
	<b>128,989,014</b>	<b>126,537,800</b>

(1) Once the effect of the capital split has been considered for comparative purposes

## NOTE 11.- Share-based payment transactions

In 2014 and 2013 the Group awarded certain incentives to members of the management committee, board members and other key employees. These incentives took the form of investment plans (hereinafter, the plans). The plan participants were, in economic terms, equivalent to shareholders, making a profit if the value of the Company rose, and assuming the risk of losing their investment if the value of the Company fell. The plans were aimed at attracting the involvement and support of a motivated management team focused on achieving the Company's business plan, and at motivating and retaining those it considered key to the Company's operations.

The plans gave participants a share in any rise in value of the Company's shares from the date the plan was launched to 31 December 2025, with the possibility of extending the plan for a further 5 years at the request of the board of directors. However, the plan's maturity would be brought forward if, among other circumstances, the Company was floated on the stock exchange.

Beneficiaries' participation in the plan was conditional on payment of certain amounts in respect of an initial price of Euros 4,336 thousand, partially financed through loans that accrued interest at the legal rate. At 31 December 2014, loans extended in relation to share-based payments amounted to Euros 3,132 thousand, of which Euros 2,686 thousand was recognised under non-current investments.

The Company was floated on 1 July 2015, an event not foreseen at the 2014 reporting date and which was decided by the board of directors after the close of the 2014 financial year. Consequently, all commitments had to be recognised, and the deadlines for settling the obligations were reduced significantly.

Movement in incentive plan liabilities, which are recognised under non-current payables, is as follows:

	31.12.15	31.12.14
Balances at 01.01	12,168	2,837
Charges (note 14.5)	30,705	7,832
Contributions	-	1,499
Loan repayments	(3,132)	-
Payments	(39,741)	-
Balances at 31.12	-	12,168

## NOTE 12.- Financial liabilities

### 12.1. Classification by category

Details of financial liabilities classified by category are as follows:

	Debts and payables		Financial liabilities at fair value		Total	
	31.12.15	31.12.14	31.12.15	31.12.14	31.12.15	31.12.14
<b>Non-current</b>						
Loans received	1,352,922	194,517	-	-	1,352,922	194,517
Finance leases	87	-	-	-	87	-
Derivatives	-	-	-	6,226	-	6,226
Other financial liabilities	8,007	12,206	-	-	8,007	12,206
	<u>1,361,016</u>	<u>206,723</u>	<u>-</u>	<u>6,226</u>	<u>1,361,016</u>	<u>212,949</u>
					0	
<b>Current</b>						
Loans received	1,130	48,819	-	-	1,130	48,819
Finance leases	101	-	-	-	101	-
Other liabilities	616	387	-	-	616	387
Suppliers	85,857	38,670	-	-	85,857	38,670
Asset purchase payables	35,686	20,072	-	-	35,686	20,072
Salaries payable	5,339	3,683	-	-	5,339	3,683
	<u>128,729</u>	<u>111,631</u>	<u>-</u>	<u>-</u>	<u>128,729</u>	<u>111,631</u>

The Group was extended a series of loans in prior years which fall due between January 2016 and June 2020. These loans are pegged to Euribor plus a spread. In order to mitigate the variability of interest payments, the Company contracted financial swaps for an accumulated notional of Euros 150,000 thousand, with a fair value of Euros 6,226 thousand at 31 December 2014.

Average interest accrued on loans extended in 2007 was 2.70%, and 5.21% on financing received in 2012 and 2013.

As a result of the agreements reached during the stock flotation process, the Company negotiated two loans of Euros 235 million each (tranches A-1 and B-1) and a revolving credit facility of Euros 30 million to repay loans extended in prior years early, finance the extraordinary dividend referred to in note 10.5 and cover the expenses related to the admission to trading of the Company's shares. At the 2015 reporting date, no amount has been drawn down from the revolving credit facility.

For the acquisition of R Cable (see note 1), the Company borrowed two additional tranches (tranches A-2 and B-2) of Euros 300 million each, and an institutional loan (tranche B-3), underwritten by four financial institutions, also for Euros 300 million.

Interest on the new financing is pegged to Euribor plus a spread calculated by dividing net consolidated debt by consolidated EBITDA (the coefficient), both of which are defined in the loan clauses. Early repayment of the loans may be demanded if the coefficient exceeds the parameters established. Early repayment of the loan may also be demanded if there is a change in control, understood as the acquisition of more than 50% of shares with voting rights.

A summary of the main characteristics of the loans at the reporting date are as follows:

Tranche	Interest	Nominal	Maturity
A-1	2.500%	235,000	30-06-21
B-1	3.175%	235,000	30-06-22
A-2	2.500%	300,000	30-06-21
B-2	3.175%	300,000	30-06-22
B-3	4.750%	300,000	27-11-22
Credit facility	(a)	30,000	30-06-22

(a) *Not drawn down at year end*

Tranches B-1, B-2 and B-3 are repayable in a single sum as they fall due. Tranches A-1 and A-2 are repayable according to the following schedule:

	No. of six-month periods	(1)
<b>Six-monthly maturity</b>		
Period 30-06-17 to 30-06-19	4	5%
Period 30-06-19 to 30-12-19	2	10%
Period 30-06-20 to 30-12-20	2	15%
30 June 2021	1	30%

(1) *Repayment percentage calculated based on the nominal of the loans repaid on the last day of each six-month period included in the period.*

Details of the maturities of non-current loans with financial institutions are as follows:

2 years	3 years	4 years	5 years	> 5 years	Total
<u>97,070</u>	<u>94,663</u>	<u>145,789</u>	<u>192,209</u>	<u>1,043,262</u>	<u>1,572,993</u>

The Company may not distribute extraordinary dividends or redeem own shares in its own share portfolio if the coefficient exceeds 4 after the extraordinary dividend distribution. However, the financing contract stipulates that there shall be no restrictions on the payment of dividends with profit from ordinary activities.

When the financing became available, the Company signed pledges on the shares in Rede Brigantium and R Cable. It also signed a pledge on the shares of a potential corporate restructuring, or alternatively, on the Company's network.

The fair values of loans and payables do not differ significantly from their carrying amount. The fair value is calculated based on cash flows discounted at a rate pegged to the effective interest rate for borrowings.

## 12.2. Suppliers

Details of the average payment period referred to in the Spanish Institute of Accounting and Auditing's Resolution of 29 January 2016 are as follows:

	2015
Average supplier payment period (in days)	41.08
Transactions paid ratio	46.83
Transactions payable ratio	35.60
Total payments made (thousands of Euros)	253,377
Total payments payable (thousands of Euros)	104,832

The average payment period is the time between delivery of the goods or provision of the services by the supplier and payment of the transaction in accordance with the methodology described in article 5 of the Resolution. According to the Resolution, disclosure of comparative balances is not required in the notes to the annual accounts in the first year of mandatory application.

## NOTE 13.- Taxes

### 13.1. Balances with public entities

At 31 December 2015 and 2014 balances with public entities are as follows:

	2015	2014
Value added tax	3,390	4,145
Social Security	641	390
Withholdings and payments on account	4,141	386
Other liabilities	940	533
	<u>9,112</u>	<u>5,454</u>

The Company has open to inspection all main applicable taxes for the years still open to inspection. The subsidiary R Cable has open to inspection all applicable taxes for the past four years, except for income tax (since 2013).

### 13.2. Income tax

Details of income tax recognised in the income statement are as follows:

	2015	2014
Current expense		
Present year	1,901	-
Adjustments	24	(53)
Deferred expense		
Source and reversal of temporary differences	1,916	13,205
Prior year adjustments	(647)	-
Change in deductions	117	-
Taxable income	<u>3,311</u>	<u>13,152</u>



The effective tax rate has been calculated as follows:

	2015		2014	
Income and expenses for the period		10,548		49,935
Tax	28.0%	2,953	28%	13,982
Permanent differences		1,278		26
Prior year adjustments		(647)		(115)
Deductions for the current year		(263)		(741)
Other adjustments		(10)		
	31.4%	3,311	26.3%	13,152

Details of income tax recognised in reserves and other comprehensive income are as follows:

	2015			2014		
	Before taxes	Taxes	Net	Before taxes	Taxes	Net
<b>Reserves</b>						
Share issue costs	(4,733)	1,325	(3,408)	-	-	-
<b>Other comprehensive income</b>						
Hedging transactions	6,226	(1,743)	4,483	(5,425)	1,519	3,906

Details of deferred taxes at 31 December 2014 are as follows:

	31.12.13	Source	Reversal	31.12.14
<b>Deferred tax assets</b>				
Provision for bad debts	204	133	-	337
Share-based bonus plan	-	2,193	-	2,193
Restructuring provision	513	-	(513)	-
Financial liabilities	-	-	-	-
Property, plant and equipment	-	-	-	-
Intangible assets	-	-	-	-
Hedging transactions	249	1,492	-	1,741
Other assets	1,085	259	(234)	1,110
	2,051	4,077	(747)	5,381
Tax loss carryforwards	21,194	-	(12,358)	8,836
Deductions on tax due	137,388	-	(605)	136,783
	160,633	4,077	(13,710)	151,000
<b>Deferred tax liabilities</b>				
Financial liabilities	-	-	-	-
Property, plant and equipment	-	-	-	-
Intangible assets	-	-	-	-
Grants	-	-	-	-
Free depreciation	-	-	-	-
Sales in instalments	-	(2,079)	-	(2,079)
Other	-	-	-	-
	160,633	1,998	(13,710)	148,921

Details of deferred taxes at 31 December 2015 are as follows:

	31.12.14	Source	Reversal	Business combinations	Other	31.12.15
<b>Deferred tax assets</b>						
Provision for bad debts	337	-	(51)	-	-	286
Share-based bonus plan	2,193	-	(2,193)	-	-	-
Restructuring provision	-	-	-	-	-	-
Financial liabilities	-	-	-	-	-	-
Property, plant and equipment	-	-	-	8,718	-	8,718
Intangible assets	-	-	(49)	1,645	-	1,596
Hedging transactions	1,741	-	(1,741)	-	-	-
Other assets	1,110	4	(135)	(73)	(860)	46
	5,381	4	(4,169)	10,290	(860)	10,646
Tax loss carryforwards	8,836	-	-	-	(1,626)	7,210
Deductions on tax due	136,783	142	(258)	2,142	1,054	139,863
	<b>151,000</b>	<b>146</b>	<b>(4,427)</b>	<b>12,432</b>	<b>(1,432)</b>	<b>157,719</b>
<b>Deferred tax liabilities</b>						
Financial liabilities	-	-	-	(412)	-	(412)
Property, plant and equipment	-	-	72	(20,646)	-	(20,505)
Intangible assets	-	-	268	(31,852)	-	(31,584)
Grants	-	-	168	(11,320)	-	(11,152)
Free depreciation	-	-	-	(12,112)	-	(11,721)
Sales in instalments	(2,079)	-	-	-	2,079	-
Other	-	-	-	(448)	-	(908)
	<b>(2,079)</b>	<b>-</b>	<b>508</b>	<b>(76,790)</b>	<b>2,079</b>	<b>(76,282)</b>
	<b>148,921</b>	<b>146</b>	<b>(3,919)</b>	<b>(64,358)</b>	<b>647</b>	<b>81,437</b>

Other corresponds to differences between estimated income tax and income tax declared.

Details of tax loss carryforwards and unused deductions are as follows:

	Taxable income	Deductions	Applicable
<b>Deductions prior to 01.01.14</b>	75,662	141,517	
Applied in 2014	(49,907)	(791)	
Applied in 2015	-	(116)	
	25,755	140,610	2028
Generated in 2014 and not applied	-	200	2029
Generated in 2014 and not applied	-	2,204	2030
Generated in 2015 and not applied	-	98	No limit
	<b>25,755</b>	<b>143,112</b>	

Euros 139,863 thousand of the aforementioned deductions have been capitalised at 31 December 2015 (Euros 136,783 thousand at 31 December 2014). The Company has capitalised tax loss carryforwards of Euros 25,755 thousand which were generated in 2011. The Company has no unrecognised tax loss carryforwards.

Except for an amount of Euros 4,071 thousand, the recovery period for unused deductions exceeds twelve months. The Company expects to apply tax loss carryforwards in its 2016 income tax return.

The capitalisation of tax credits is based on annual recoverability analyses carried out by the Group. The business plans of the respective companies included therein show that the Company will have sufficient future taxable income against which tax credits capitalised at year end can be utilised.

## NOTE 14.- Income and expenses

### 14.1. Revenues

The activity of the companies comprising the Group primarily include: the provision of combined broadband, Pay TV, mobile and fixed-line telephone services to residential customers, freelancers ("Small Office / Home Office - SOHOs"), small and medium-sized enterprises (SMEs), large accounts (including the public sector) and the wholesale market. These transactions constitute the Group's only segment of activity.

For internal management purposes, the Group differentiates between the following types of customers:

- Residential
- Business
- Wholesale
- Other

Details of revenues by type of customer are as follows:

	2015	2014
Residential	215,769	195,700
Business		
SOHOs	40,345	35,961
SMEs	18,926	18,537
Large accounts	40,114	38,884
Wholesale and other	25,445	25,221
Other	8,884	6,858
<b>Total</b>	<b>349,483</b>	<b>321,161</b>
Work performed by the entity and capitalised	(5,793)	(5,721)
Other operating income	(431)	(331)
<b>Revenues</b>	<b>343,259</b>	<b>315,109</b>

#### Residential

The Group offers customers in this category a combination of fixed-line and mobile telecommunication services, as well as other added-value services which it renders through its fibre optic network and the virtual mobile operator agreement. These customers receive combined offers of broadband access, Pay TV and fixed-line and mobile telephone services which are billed as a bundle at competitive prices.

## **Business**

Customers in this category - SOHOs, SMEs and large accounts, including the public sector - also receive fixed-line and mobile telecommunication services. In the case of SMEs and large accounts, our sales team is able to offer integrated, tailor-made services to financial institutions, large companies, healthcare providers and public entities.

- SOHOs: We have a specific commercial package for these types of customers, which include businesses with less than 10 employees. The services we provide include technical support, online support and electronic mail. As in the residential segment, we offer a wide range of combined packages such as broadband access, Pay TV and fixed-line and mobile telephone.
- SMEs: We offer a broad array of solutions adapted to businesses with between 10 and 40 employees. Our services include broadband access with speeds of up to 350 Mbps, symmetrical fibre access with speeds of up to 1 Gbps, MPLS access, fixed-line/mobile convergence, IP Switch and advanced IT services.
- Large accounts: Our large accounts include public sector customers and large companies. Our large accounts require technically complex solutions that demand tailor-made responses, including fibre access with speeds of up to 1 Gbps, MPLS access, fixed-line/mobile convergence, IP Switch, cloud firewalls and virtual data centres. We offer these types of services through a dedicated sales team that includes engineers who participate in the life cycle of the project (pre-sales, implementation and after sales service).

## **Wholesale**

We offer communication services including line access, and voice and data services to other operators in the telecommunications sector which use our infrastructure and installations for providing services to their customers. Part of the revenues generated in the wholesale market come from the Group's main direct competitors, to which we provide services such as SDH (Synchronous Digital Hierarchy) line access, Ethernet and Dark Fibre technologies, voice services (which allow distributors to complete the termination of calls originating or ending in our territory) and enabling services, which are based on our BSS networks and mobile backhaul network. We also offer services related to the placement and resale of voice services. Finally, as a result of the agreements with the Catalonia Automobile Association (RACC) we offer mobile telephone services in this region under the brand "RACC Mòvil".

## **Other**

This corresponds to the sale of electronic material and equipment to third parties which provide installation services.

## 14.2. Supplies

Details are as follows:

	2015	2014
<b>Merchandise used</b>		
Purchases	21,600	18,898
Change in inventories	444	886
	<u>22,044</u>	<u>19,784</u>
<b>Subcontracted work</b>		
Interconnection expenses	45,237	41,501
Other supplies	10,018	11,236
	<u>55,255</u>	<u>52,737</u>
<b>Impairment of merchandise</b>	(79)	(997)
	<u><u>77,220</u></u>	<u><u>71,524</u></u>

## 14.3. Personnel expenses

Details are as follows:

	2015	2014
Salaries and wages	20,323	24,352
Extraordinary personnel remuneration (note 2)	3,365	-
Employee benefits expense (other employee benefits expense)	4,905	5,966
Total	<u><u>28,593</u></u>	<u><u>30,318</u></u>

Extraordinary personnel remuneration includes an amount of Euros 2,680 thousand in share-based bonuses (see note 10.1).

The average headcount, distributed by category, is as follows:

	2015	2014
Senior management	34	35
Management	37	41
Other professionals	291	424
	<u><u>362</u></u>	<u><u>500</u></u>

The distribution by gender of the Company's headcount at 31 December 2015 and 2014 is as follows:

	2015			2014		
	Male	Female	Total	Male	Female	Total
Senior management	35	7	42	29	5	34
Management	44	10	54	24	13	37
Other professionals	241	227	468	124	157	281
	<u><u>320</u></u>	<u><u>244</u></u>	<u><u>564</u></u>	<u><u>177</u></u>	<u><u>175</u></u>	<u><u>352</u></u>

During 2014, agreements were reached with strategic partners in the fields of information systems (with the French multinational GFI) and network management and maintenance (with the Chinese multinational ZTE). Through these agreements, know-how has been shared and Euskaltel employees from these areas of activity have been hired by the above companies.

At the date these consolidated annual accounts were authorised for issue, the board of directors of the Company was comprised of 6 men and 3 women (7 men and 3 women at the end of the prior year).

#### 14.4. Other operating expenses

Details are as follows:

	2015	2014
Advertising	8,577	7,196
Repairs and maintenance	27,812	18,955
Services provided by third parties	36,542	22,322
Other external services and utilities	12,130	9,954
Taxes	4,664	3,028
Losses, impairment and changes in trade provisions	2,328	2,014
Other gains	1,561	1,143
	<u>93,614</u>	<u>64,612</u>

In 2015 the Company incurred the following non-recurring expenses:

	2015
R Cable acquisition costs (note 2)	5,477
Stock flotation expenses	6,558
Total	<u>12,035</u>

#### 14.5. Net finance income/cost

Details are as follows:

	2015	2014
<b>Finance income</b>		
Third parties	192	36
<b>Finance costs</b>		
Other	(19,263)	(14,378)
Hedging derivatives	(6,349)	(1,224)
Changes in the valuation of share-based payments (note 11)	(30,705)	(7,832)
	<u>(56,317)</u>	<u>(23,434)</u>
<b>Exchange losses</b>	(34)	(9)
<b>Impairment and gains/(losses) on disposal of financial instruments</b>	(40)	143
	<u>(56,199)</u>	<u>(23,264)</u>

Finance costs accrued on loans and payables amounted to Euros 14,256 thousand. The costs of cancelling debts and derivatives amounted to Euros 10,556 thousand.

## NOTE 15.- Commitments

### 15.1. Sale/purchase commitments

At the reporting date, the Company has purchase commitments for the following items and amounts, all of which are related to its everyday operations and are expected to materialise in the coming year:

	2015	2014
Intangible assets	61	182
Property, plant and equipment	3,944	8,800
Inventories	1,869	1,697
	<u>5,874</u>	<u>10,679</u>

### 15.2. Operating lease commitments and other associated commitments

The Group has contracts for releasing surplus fibre optic capacity, for pipeline access and for the use of spaces for locating nodes. The Group also has maintenance contracts for leased fibre optic capacity.

Payments in relation to these contracts are as follows:

	2015	2014
Less than one year	5,213	2,140
One to five years	21,997	9,844
Over five years	16,000	14,666
	<u>43,210</u>	<u>26,650</u>

The operating lease expense recognised in the income statement for the period ended 31 December 2015 amounts to Euros 4,171 thousand (Euros 4,266 thousand for the same period in 2014).

## NOTE 16.- Related party transactions

### 16.1. Transactions and balances with key personnel

Details of transactions with key Company personnel are as follows:

	2015		2014	
	Board members	Senior management	Board members	Senior management
Salaries and wages	762	4,461	663	5,909
Share-based payments	7,359	23,346	2,194	5,638
Personnel remuneration through shares	-	352	-	-
Other remuneration	6	85	-	-
	<u>8,093</u>	<u>28,244</u>	<u>2,857</u>	<u>11,547</u>

At 31 December 2014, loans extended to members of the board of directors and other key personnel amounted to Euros 650 thousand and Euros 2,035 thousand, respectively.

The Company has no pension or life insurance obligations with current or former board members, or with other members of senior management.

## 16.2. Transactions and balances with related parties

Details of transactions and balances with significant shareholders are as follows:

	2015	2014
Sales	10,125	9,498
Services rendered	(2,315)	(410)
Finance income	2	1
Finance costs	(9,549)	(8,654)
	<u>(1,737)</u>	<u>435</u>

Details of outstanding collections and payments related to transactions with significant shareholders are as follows:

	31.12.15		31.12.14	
	Current	Non-current	Current	Non-current
Receivables	1	-	-	-
Current account	13,069	-	8,900	-
Loans extended	73	(186,051)	(17,744)	(115,125)
Payables	(637)	-	-	-
	<u>12,506</u>	<u>(186,051)</u>	<u>(8,844)</u>	<u>(115,125)</u>

The directors of the Parent have not carried out any transactions other than ordinary business or applying terms that differ from market conditions with the Parent or any other Group company.

## 16.3. Conflicts of interest

At the 2015 reporting date no member of the Company's board of directors or their related parties, as defined in the Spanish Companies Act, has communicated any direct or indirect conflict of interest with the Company.

## NOTE 17.- Other information

The firm auditing the annual accounts of the Company has invoiced the following net fees for professional services during the years ended 31 December 2015 and 2014:

	2015	2014
Audit services	54	54
Other assurance services	160	57
Other services	90	55
	<u>304</u>	<u>166</u>

Other assurance services and other services includes those related to the issuance of comfort letters, limited reviews, audits of financial statements prepared under IFRS-EU and other services related to the stock flotation and the acquisition of R Cable y Telecomunicaciones Galicia, S.A.



Other auditors have invoiced the following fees and expenses for professional services during the year ended 31 December 2015:

	2015
Audit services	60
Other assurance services	385
Other services	47
	<u>492</u>

## NOTE 18.- Environmental information

The Group considers the environmental impact of its products and services right from the design stage, and seeks to minimise this impact through efficient and effective ways of promoting responsible use.

Since 1999 the Company has had an Environmental Management System which complies with European Regulation 1221/2009 (EMAS III) and the UNE-EN ISO 14001:2004 standard. As a result of this commitment to excellence in environmental management, the Company has had its Environmental Impact Declaration for 2014 validated by a recognised independent party, in accordance with EMAS regulation.

The Company has a policy on Quality, Environment and Safety in the Workplace. The Company regularly participates in environment-related forums and initiatives, collaborates actively, and with its suppliers and customers, in reducing, recycling and reusing possible waste products generated by its activities, and makes the pertinent declarations of packing and packaging materials, electrical and electronic equipment and cells and batteries released in the market. The Company has also signed up to the Eco-efficiency of Basque businesses Programme for 2010-2014 promoted by the Basque Government, the main goal of which is to make Basque businesses more sustainable, innovative and efficient, by introducing environmentally-friendly practices in their processes.

The Company has drawn up an environmental master plan for 2014-2016 that sets out the strategy and programmes and initiatives to be implemented and developed for managing environmental impact, in line with the Basque Environmental Strategy for Sustainable Development 2002-2020 and the Framework Environmental Programme of the Autonomous Community of the Basque Country, promoted by the Basque Government.

The Company, committed to the fight against climate change, prepared a plan for reducing greenhouse gas emissions in 2014. The Company has broadened this commitment by calculating its carbon footprint based on ISO 14064 guidelines and preparing the greenhouse gas emissions report for 2014.

The Company is a member of the Basque Ecodesign Center, an entity with headquarters in the Basque Country and the fruit of collaboration between private sector companies and the Basque Government. The purpose of this centre is to design and execute innovative ecodesign projects. In the context of this collaboration, in 2014 the Company established a system for calculating its carbon footprint and analysing the life cycle of its products.

In 1999, R Cable conducted an environmental impact study of the cable network project in the municipalities in which it was to carry out its network roll-out activities. This study confirmed that the impact of the Red Cable Project on the environment was compatible with the normal development of environmental processes, providing the necessary preventive measures were taken and corrective measures were applied as required. Network roll-out activities carried out by subcontractors have also been monitored so that any necessary preventive and corrective measures have been applied to minimise the impact on the environment.

## **NOTE 19.- Guarantees**

The Group has to submit certain guarantees as part of its everyday commercial activity, for concession and spectrum tenders derived from legal obligations through its participation in the development of the telecommunications sector, for network roll-out licences from public administrations, and to comply with its long-term contractual obligations with service providers.

The Group has extended guarantees to safeguard the working conditions of employees hired by the companies with which the agreements mentioned in note 14.3 were reached.

As a result of the Company's financing, pledges on certain assets have been extended (see note 12).

The Group does not estimate that the guarantees extended would give rise to any additional liabilities in the financial statements.



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# Directors' Report 2015

## Euskaltel, S.A. and consolidated companies

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails)

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# 1. Business and economic environment and regulatory framework

## Introduction

In 2015 a series of events took place in the Company that led to relevant changes in its shareholder, corporate and balance sheet structures.

At the meeting held on 3 February 2015 the board of directors of Euskaltel, S.A. agreed, among other matters, to explore the possibility of floating the Company's shares on the Spanish stock market. This kick started a process that concluded in the admission to trading of the Company's shares on the Madrid, Barcelona, Bilbao and Valencia stock exchanges on 1 July 2015 for a total of 80,408,930 shares at a price of Euros 9.50 per share.

This flotation resulted in a change in shareholder structure, with some shareholders withdrawing completely and others seeing their investment reduced, as the Company went from having few shareholders with substantial investments to numerous shareholders with more diversified investments.

Euskaltel thus became a listed company, assuming the regulatory requirements associated with its new status.

In October 2015 Euskaltel and the shareholders of R Cable y Telecomunicaciones Galicia, S.A. (R Cable) entered into a share-purchase agreement for the entirety of R Cable's shares, whereby Euskaltel would acquire control of R Cable through the purchase of 100% of the share capital of Rede Brigantium, S.L., the owner of shares representing 70% of the share capital of R Cable, and the purchase of the remaining 30% from Abanca Corporación Industrial y Empresarial, S.L.U. (Abanca).

In November 2015 the Spanish Competition Authority (CNMC) authorised Euskaltel to acquire exclusive control of R Cable y Telecomunicaciones Galicia, S.A.

On 27 November 2015 the Company completed the direct and indirect acquisition of the entire share capital of R Cable y Telecomunicaciones Galicia, S.A.

Both the stock flotation and the acquisition of R Cable resulted in changes to the Company's balance sheet structure. In June 2015 the Company obtained loans totalling Euros 470 million, which were used to refinance existing debt of Euros 232 million, pay an extraordinary dividend of Euros 207 million and cover certain payments relating to the stock flotation process and expenses derived from refinancing itself. The acquisition of R Cable, for an ultimate price of Euros 1,190 million, including the company's net financial debt, was financed by Euskaltel through the expansion of existing lines of bank credit by Euros 600 million, a tranche of institutional debt of Euros 300 million, the issuance of new shares for Euros 255 million and funds available in cash.

This directors' report will explain the main events and figures for Euskaltel, S.A. for the entire year, plus one month (December 2015) of consolidated activity of R Cable Telecomunicaciones de Galicia, S.A. These consolidated data are compared to accumulated data for December 2014, which only include indicators and figures for Euskaltel, S.A.

## Overview of the business

FY 2015 saw a change in the trend of our business. It is the first year since 2012 that we have experienced a growth in revenue, which rose by 8.8% to Euros 349.4 million. Of this total, Euros 21.6 million comprises revenue from R Cable in December 2015.

It was in 2014 that we began to see the first shoots of recovery in the residential market, with growth of 0.4% on the prior year. This was seen as a potential turning point that has been confirmed this year.

Apart from a notable improvement in the macroeconomic environment, we consider key to this recovery the confirmation of our commercial strategy in recent years for the residential market and SOHO segment, the main goal of which was to secure new customers for high-value 3P and 4P packages and focus on cross-selling and up-selling with a view to maximising customer lifetime value within our existing customer base.

Our profitability has increased on the back of the recovery in revenue, and our position as a sector leader has been ratified in cash conversion ratio terms.

In the analysis of our results for 2015 we cannot ignore the numerous extraordinary events that occurred during the year. These have given rise to non-recurring impacts that we consider should be isolated as they affect the comparability of the Company's results for 2015 with those of 2014. As a result of the stock flotation and the acquisition of R Cable, the Company incurred significant expenses that are reflected in the income statement. Details are as follows:

	<u>2015</u>	<u>2014</u>
Incentive plan (*)	30,705	7,832
Extraordinary personnel remuneration	3,365	-
Cancellation of derivatives and financing	10,556	-
Stock flotation expenses	6,558	-
R Cable acquisition expenses	5,477	-
	<u>56,661</u>	<u>7,832</u>

(\*) See details in Note "2015: settlement of incentive plans for directors and executive board members accrued as a result of the Company's stock flotation", in section 5 (Economic-Financial Situation and Key Business Indicators) of this directors' report.

The following table shows details of the Company's key business indicators, identifying actual data for 2015 and those we have labelled "adjusted", which eliminate the impact of the non-recurring expenses described in the previous paragraph.

€m	2015			2015 Adjusted (**)			2015 Adjusted vs		
	2015 <u>Euskaltel</u>	December <u>2015 R</u>	2015 <u>Consolidated</u>	2015 <u>Euskaltel</u>	December <u>2015 R</u>	2015 <u>Consolidated</u>	<u>2014</u>	<u>2014</u>	<u>2014%</u>
<b>Total Revenue</b>	<b>327.8</b>	<b>21.6</b>	<b>349.4</b>	<b>327.8</b>	<b>21.6</b>	<b>349.4</b>	<b>321.2</b>	<b>28.2</b>	<b>8.8%</b>
Residential	202.4	13.4	215.7	202.4	13.4	215.7	195.7	20.0	10.2%
Business	92.2	7.1	99.3	92.2	7.1	99.3	93.4	5.9	6.3%
Wholesale & Other	24.3	1.1	25.4	24.3	1.1	25.4	25.2	0.2	0.8%
Other (*)	8.9	0.0	8.9	8.9	0.0	8.9	6.9	2.0	29.5%
<b>Ebitda</b>	<b>142.7</b>	<b>8.9</b>	<b>151.6</b>	<b>158.1</b>	<b>8.9</b>	<b>167.0</b>	<b>155.9</b>	<b>11.1</b>	<b>7.1%</b>
<i>Ebitda Margin</i>	<i>43.5%</i>	<i>41.3%</i>	<i>43.4%</i>	<i>48.2%</i>	<i>41.3%</i>	<i>47.8%</i>	<i>48.5%</i>	<i>-0.7 pp</i>	
<b>OpFCF</b>	<b>95.9</b>	<b>2.6</b>	<b>98.4</b>	<b>111.3</b>	<b>2.6</b>	<b>113.8</b>	<b>113.6</b>	<b>0.3</b>	<b>0.2%</b>
<i>Conversion rate</i>	<i>67.2%</i>	<i>29.6%</i>	<i>64.9%</i>	<i>70.4%</i>	<i>29.6%</i>	<i>68.2%</i>	<i>72.9%</i>	<i>-4.7 pp</i>	
<b>Net income</b>	<b>6.8</b>	<b>2.0</b>	<b>7.2</b>	<b>49.1</b>	<b>2.0</b>	<b>49.6</b>	<b>(**)42.4</b>	<b>7.2</b>	<b>16.9%</b>
<b>Net Financial Debt</b>			<b>1,358.3</b>				<b>236.9</b>	<b>1,121.3</b>	
<b>Net income per share (€)</b>			<b>0.06</b>			<b>0.39</b>			
<b>Cash Flow per share (€)</b>			<b>0.76</b>			<b>0.90</b>			

(\*) Profit neutral operations

(\*\*) Excluded costs related to the IPO process, debt cancellation and the acquisition of R Cable.

Adjustments	2015	2014
Ebitda	15.4	0.0
Net Finance cost	41.3	7.8
Tax effect	(14.4)	(2.2)
	<b>42.3</b>	<b>5.6</b>

We continue to perceive as relevant that our cash flow conversion rates set us apart from other European companies with the same characteristics. In the year ended 31 December 2015, for each euro generated in adjusted EBITDA, we converted Euros 0.68 into cash flow.

This superior cash flow conversion is primarily a consequence of our proprietary, next generation fibre network and our business strategy, which allow us to focus our capital investments on maintenance and attracting customers rather than on new, capital-intensive projects.

## Macroeconomic Environment

After years of severe economic crisis in Spain, 2015 saw the consolidation of a turnaround in the macroeconomic situation. The Spanish economy continued the pattern of growth that started in 2014 (1.4%), with a rise of 3.2% in 2015 (source: Spanish Statistics Institute - INE), with somewhat lower increases of 2.7% and 2.3% expected for 2016 and 2017, respectively (source: IMF, World Economic Outlook Database, January 2016). According to all economic report forecasts, the Spanish economy peaked in the fourth quarter of 2015, then began to dip. While GDP per capita remains below the EU average, Spain has seen improvements of 1.2% in 2014 and 4% in 2015.

The Basque Country has experienced many of the same recent economic trends as Spain; however, given its highly industrialised economy, and the fact that it is one of the most affluent regions in Spain, it has proved to be more resilient than the broader country, with Basque GDP outstripping Spanish GDP in four out of the last six years. The Basque Country is also consolidating its recovery, with GDP growing 1.4% in 2014 and 2.8% in 2015 (source: Eustat). Galicia has shown slightly weaker signs of recovery than the rest of Spain, with GDP exceeding Spanish GDP in two out of the last six years. However, it is also consolidating its recovery, with GDP up 0.4% in 2014 and 2.1% in 2015 (source: Galicia Statistics Institute (IGE)).

The Basque corporate sector is showing signs of stabilisation, with the harmonised business confidence index rising by 12.2% in 2014 and 7.3% in 2015. In addition, after several years of negative growth in the number of companies on the Social Security register, the Basque Country has seen net additions of 620 companies in 2014 and 638 in 2015 (source: Spanish Ministry of Employment and Social Security). The Galician corporate sector is also showing signs of stabilisation, with the harmonised business confidence index increasing by 10.8% in 2014

and 5.7% in 2015. In addition, after several years of negative growth in the number of companies on the Social Security register, Galicia has seen net additions of 182 companies in 2014 and 754 in 2015 (source: Spanish Ministry of Employment and Social Security).

## Industrial Environment

The Spanish telecommunications market underwent a major transformation between 2011 and 2015 in order to adjust to the challenging macroeconomic environment. The main trends that impacted the market are the following:

- **Convergence and pricing pressure:** The Spanish telecommunications market has most recently been characterised by a rapid transition towards convergence of fixed-line and mobile services, with operators bundling services such as broadband, Pay TV, mobile and fixed-line telephony services into integrated offerings. In October 2012, Telefónica introduced heavily-discounted convergent offerings under the quadruple-play offer commercially known as “Fusión”. As a result, prices in the Spanish telecommunications market dropped significantly with a rapid shift to convergence as other operators followed Telefónica's example. The proportion of the market represented by 3P/4P bundles increased from 13% in 2012 to 50% in 2014 and 57% by mid-2015.
- **Consolidation:** Over the past three years, the Spanish market has been characterised by consolidation, primarily driven by mobile-centric operators acquiring fibre operators. As a result, the top three operators accounted for 77% of the market in 2012 and 84% in 2014, due to the effect of the incorporation of Ono and Jazztel, and 85% in the second quarter of 2015. The reduction in the number of operators is favouring both investments and a more rational competitive behaviour, as infrastructure investments require price discipline to achieve target returns.
- **Increasing importance of high-speed internet:** Spain is one of the largest broadband markets in Europe, with approximately 13.1 million broadband subscriptions at 30 November 2015 (source: CNMC). In terms of high-speed broadband access (lines capable of providing at least 30Mbps), the Spanish market is underpenetrated. However, the market has seen growth in recent years, with fibre, including cable and FTTx, representing 41% of the Spanish market in November 2015 (compared to 29% in 2014), and FTTH increasing considerably between 2012 and 2015, from 2.9% to 22.5% of Spanish fixed-line broadband subscribers (source: CNMC).

## Regulatory Environment

The Spanish telecommunications market is subject to changes implemented by its regulatory body, the CNMC.

In November 2015 the CNMC approved a draft law covering the Spanish wholesale broadband market in which it proposes that Telefónica should open up its fibre network in all of Spain except for cities in which at least three operators are present. There are currently 34 municipalities that comply with this competition requirement, reaching 26% of the population: Alicante, Almería, Badalona, Barcelona, Cornellà de Llobregat, Granollers, Hospitalet de Llobregat, Sant Adrià de Besòs, Santa Coloma de Gramenet, Cerdanyola del Vallès, Burgos, Córdoba, Granada, Huelva, Lérida, Alcalá de Henares, Alcorcón, Coslada, Fuenlabrada, Getafe, Leganés, Madrid, Móstoles, Parla, Pinto, Torrejón de Ardoz, Málaga, Seville, Mislata, Tavernes Blanques, Valencia, Vigo, Valladolid and Zaragoza. In the remaining municipalities, Telefónica will have to offer the alternative operators access to its fibre optic network - without the 30 Mbps limit - at a price that allows them to match Telefónica's offerings.



In January 2016 Telefónica and Mediapro reached an agreement through which the operator acquires football rights that will give it exclusive control of all league (Liga) matches for the next three seasons, except in bars, and all UEFA Champions League matches. The CNMC will have to determine whether this content is subject to the commitments undertaken by Telefónica as part of its authorisation to acquire DTS (Canal+), in which case the remaining operators would have the opportunity to access them.

## 2.-Commercial activity and customer relations

### 2.1 Commercial activity

In this section we refer to activities carried out at Euskaltel. We have opted to omit reference to R Cable's activity as it is difficult to confine it exclusively to the month of December. What is evident is that R Cable's commercial activity is very significant and intense in light of the progress made in this area, and details will be included in subsequent complete accounting periods.

#### a) Residential Market

During the year ended 31 December 2015 we continued our strategy of directing our new and existing customer bases towards convergent bundles with the highest added value.

In the case of R Cable, its residential market strategy is practically identical to that employed by Euskaltel during the year, although there may be slight differences in maturity or penetration indicators for certain packages or services.

The incorporation of R Cable's residential customer portfolio has brought the number of customers in the consolidated group at year end to 545,502, compared to the 296,023 customers Euskaltel had at the end of 2014. Of this consolidated total, R Cable contributed 249,345 customers.

This strategy, in line with that of the prior year, has brought our portfolio of customers on 3P or 4P contracts to 63.3% of the total at year end, compared to 55.3% for these high added-value customers at the 2014 close.

In this regard, residential customers had net positive growth, with a 101.96% increase in the number of products contracted, of which 998,871 products corresponded to Euskaltel customers and 810,849 to R Cable residential customers.

Apart from the notable effect of including R Cable in the consolidated group, improvements in mobile telephony, the possibility of financing purchases of mobile devices and the launching of the 4G service have all contributed to the healthy performance in this area. This is also seen in residential customers on billed mobile contracts, rising from 273,906 products in 2014 to 702,892 in 2015 (of which 335,006 were contributed by R Cable), and in the higher percentage of customers with mobile devices (49.1% in 2014 vs 71.7% in 2015).

We have also seen growth in the number of broadband customers (171,730 up on 2014, of which R Cable contributed 167,883, and with individual Euskaltel year-on-year growth of 1.76%) and television customers (125,437 more than in 2014, of which R Cable contributed 118,228, and with individual Euskaltel year-on-year growth of 5.78%), despite the significant impact of not being able to offer football coverage for the 2015-2016 season.

As a result, the product/customer ratio rose from 3.0 in 2014 to 3.3 in 2015.

In the residential business segment, R Cable also clearly aims to complete fixed-line/mobile convergence as a strategy to achieve services and revenue growth and reduce churn. The prices of R Cable combo (convergent packages) and mobile plans were tactically adjusted in June 2015, taking advantage of sector trends following several years of price reductions.

Furthermore, according to the latest study by GFK (2015), R Cable retains its leadership in the Brand Potential Index, in market share in the four services where it has a network and in customer satisfaction as a quad-play operator. Also highlighted are the quality of telecommunications services, innovation, projection of a clear identity, fast resolution of doubts and incidents, professionalism and proximity to customers.

Although our commercial strategy is clearly focused on the management and sale of convergent product packages, below is a brief description of the main characteristics of the actions carried out for the different services that make up these packages:

## MOBILE

Throughout 2015 we continued adapting to our customers' growing needs for greater and faster internet browsing on their mobile devices. We achieved this through Euskaltel WiFi, which became Euskaltel's biggest launch in 2015. Since March, Euskaltel WiFi has enabled our customers to connect to the internet in the streets of the Basque Country using their mobile and tablet devices through more than 128,000 WiFi hotspots.

Euskaltel WiFi came into being as an exclusive idea for our customers. By the end of 2015 we had more than 150,000 WiFi hotspots and we will continue to expand our coverage throughout 2016. Euskaltel WiFi is, and will continue to be, an innovative, and revolutionary service, and one that sets us apart.

As regards R Cable, outdoor WiFi services are growing, with 112,086 active lines, 82,500 free hotspots and average daily traffic of almost 2 TB. Almost 27,000 lines consume more than 200 MB per month of free WiFi with R WiFi customers and total traffic accounts for approximately 20% of total 3G network traffic. In 2016 we will continue to incorporate lines to the service and begin rolling out professional outdoor hotspots to provide service in high-demand areas, with higher-capacity connections and speed for users.

Accompanying the re-launch of the mobile service is our policy of increasing the data allowances included in our plans and roll-out of the 4G service. Once 4G networks became consolidated and coverage reached more than 80% of the Spanish population, we launched our 4G service in October in such a way that customers did not have to do anything or change cards, automatically incorporating it into plans in which users can enjoy reasonable browsing experiences (from 1.5 GB). Furthermore, we made the Family plan (*Tarifa Family*), which is a multi-line plan, more flexible by offering customers specific, optional 4G modules to add to whatever lines they wish.

In October we also launched a new mobile browsing service that allows customers to continue browsing at high speed after using up the limit included in their plan. This service, together with the possibility of using the same plan on several devices, offers our customers more possibilities to continue browsing at high speed.

In 2015 R Cable became the market leader in the mobile sector for individual users in areas in which it offers a direct service. R Cable now leads the mobile market for both residential and business users in areas serviced by its fibre optic network.

## INTERNET

As part of our commitment to enhancing our customers' internet experience at home, we have increased connection speeds in such a way that 78.7% of our customers now enjoy speeds in excess of 50 Mbps, which is seven times faster than the average ADSL speed. Furthermore, almost 40% of our customers enjoy speeds of over 150 Mbps, making the Basque Country the region of Spain with the fastest broadband speed, and one of the fastest in Europe.

In June 2015 we repositioned our broadband offering with four new options: 15 Mbps, 50 Mbps, 150 Mbps and 350 Mbps.

In addition, convinced of the exponential growth of devices that use WiFi networks in the home, we have evolved our internet connectivity equipment portfolio by releasing a new WiFi cable modem that allows our users to reach connection speeds of up to 350 Mbps. We have also sold additional equipment such as specific advanced routers, repeaters and PLCs to adapt home WiFi networks to the needs of our users.

In Galicia, R Cable increased customer internet speed five-fold (from 20 to 100 Mbps), meaning 62.9% of its residential customers enjoyed speeds of 100 Mbps or more by the end of 2015. In the first half of 2015 the company proactively upgraded customers' equipment to support the new speeds. In December 2015 a new internet speed map of 350 / 150 / 50 Mbps was released to facilitate upgrading from the 200 / 100 / 20 offering in the first half of 2016.

## TELEVISION

During 2015 we made a strategic commitment to continue underpinning our television offering with the most technologically advanced services.

In addition to the services launched in 2014, Videoclub and Edonon, we now have a new recording service. Recording is one of the services most requested by our customers, who want to be able to watch their favourite programmes and series whenever they want, not just when they are broadcast.

We have also evolved Edonon, thanks to which our customers can watch television wherever they want, on their tablets, computers or mobiles, as long as they have a WiFi connection. This service now incorporates new functionalities that make it even better to use for our customers, such as viewing content already started from the beginning (start over), pausing a live programme (timeshift), listing the episodes of a series in viewing order, searching for channels by genre and, of course, recording.

In addition to launching new services, we have also continued to enrich our content offering by incorporating two compelling new channels, Canal de Estrenos de Cine (new film releases) and Canal de Series (series), aimed at film lovers who wish to see the latest cinema releases and those who enjoy the latest in popular and critically-acclaimed television series. Also added to the offer are other channels such as Somos and Extreme Sports, and the Videoclub has been expanded to allow customers to choose from a wide variety of viewing options, from the latest film releases to adult and free content.

R Cable television hit an all-time high in 2015 with 125,000 decoders installed, 70% of which have interactive and high-definition capabilities. Rebobina R (R Rewind, an on-demand content viewing service) was confirmed as a loyalty-winning service, with 65% of customers making intensive use of it and more than 2.5 million streams viewed per month.

### b) Business Market

The business segment has responded positively to our strategy of maximising bundles and 3P and 4P offerings. The number of business customers has risen from the prior year to 47,684, while the number of products contracted by these companies is up 13.5% on the end of 2014 (162,844 compared to 143,472).

There have been various developments in offerings which we have used to achieve these results. In May we launched a new convergent services bundle aimed at businesses called Euskaltel PRO. This solution covers the global needs of the small business segment through a high-performance connectivity solution (voice and broadband), which also includes a series of added-value services for small companies such as convergent fixed-line/mobile voice, e-mail and calls.

This year also saw the launch of the Team plan (*Tarifa Equipo*), a multi-line plan aimed at businesses with several employees, with unlimited calls and 2 GB of data for each line at an unbeatable price.

In the medium term, our aim is to become the leading information security provider for the SME market. In the business market, we have channelled our efforts into improving our security products offering: We launched our protection against denial of service attacks service to complement our perimeter security services offering, in which the Cloud Firewall was rated best product by our customers. We also have agreements with Panda allowing us to offer an antivirus service for mobile devices.

As part of another medium-term objective for the business market, outsourced corporate services, we are continuing to consolidate our data centre services with the support of our proprietary CPD Tier 4 infrastructures.

In order to provide our customers with management tools for improving productivity, we have reached an agreement with IBM to integrate their Remote Mobile Device Management service (MaaS360) in our catalogue of products. This service allows customers to maintain complete control over their range of mobile devices, and amongst its many features are a permanently updated inventory, and the ability to control permitted applications or remotely delete all corporate content on the device in the event of loss or theft.

R Cable retains its leading position in the business sector in Galicia. Cloud services are consolidating, confirming R Cable's private cloud concept as a source of growth. In 2015, there were over 1,000 virtual business servers and 500 TB of storage in corporate projects.

In 2015, R Cable continued developing its smart cities line of business, securing the DEPOGAP (Pontevedra Intelligent Province) project with the same consortium it won the A Coruña Smart City project. With this second contract, R Cable has been involved in the only two relevant smart cities contracts in Galicia, thus positioning it favourably for developing this business segment in Galicia.

## 2.2 Customer relations

Throughout 2015 we have focused on getting to know our customers better and generating value propositions adapted to their particular needs and situations. Segmented up-selling and cross-selling initiatives are directed at new customers with a view to generating greater customer satisfaction and loyalty.

Backed by a bigger and better multi-channel approach (with a focus on online resources), the most suitable products for each situation are presented and the responses of each case processed to enrich our customer knowledge and enhance the value proposition.

At the same time, proactive and reactive steps are taken to retain customers and adapt their situation to their new realities, and products are adjusted to strike the best balance between performance and price.

The number of residential customers who choose internet as a means of communicating with Euskaltel rose by 26% in 2015, gaining ground over telephone support and points of sale, although telephone still remains the first choice. Activity on these platforms has fallen thanks to self-management (Web and IVR) and the 10% drop in repeat queries compared to 2014, and customer satisfaction ratings are in excess of 9/10. The number of unresolved complaints has fallen slightly in 2015, as has the time spent on addressing them. Attention was also focused during the year on boosting the commercial side of telephone support platforms, resulting in 22% sales growth compared to 2014.

Progress on the Online First initiative was ongoing throughout the year, and in December, it became our customers' channel of choice for communicating with Euskaltel. 55% of our customers (active) have a common web user to access Euskaltel's main services, while the number of customers accessing the self-management web is up 26% on 2014. As a result, total access volume rose by 45%, in other words, more customers access more often, as a result of focusing on providing the channel with self-management and query functionalities and enhancing the user experience.

Additionally, efforts have been made to generate new residential customer sales volume through this channel, resulting in 19% growth compared to 2014 and which now accounts for 17% of total sales.

### 3.- Operations

In this section we refer to activities carried out at Euskaltel. We have opted to omit reference to R Cable's activity as it is difficult to confine it exclusively to the month of December. What is evident is that R Cable's operations and network activity is very significant and intense in light of the progress made in this area, and details will be included in subsequent complete accounting periods.

One of the basic cornerstones of our business strategy is to have the most advanced network possible, giving our customers access to the best services and maximising their user experience. The main Operations projects in 2015 were as follows:

a) WiFi Kalean

The aim behind this project, launched at the end of 2014, is for Euskaltel customers to avail of free WiFi in as many places as possible. In March 2015 this was rolled out at street level (Community) with 120,00 hotspots. During 2016 the number of hotspots to this network, which is accessed by around 75,000 lines daily, will be increased to an estimated 160,000.

b) Launch of 4G and roll-out of the proprietary LTE network

In October, we launched our 4G service for mobile customers, through Orange's network (our host). In the coming years, this service will be enhanced with the roll-out of a proprietary LTE network across the Basque Country. Euskaltel holds administrative concessions for two blocks of frequencies in the 2.6 GHz bandwidth, which will reduce interconnection costs. At the end of 2015, 8 stations were active.

c) Roll-out in new homes

In 2015, the roll-out of the proprietary fixed line was relaunched with the aim of facilitating connection to 51,000 homes over the next 4 years. By the end of 2015, connection had been made available to over 10,000 homes. The majority of homes were in areas with active nodes already in our network.

d) Roll-out in industrial estates

Apart from the homes mentioned above, 8 industrial estates were included for new FTTH technology roll-out under the proprietary fixed-network plan, 2 of which were in service by the end of 2015.

Additionally, a further 29 industrial estates are earmarked for roll-out, with speeds of over 100 Mbps through an FTTH-GPON network. Aid was obtained for this project from the Secretary of State for Telecommunications and the Information Society under the programme for next generation broadband expansion.

e) Voice over Internet Protocol (VoIP)

Throughout 2015 we have carried out migration projects from the current fixed-voice platforms to new platforms that support VoIP services and position Euskaltel's network for the challenges of the future.

f) Broadband

We have expanded and adapted our broadband network so that our customers can enjoy speeds of up to 350 Mbps. By the end of 2015 around 80% of our residential broadband customer base had speeds in excess of 50 Mbps.

g) Television

In 2015 we launched a new 4K decoder project with added-value TV functionalities (OTT, VoD etc.). This decoder is due to enter service in the first few months of 2016.

We also launched various projects which will allow our customers to enjoy greater capabilities:

- Cloud recording: The possibility of recording TV content. Entry into service in September 2015.
- StartOver: this allows an event which has already started but not finished to be watched from the beginning. Project launched in 2015 and available in the first quarter of 2016.
- TimeShift: this allows the viewer to pause a live broadcast and continue watching at a later stage. Project launched in 2015 and available in the first quarter of 2016.

h) Other projects

- Implementation of an internet attack incident platform (ARBOR), which provides a detection and migration tool for denial of service attacks. The project has two areas of application, the proprietary network and services to large account customers. This platform went live in May 2015.
- Online channel:
  - ✓ Our after sales web: activated in March for residential customers and November for businesses.
  - ✓ New architecture, mobile apps and improvements geared towards increasing customer use of our Online Channel as a more efficient vehicle for dealings and queries than calls to our Call Centre.
- Investors' website brought online to cover the requirements and obligations derived from the stock flotation and investor relations.

## 4. People

There was a hive of activity in the consolidated Group in December 2015 involving the cultural integration and management of Euskaltel and R Cable employees. This is the first step on a long road whose essence will be developed over the coming months. Consequently, as in previous sections, we will refer to activities carried out at Euskaltel. We have opted to omit reference to R Cable's activity as it is difficult to confine it exclusively to the month of December. What is evident is R Cable is an example of how to manage the people and talent of its organisation, and details will be included in subsequent complete accounting periods.

A healthy organisation attends to and maximises the labour resources of its employees, including the physical working environment, training, personal productivity tools, sufficient autonomy in their job, adequate social support, flexible timetables etc. so that people can perform optimally without compromising their health and well-being.

A healthy organisation also assumes that the good psychosocial well-being of its employees is central to achieving its own objectives. To attain this, it systematically makes planned and proactive efforts to improve the physical and emotional well-being of its employees by maximising the personal resources of its employees.

The more and better the labour resources offered by an organisation, and the more personal resources employees have at their disposal, the better the positive psychological state of its employees in relation to their work, and the better they will perform.

Consequently, healthy organisations must appropriately manage the personal and labour resources of their employees, and aim to generate 'virtuous circles' that provide benefits to all.

To accomplish this, an Organisation, Human Resource and Quality Management Plan has been drawn up which contains a Motivation and Alignment Programme, a People Programme and an Organisation Programme, in the form of groups of instrumental plans tasked with implementing all the initiatives contained in the three lines of action: Confidence, Individual Performance and Collective Performance

### a) Motivation and Alignment Programme (Confidence)

The main aim of this programme is to build up the confidence of our people as a basis for raising motivation and commitment. It was thus necessary to re-establish an ambience of social peace in a framework of stable labour relations in order to reach a new collective labour agreement that was acceptable to the majority of the Company's employees.

Finally, in 2015 this new collective agreement was achieved, and unanimously accepted by all trade unions in the Company and the workers' committee. This agreement resulted in the III Euskaltel Collective Labour Agreement, valid until 2018, with marked conditions from both an economic (salary increases linked to the Company's results), and quality of life (with emphasis on work/life balance and equality) perspective. This is an innovative agreement, suited to the new chapter of the Company, that generates stability and promotes social peace for the coming years.

Furthermore, the fact that all employees are now shareholders of the Company after receiving an extraordinary bonus in Company shares equivalent to two month's salary, coinciding with the stock flotation, has aided greatly in improving the working atmosphere and raising the level of commitment

b) People Programme (Individual Performance)

As mentioned in the introduction to this section, a healthy organisation attends to and maximises the labour resources of its employees, including the physical working environment, training, personal productivity tools, sufficient autonomy in their job, adequate social support, flexible timetables etc. so that people can perform optimally without compromising their health and well-being.

In addition to all the measures related to the undertakings in the new collective labour agreement such as salary conditions, flexible timetables, teleworking, work/life balance, equality, etc. the following lines of action taken in 2015 within the scope of this programme also deserve a mention:

- *Equality and work/life balance plan.* The Work/Life Balance Plan has been revised and new initiatives incorporated, such as the possibility of a temporary transfer to the nearest work centre to the family home in summer, and greater flexibility in unpaid leave for employees who participate in fostering programmes for children from Chernobyl, the Sahara etc. in summer.
- *Integration of disabled people.* Development of the Family plan (*Plan Familia*) for employees with disabled family members and the Emergence plan (*Plan Aflora*), designed to bring to the fore unrecognised disabilities in people already employed in Euskaltel.
- *Training and Qualification of Euskaltel professionals.* During 2015 a total of 20,055 hours' training was given, corresponding to 232 training initiatives affecting 99% of the workforce. The level of **satisfaction** with training received during the year was 4.98/6, while **efficiency**, which measures the transfer of learning to the workplace, was 4.71/6 (average rating of the total training plan), and 99% of training initiatives covered the targets established.
- *Mentoring.* Initiatives aimed at junior management to boost their people leadership and management skills.
- *Rotations and Promotions.* During 2015, 49 positions were covered by internal rotations, five of which were management positions through internal promotions.
- *Welcome procedure.* In-depth review of the welcome procedure for new employees and interns.
- *Professional training analysis.* Active participation in a task force promoted by the Basque government's Department of Work, Industry and Professional Training and Confebask (Basque employer's association), charged with coordinating the needs and interests of the industry in relation to professional training.
- *Corporate voluntary work.* Activities related to promoting and assisting NGOs in which our employees participate.
- *Educational cooperation.* During 2015, we accepted 15 students for work practice.
- *Emotional barometer.* At the end of 2015, an emotional pilot survey was carried out to measure the level of engagement of Company employees, and a psychosocial risk assessment process was launched.
- *Health.* Voluntary annual medical check-ups were offered to Company employees and a survey conducted of the level of satisfaction with medical insurance. OHSAA 18001 certification for our Occupational Health and Safety Management Systems was renewed for three years.



c) Organisation Programme (Collective Performance)

In 2015, our Integral Management System was upgraded to implement the risk management system for the prevention of crime, which was audited and certified at year end by Aenor. It should be noted that Euskaltel is the first company in the Basque Country and the first telecommunications operator in Spain to receive this certification.

## 5.- Economic-financial situation and key business indicators

There was a flurry of activity at Euskaltel during 2015, resulting in relevant changes in its corporate, shareholder and balance sheet structures. The most relevant milestones were as follows:

### April 2015: conversion and adaptation of our financial statements to international standards (IFRS)

In response to the new requirements of a potential stock floatation, we decided to adapt our financial reporting from Spanish GAAP to international accounting principles (IFRS).

Despite not being legally obliged to do so, as we were not a group of consolidated companies prior to being floated, we deemed it necessary to adopt international reporting standards to facilitate comparison with similar international companies, and enhance transparency and understanding for domestic and international investors.

We converted the accounts for 2012, 2013 and 2014, and since then, have reported under international standards. As a result of the acquisition of R Cable y Telecomunicaciones Galicia, S.A., the accounts to be presented under international accounting principles (IFRS as adopted by the EU) will be those corresponding to the consolidated Group.

### June 2015: signing of a new syndicated financing agreement

As a result of the agreements reached during the stock floatation process, the Company negotiated two new loans of Euros 235 million each (tranches A-1 and B-1) and a revolving credit facility of Euros 30 million to repay loans extended in prior years early, finance the extraordinary dividend payable to shareholders existing before the initial public offering (IPO) and cover the expenses related to the admission to trading of the Company's shares.

This new financing has stretched the average term of financing to 5.8 years and reduced the average effective cost of borrowing to 1.8%, compared to 4.6 years and 5.5% with the previous financing.

### June 2015: split of outstanding shares in the proportion 20 x 1

At 31 May 2015 subscribed capital was represented by 6,326,890 registered shares of Euros 60 par value each, with the same rights and obligations, and subscribed and fully paid.

At their annual general meeting held on 1 June 2015, the shareholders decided to split the number of outstanding shares in the proportion of 20 new shares for each old share, and reduce their par value from Euros 60 per share to Euros 3 per share. As a result, the number of new shares outstanding amounted to 126,537,800 of Euros 3 par value each. At the aforementioned annual general meeting, it was also decided to modify the system of representation of the shares by converting the former registered shares into book entries.

#### June 2015: payment of an ordinary dividend to existing shareholders

In the context of floating the Company on the stock exchange, the board of directors conducted an analysis to determine the most optimum balance sheet structure to maximise the Company's value upon flotation. This analysis determined that a debt structure ratio of between 3:1 and 4:1 of Financial Debt:EBITDA (without considering extraordinary M&A transactions) to be an appropriate balance and an optimised cost of the resources employed for the Group's activity. At the annual general meeting held on 26 June 2015, the shareholders agreed to distribute an extraordinary dividend of Euros 207 million to shareholders existing before the stock flotation.

#### July 2015: Initial Public Offering of shares and conversion into a company listed on the Spanish stock exchanges

On 16 June 2015, and in the context of the Company's admission to trading, the shareholders of Euskaltel, S.A. agreed to make an initial public offering (IPO) of 80,408,930 shares, representing 63.55% of share capital, increasable to a maximum of 88,449,823 shares, representing 69.90% of share capital, if the purchase option (green shoe) extended by the selling shareholders to the global coordinators, and aimed solely at qualified investors, were exercised.

On 1 July 2015, the shares were released on the Bilbao, Madrid, Barcelona and Valencia stock exchanges, at a price of Euros 9.50 per share. The total volume of shares sold amounted to 88,449,823, equivalent to 69.9% of share capital, once the entire greenshoe option had been exercised in the days immediately after admission to trading.

On the same date, the shareholders authorised the board of directors to carry out a derivative acquisition of own shares until the admission to trading date. The derivative acquisition of own shares involved awarding shares free of charge to Company employees in an amount equivalent to two month's salary, and reinvesting 50% of the remuneration, net of withholdings, received by beneficiaries of the incentive plans upon maturity, in shares. Own shares were acquired within the framework of the IPO agreed by the Company's shareholders, and purchased under the same terms as the remaining investors.

#### October 2015: awarding of a credit rating by Moody's and Standard & Poor's

As part of the Company's strategy to increase its visibility in the financial markets, in both debt and capital terms, in September and October the Standard & Poor's and Moody's ratings agencies reviewed our business plan and financial solvency. As a result of this work by these internationally renowned agencies, we were awarded credit ratings of BB- (S&P) and B1 (Moody's).

According to both agencies, Euskaltel's principal strengths lie in its considerable cash generating capacity, a stable market, and healthy growth prospects, with a sound, sustainable business plan for the coming years.

#### November 2015: signing of a new syndicated financing agreement for the purchase of R Cable y Telecomunicaciones de Galicia, S.A.

For the acquisition of R Cable y Telecomunicaciones Galicia, S.A., the Company borrowed two additional tranches (tranches A-2 and B-2) to those signed in May, of Euros 300 million each, and an institutional loan (tranche B-3), underwritten by four financial institutions, also for Euros 300 million.

The main new feature of this banking syndication was the institutional debt tranche of Euros 300 million (TLB-3), underwritten by four financial institutions and successfully syndicated among domestic and international institutional funds under the terms offered to the market. The underwriters received subscription offers from institutional investors, and demand far outstripped double the tranche offered.

The syndication of the TLB-3 tranche represented the final milestone in the Euros 900 million borrowing process to finance the acquisition of R Cable and refinance its debt. This involved (i) raising both tranches of the loans signed on 5 October last by Euros 300 million each, and (ii) the TLB-3 institutional loan tranche of Euros 300 million referred to in the previous paragraph.

Interest on the new financing is pegged to Euribor plus a spread calculated by dividing the Group's consolidated net debt by consolidated EBITDA (the coefficient), both of which are defined in the loan clauses. A summary of the main characteristics of the loans at the reporting date are as follows:

Tranche	Interest	Nominal	Maturity
A-1	2.500%	235,000	30/06/2021
B-1	3.175%	235,000	30/06/2022
A-2	2.500%	300,000	30/06/2021
B-2	3.175%	300,000	30/06/2022
B-3	4.750%	300,000	27/11/2022
Credit facility	(a)	30,000	30/06/2022
(b) <i>Not drawn down at year end</i>			

Tranches B-1, B-2 and B-3 are repayable in a single sum as they fall due. Tranches A-1 and A-2 are repayable according to the following schedule:

	No. of six-month periods	(1)
<b>Six-monthly maturity</b>		
Period 30-06-17 to 30-06-19	4	5%
Period 30-06-19 to 30-12-19	2	10%
Period 30-06-20 to 30-12-20	2	15%
30 June 2021	1	30%
(2) <i>Repayment percentage calculated based on the nominal of the loans repaid on the last day of each six-month period included in the period.</i>		

#### November 2015: capital increase

At their annual general meeting held on 12 November 2015, the shareholders authorised the board of directors to increase share capital within 5 years up to half of the share capital existing at the agreement date, with the power to exclude the preferential subscription right up to a limit of 20% of capital at the time of delegation.

By virtue of this authorisation, the board of directors increased share capital by Euros 75,923 through the issue of 25,307,560 new shares of Euros 3 par value each, with exclusion of the preferential subscription right. This capital increase, which was used to partially finance the acquisition of R Cable, was subscribed in full at an issue of Euros 10.08 per share. The new shares were floated on the Barcelona, Bilbao, Madrid and Valencia stock exchanges on 26 November 2015.

#### November 2015: Acquisition of R Cable Telecomunicaciones de Galicia, S.A.

On 27 November 2015 the Company acquired a 30% interest in R Cable y Telecomunicaciones Galicia, S.A. and 100% of the share capital of Rede Brigantium, S. L., the holder of the remaining 70% stake in R Cable y Telecomunicaciones Galicia, S.A. With these acquisitions, the Company directly or indirectly holds the entire share capital of R Cable y Telecomunicaciones Galicia, S.A., with the aim of consolidating itself as the leading operator in convergent offerings in northern Spain, and making the Company stronger, more efficient, with shared synergies and capacity for growth. The combination of Euskaltel, S.A. and R Cable y Telecomunicaciones Galicia, S.A. will result in better access to and bargaining power over products, services and content, sharing

of systems and technologies, optimisation of contractual relations with suppliers and harmonisation of growth strategies.

The cost of acquiring the interests in Rede Brigantium, S. L. and R Cable y Telecomunicaciones Galicia, S.A. amounted to Euros 894,497 thousand. Costs related to the acquisition amounted to Euros 5,477 thousand and are recognised under other operating expenses in the consolidated income statement.

2015: settlement of the incentives plan for senior management and executive directors, accrued as a result of the Company's flotation on the stock exchange

The total amount accrued on incentive plans for the Company's stock flotation ultimately amounted to Euros 42.87 million. Considering the initial contributions of Euros 4.33 million made by the plan participants, the total gross return on the investments amounted to Euros 38.54 million.

After tax (around Euros 23.8 million) and associated finance costs (Euros 0.2 million), the total liquid return amounted to Euros 14.5 million.

The participants and beneficiaries of the plans voluntarily opted to reinvest most of the returns in own shares of the Company. At the 2015 reporting date, a total of Euros 13.53 million had been reinvested in shares, corresponding to 1,409,475 shares, or 0.93% of the Company's share capital. The shares were acquired as they were released on the stock market (Euros 11.02 million, corresponding to 1,160,040 shares at Euros 9.50 per share), and coinciding with the capital increase carried out in November (Euros 2.51 million, corresponding to 249,435 shares at Euros 10.08 per share). The reinvestments have a 360-day lock up restriction on the transfer of ownership of the shares, which expires on 1 July 2016.

Details of the matters discussed in the paragraphs above, and how the plan affects the different groups involved, are as follows:

(Thousands of Euros)

	<u>TOTAL</u>	<u>Chairman</u>	<u>Management team</u>	<u>Other executives</u>	<u>Directors</u>
Overall amount	42,873	9,692	28,730	3,013	1,438
Contributions	(4,338)	(975)	(2,480)	(633)	(250)
<b>Gross return</b>	<b>38,535</b>	<b>8,717</b>	<b>26,250</b>	<b>2,380</b>	<b>1,188</b>
<b>Tax withholdings, rest of tax costs + financial + other</b>	<b>(23,967)</b>	<b>(5,273)</b>	<b>(16,031)</b>	<b>(1,475)</b>	<b>(1,188)</b>
<b>Liquid return (mostly committed to reinvestment in Euskaltel, S.A. shares)</b>	<b>14,568</b>	<b>3,444</b>	<b>10,219</b>	<b>905</b>	<b>0</b>
<u>Amount already invested in Euskaltel shares</u>	<u>13,534</u>	<u>3,444</u>	<u>9,185</u>	<u>905</u>	<u>0</u>
<i>Number of shares</i>	1,409,475	357,222	957,003	95,250	0
<i>% of share capital</i>	0.928%	0.235%	0.630%	0.063%	0,0%

The aforementioned Euros 38.5 million of the incentives plan forms part of the costs associated with the stock flotation, which, although largely accrued in the first quarter of 2015 and thus after the distribution of the extraordinary dividend (June 2015) mentioned previously, was taken into account when determining the extraordinary dividend payment, and the best estimate of the effect of the stock flotation expenses on equity was left on the Company's balance sheet as undistributed equity. This was done so that the Company's equity remained unaffected by these expenses.

## Key performance indicators (KPIs)

The following tables show some of our operating and financial KPIs for the period examined.

Residential					
KPI	Unit	2014	2015 Euskaltel	December 2015 R	2015 Consolidated
Homes passed	#	869,900	879,219	819,854	1,699,073
Household coverage	%	85%	86%	51%	65%
Residential subs	#	296,023	296,157	249,345	545,502
o/w fixed services	#	279,212	276,959	194,705	471,664
as % of homes passed	%	32.1%	31.5%	23.7%	28.7%
o/w mobile only subs	#	16,811	19,198	54,640	73,838
o/w 1P (%)	%	17.8%	17.3%	27.2%	21.9%
o/w 2P (%)	%	26.9%	17.6%	11.5%	14.8%
o/w 3P (%)	%	35.0%	35.4%	22.8%	29.6%
o/w 4P (%)	%	20.3%	29.6%	38.5%	33.7%
Total RGUs	#	896,077	998,871	810,849	1,809,720
RGUs / sub	#	3.0	3.4	3.3	3.3
Residential churn fixed customers	%	14.8%	14.9%	11.9%	14.8%
Global ARPU fixed customers	€/month	53.78	55.92	56.95	55.97

  

KPI	Unit	2014	2015 Euskaltel	December 2015 R	2015 Consolidated
Fixed Voice RGUs	#	279,691	277,449	189,732	467,181
as % fixed customers	%	1.0	100.2	1.0	1.0
BB RGUs	#	217,726	221,573	167,883	389,456
as % fixed customers	%	78.0%	80.0%	86.2%	82.6%
TV RGUs	#	124,754	131,963	118,228	250,191
as % fixed customers	%	44.7%	47.6%	60.7%	53.0%
Postpaid lines	#	273,906	367,886	335,006	702,892
Postpaid customers	#	153,939	203,114	209,133	412,247
as % fixed customers (only mobile excluded)	%	49.1%	66.4%	79.3%	71.7%
Mobile lines / customer	#	1.8	1.8	1.6	1.7

2015 saw the re-launch of the proprietary fixed-line network roll-out to facilitate connection for 51,000 homes over the next 4 years. This year connection was made available to more than 10,000 new homes.

Apart from the notable effect of including R Cable in the consolidated group, improvements in mobile telephony, the possibility of financing purchases of mobile devices and the launching of the 4G service have all contributed to the healthy performance in this area. This is also seen in residential customers on billed mobile contracts, rising from 273,906 products in 2014 to 702,892 in 2015 (of which 335,006 were contributed by R Cable), and in the higher percentage of customers with mobile devices (49.1% in 2014 vs 71.7% in 2015).

We have also observed growth in the number of broadband customers (171,730 up on 2014, of which R Cable contributed 167,883, and with individual Euskaltel year-on-year growth of 1.76%) and television customers (125,437 more than in 2014, of which R Cable contributed 118,228, and with individual Euskaltel year-on-year growth of 5.78%), despite the significant impact of not being able to offer football coverage for the 2015-2016 season.

As a result of the above the products/customer ratio rose considerably in 2015 (from 3.0 in 2014 to 3.4 in 2015 in Euskaltel and, and 3.1 to 3.3 in R Cable).

The higher percentage of customers with a mobile telephone and the associated loyalty effect has allowed us to maintain the churn rates at levels similar to the prior year, despite the negative impact, in terms of loss of customers, of not being able to offer football since August.

ARPU has grown by Euros 2.19 (+4.07%) in 2015. Sales policies vis-à-vis mobile telephones, higher-added value services (upgrading) and additional services to existing customers (up-selling) have contributed to this growth. Of particular note has been the rise in 3P and 4P customers, which rose from 55.3% of the total customer base in 2014 to 63.3% in 2015.

Soho					
KPI	Unit	2014	2015 Euskaltel	December 2015 R	2015 Consolidated
Subs	#	47,038	47,684	40,479	88,163
o/w 1P (%)	%	32.7%	29.1%	27.8%	28.5%
o/w 2P (%)	%	26.1%	18.2%	37.3%	27.0%
o/w 3P (%)	%	31.1%	38.4%	28.6%	33.9%
o/w 4P (%)	%	10.2%	14.2%	6.3%	10.6%
Total RGUs	#	143,472	162,844	115,470	278,314
RGUs / sub	#	3.1	3.4	2.9	3.2
Global ARPU Fixed customers	€/month	65.0	65.7	59.9	65.3

Commercial strategy in the Business market is in line with that of the Residential segment. The growth in customers, despite not being able to offer football since August 2015, coupled with product initiatives and upgrading and up-selling policies, have contributed to improving all year-on-year indicators. There has been 93.98% growth in products sold and maintenance of ARPU, compared to 2014.

Selected financial data					
	Unit	2014	2015 Euskaltel	December 2015 R	2015 Consolidated
<b>Total revenues</b>	€m	<b>321.2</b>	<b>327.8</b>	<b>21.6</b>	<b>349.4</b>
Y-o-y change	%				8.8%
o/w residential	€m	195.7	202.4	13.4	215.7
Y-o-y change	%				10.2%
o/w Business	€m	93.4	92.2	7.1	99.3
Y-o-y change	%				6.3%
o/w Wholesale and Other	€m	25.2	24.3	1.1	25.4
Y-o-y change	%				0.8%
o/w Other Profit Neutral Revenues	€m	6.9	8.9	0.0	8.9
Y-o-y change	%				29.5%
<b>Adjusted EBITDA</b>	€m	<b>155.9</b>	<b>158.1</b>	<b>8.9</b>	<b>167.0</b>
Y-o-y change	%				7.1%
Margin	%	48.5%	48.2%	41.3%	47.8%
<b>Capital expenditures</b>	€m	<b>(42.2)</b>	<b>(46.9)</b>	<b>(6.3)</b>	<b>(53.1)</b>
Y-o-y change	%				25.9%
% total revenues	%	-13.1%	-14.3%	-29.1%	-15.2%
<b>Operational Free Cash Flow</b>	€m	<b>113.6</b>	<b>111.3</b>	<b>2.6</b>	<b>113.8</b>
Y-o-y change	%				0.2%
% EBITDA	%	72.9%	70.4%	29.3%	68.2%
<b>Net income</b>	€m	<b>36.8</b>	<b>6.8</b>	<b>2.0</b>	<b>7.2</b>

Residential revenues grew by 10.2% in 2015 compared to the prior year. This is due to the incorporation of R Cable revenues in December (Euros 13.4 million), an improvement in the ARPU (Euros 55.97 in 2015, an increase of Euros 2.19 on 2014) and an increase in products contracted by customers (from 3.0 to 3.3). For mobile customers, this increase has been 258,308 with a ratio of 1.7 lines per customer.

Business revenue amounted to Euros 99.3 million, up 6.3% on the same period in the prior year. This is largely attributable to R Cable's contribution in December (Euros 7.1 million), the decline in revenues from SMEs and large accounts in 2014 due to austerity measures in companies, and pressure on prices from the competition. This difference has been falling monthly however, with positive year-on-year growth rates in the last quarter of 2015. Business segment performance (SOHO) has been positive in 2015, with revenue growth of Euros 1.8 million compared to 2014, a rise of 5.0%.

Wholesale and other revenues are up a moderate 0.8%, despite the negative impact of regulatory changes on operator revenue at the end of 2014.

Adjusted EBITDA, which does not include the effect of costs related to the stock flotation or the acquisition of R Cable, amounted to Euros 167.0 million in 2015, an increase of 7.1% on 2014, with a revenue margin of 47.8%. These results show the success of managing operating costs and the efficiency measures implemented in prior years.

Investments during the year came to Euros 53.1 million, a Euros 10.9 million increase on the prior year. This rise is due to the incorporation of R Cable's investments in December (Euros 6.3 million), and to relevant projects carried out or started at Euskaltel in 2015. The plan to facilitate connection to 51,000 houses and industrial estates, the migration to VoIP platforms, the repositioning of broadband speeds, the WiFi Klean project, the new functionalities of the television service, and the initial roll-out of the proprietary 4G network have all contributed to this growth. These are projects involving technological, customer-oriented innovations which will allow them to enjoy the best services and us to increase our commercial offering and revenues in the coming years.

Operating cash flow, defined as the difference between EBITDA and investments, has resulted in a conversion rate of over 68%, maintaining our leading position in comparison with similar sector companies in Europe.

## Comparison of results for the years ended 31 December 2014 and 2015

As mentioned several times throughout this report, comparative data for 2015 reflects the consolidation of 12 months of activity at Euskaltel and the month of December for R Cable, whereas 2014 refers exclusively to the 12 months of activity at Euskaltel.

### a) Revenues

Revenues for the year ended 31 December 2015 amounted to Euros 343,259 thousand compared to Euros 315,109 thousand for the year ended 31 December 2014, an increase of Euros 28,150 thousand (of which Euros 20,967 thousand corresponds to R Cable) or 8.9%.

This increase is due to a substantial upturn in the macroeconomic environment and is confirmation of our recent years' residential and SOHO commercial strategy aimed at winning new customers in the 3P and 4P high-value packages and focusing on cross-selling and up-selling.

### b) Other income

Other income for the year ended 31 December 2015 amounted to Euros 431 thousand (of which Euros 64 thousand corresponds to R Cable), compared to Euros 331 thousand for the year ended 31 December 2014.

c) Work performed by the entity and capitalised

Work performed by the entity and capitalised for the year ended 31 December 2015 amounted to Euros 5,793 thousand (of which Euros 696 thousand corresponds to R Cable), compared to Euros 5,721 thousand for the year ended 31 December 2014. During 2014, agreements were reached with strategic partners in the areas of information systems (with the French multinational GFI) and network management and maintenance (with the Chinese multinational ZTE). Through these agreements, two instances of outsourcing have taken place involving the transfer of Euskaltel employees from these areas of activity. Although there was an increase in the number of household connections and a greater volume of new products and services, this caption has fallen due to the transfer of the workers mentioned. Previously, these employees performed internal work eligible for capitalisation, but are now invoiced by these companies and the investment is recognised directly.

d) Supplies

Supplies for the year ended 31 December 2015 amounted to Euros 77,220 thousand (of which Euros 6,130 thousand corresponds to R Cable), compared to Euros 71,524 thousand for the year ended 31 December 2014. Analysing only Euskaltel, these costs fell by Euros 434 thousand, or 0.6%. This reduction is basically due to the lower cost of content, mainly football in the last quarter of the year, and the competitive contract we have with our host that has largely offset the higher interconnection costs associated with the notable increase in mobile telephone lines during the year and the greater consumption of mobile data per line.

e) Personnel expenses

Personnel expenses for the year ended 31 December 2015 amounted to Euros 28,593 thousand (of which Euros 1,646 thousand corresponds to R Cable), compared to Euros 30,318 thousand for the year ended 31 December 2014, a decrease of Euros 1,725 thousand or 5.7%. This decline is due to the reduction in headcount related to the outsourcing of activities to GFI and ZTE, mentioned previously.

f) Other operating expenses

Other operating expenses for the year ended 31 December 2015 amounted to Euros 93,614 thousand (of which Euros 6,620 thousand corresponds to R Cable), compared to Euros 64,612 thousand for the year ended 31 December 2014, an increase of Euros 29,002 thousand or 44.9%. This rise is due to the aforementioned outsourcing and the significant, non-recurring costs incurred as a result of the stock flotation and the acquisition of R Cable.

g) Depreciation, amortisation and impairment

Depreciation, amortisation and impairment for the year ended 31 December 2015 amounted to Euros 83,309 thousand (of which Euros 5,854 thousand corresponds to R Cable), compared to Euros 81,508 for the year ended 31 December 2014, an increase of Euros 1,801 thousand. This rise is due to the contribution of R Cable in December, which was partially offset by the reversal of the provision for licences after the decision to roll out the 4G network.

It is also important to mention that as a result of the acquisition of R Cable, and after the purchase price allocation (PPA) process, certain intangible assets have been recognised and certain property, plant and equipment has been restated at fair value, which also entailed higher amortisation/depreciation.

h) Results from operating activities

As a result of the above, results from operating activities for the year ended 31 December 2015 fell by Euros 6,452 thousand to Euros 66,747 thousand (of which Euros 2,892 thousand corresponds to R Cable), compared to Euros 73,199 thousand for the year ended 31 December 2014. The main reason for this drop are the non-recurring expenses of Euros 15.4 million incurred as a result of the stock flotation and the acquisition of R Cable. Isolating this effect, results from operating activities would have been Euros 82,147 thousand, or 12.22% up on the prior year.



i) Net finance costs

Net finance costs for the year ended 31 December 2015 amounted to Euros 56,199 thousand (of which Euros 2,294 thousand corresponds to R Cable), compared to Euros 23,264 thousand for the year ended 31 December 2014, an increase of Euros 32,935 thousand, or 141.6%. This increase is basically attributable to the following:

- Expenses recognised during the year and related to the incentives plan for senior management, the board of directors and other key employees came to Euros 30,705 thousand compared to Euros 7,832 thousand for the year ended 31 December 2014.
- Costs of cancelling derivatives and financing amounted to approximately Euros 10,556 thousand.
- Despite debt rising from Euros 236.9 million at 31 December 2014 to Euros 1,369.1 million at 31 December 2015 (as a result of all the events described in section 5), borrowing costs have fallen due to the drop in average interest rates compared to the prior year. It should also be noted that a substantial part of debt in 2015 is attributable to the acquisition of R Cable at the end of November.

j) Income tax

Income tax for the year ended 31 December 2015 came to Euros 3,311 thousand (of which Euros 142 thousand corresponds to R Cable), compared to Euros 13,152 thousand for the year ended 31 December 2014. This reduction is due to lower profit before tax on account of the aforementioned non-recurring expenses.

k) Profit for the period

As a result of the above, profit for the period ended 31 December 2015 fell by Euros 29,546 thousand to Euros 7,241 thousand (of which Euros 456 thousand corresponds to R Cable), compared to Euros 36,783 thousand for the year ended 31 December 2014. As mentioned previously, profit for the year has been severely impacted by the non-recurring expenses of the stock flotation, the acquisition of R Cable and the repayment of debt. If we isolate the impact of non-recurring expenses for the past two years, net profit would have been Euros 49.6 million in 2015 and Euros 42.4 million in 2014, an increase of 16.9% in the last year.

## 6. Corporate governance and social responsibility

### 6.1 Corporate governance

In 2014 and 2015 we consolidated our actions with regard to corporate governance, implementing changes that enable us to assert that we work in a company that clearly promotes transparency and implements the good governance recommendations generally accepted in international markets, applying advanced business management ideas even beyond what would be strictly applicable under prevailing legislation.

These changes include the appointment of independent advisors, the creation of consultative committees within the board of directors (Audit and Control and Appointments and Remuneration for now, as the Company's by-laws and the regulations of the board permit other options), the launch of a corporate defence programme, with an ethical conduct channel that encourages the flow of information with absolute confidentiality, and the creation of an internal audit management team, whose functions are to provide assurance and advisory services with a systematic approach in compliance with the 2014-2016 Plan targets.

The Company has adapted its corporate governance to best practices.

## 6.2 Board of directors

Our board of directors is responsible for overseeing the Company and establishing our strategic, accounting, organisational and financial policies, among others. In accordance with Spanish legislation, the regulations of the board, and our by-laws, the chairperson of the board and, if applicable, the vice-chairperson, who acts as chair if the chair is absent or incapacitated, are elected from the members of the board of directors. The secretary and, if applicable, the vice-secretary of the board do not necessarily have to be board members. The board of directors is charged with calling general meetings of shareholders and applying any resolutions adopted by the shareholders.

The board of directors meets at least quarterly. Our by-laws and the regulations of the board stipulate that the majority (half plus one) of the members of the board (whether present in person or duly represented by another member of the board) constitutes a quorum. Unless otherwise stated in legislation or our by-laws, the resolutions of the board are approved by an absolute majority of the members present at a meeting, whether in person or duly represented. In the event of a tied vote, the chair has a casting vote.

### a) Consultative committees of the board

In compliance with our by-laws and the regulations of the board, our board of directors has an Audit and Control Committee and an Appointments and Remuneration Committee which are governed by the "Audit and Control Committee Regulations" and the "Appointments and Remuneration Committee Regulations", respectively.

#### *Appointments and Remuneration Committee*

The composition, duties and rules of the Appointments and Remuneration Committee is governed by our Appointments and Remuneration Committee Regulations.

The committee comprises a minimum of three and a maximum of five external directors (i.e. proprietary and independent). The majority of the Committee's members are independent directors. The Committee elects a chair from among the independent directors sitting on the Committee, with the chair having the casting vote in the event of a tied vote. The Committee appoints a secretary, who may be one of its members or the secretary or vice-secretary of the board.

The members of the Appointments and Remuneration Committee are appointed for a maximum of four years, and may be re-elected one or more times for maximum periods of four years. The chair's tenure is for a maximum of four years, and they may not be re-elected until one year has elapsed, without prejudice to remaining a member of the Appointments and Remuneration Committee. The secretary of the Committee's tenure is for a maximum of four years, and they may be re-elected one or more times for maximum periods of four years.

The Appointments and Remuneration Committee is charged, inter alia, with the following:

- advising the board of directors on the most appropriate make up of its committees in terms of size and the balance between the different types of directors;

- establishing and reviewing the criteria to be followed for the composition of the board and the selection of its candidates, defining its functions, capacities and competences, as well as determining the time and dedication necessary to carry out its duties properly;
- ensuring that whoever assumes the post of director satisfies, in all respects, the requisites of reputation, suitability, solvency, adequacy, experience, qualification, training, availability and dedication as regards their function and that they not be affected, directly or indirectly, by any incompatibility, prohibition, conflict or opposition of interests as regards the interests of the Company, when proposing candidates for the board;
- examining and organising the succession of the chair of the board and the Company's CEO and, if applicable, proposing candidates for the board of directors in order that succession be conducted in an orderly, planned fashion;
- submitting candidates for the appointment, promotion or cessation of executives, as well as proposals for reviewing and modifying the organisation structure and the allocation of responsibilities in the Company;
- informing the board of directors of the selection, appointment and remuneration of directors and senior executives of the Company and its Group;
- periodically reviewing the Company's policy of remunerating senior executives and proposing modifications and updates to the board of directors;
- ensuring compliance with the Company's remuneration policy and providing information on documents which require board approval.

The Appointments and Remuneration Committee meets between two and four times a year, and when its chair deems necessary.

#### *Audit and Control Committee*

The composition, duties and rules of the Audit and Control Committee are governed by our Audit and Control Committee Regulations.

Our Audit and Control Committee Regulations require that the Audit and Control Committee have a minimum of three and a maximum of five members, all of whom must be external directors. At least two members of the Audit and Control Committee must be independent directors and their appointment shall take into account their knowledge and experience in accounting, audit or both.

The chair of the Audit and Control Committee is elected by the committee from among its independent directors, who are elected for a maximum of four years, and they may only be re-elected one year after their tenure has ended, without prejudice to remaining a member of the Audit and Control Committee. The secretary of the Committee may be one of the members of the Committee or the secretary or vice-secretary of the board of directors.

The Audit and Control Committee is charged, inter alia, with the following:

- analysing the financial statements after the end of each year, examining the draft audit opinion, discussing the annual accounts and the audit report with the auditors, and presenting their recommendations to the board of directors before the annual accounts are authorised for issue based on the conclusions of the aforementioned activities;
- informing the shareholders at their annual general meeting on matters relating to the points proposed by the shareholders for their attention;
- supervising the internal audit and risk management services, as well as analysing the internal control systems with the external auditors to identify possible significant weaknesses;
- knowing, understanding and taking due account of the Company's financial reporting processes and internal control systems;

- establishing appropriate relations with the external auditor in order to receive information on issues that could compromise their independence, for analysis by the Committee, as well as any information related to the audit process;
- examining, before presentation, the financial reporting to be presented to the pertinent market regulators;
- providing information on transactions that could entail a conflict of interest;

The Audit and Control Committee meets between two and four times a year, before financial and risk management reports are presented to third parties, and as the chair deems necessary.

## Our social responsibility approach

Our social responsibility policy is based on the concept of sustainability, where Euskaltel, as a socially-responsible company, seeks to balance its Mission and Vision-driven corporate objectives with the expectations of its stakeholders, taking into account the economic, social and environmental aspects of its commitment to the economic and social development of the community in which it renders its services. Annually, and as part of its transparency undertaking to stakeholders, Euskaltel prepares its Corporate Responsibility Report, following the methodology based on the Global Reporting Initiative (GRI) 2006 for sustainability reports, and the GRI Sector Supplement for the telecommunications sector (2003).

Economic strategy is centred on maximising the value of its customer base, taking advantage of its leading position in the Basque Country, customer loyalty, its proprietary fibre optic network - which does not require any additional significant investment - and high brand value to consolidate market share and contribute to growth. Euskaltel is focused on increasing the penetration of convergent services bundles in order to raise average revenue per user (ARPU) and reduce churn. Mobility is key to this strategy and Euskaltel's goal is to offer its customers high-speed access anywhere through its fibre network, WiFi hotspots and the roll-out of its 4G network.

The cornerstone of the Company's strategy is that the incorporation of risk management in business decisions is essential for creating value for stakeholders and for developing a strategy that seeks long-term success and sustainability for both the company and the environment. One of these risks is environmental risk.

Euskaltel strives to effectively integrate environmental risk management into its management system, on the assumption that environmental protection concerns all people and activities and is a key issue for corporate sustainability. An environmental master plan has been drawn up and is employed as the principal tool.

This master plan is aligned and responds to Euskaltel's different internal and external undertakings, including those directly related to the environment, such as:

- UNE-EN ISO 14001: Environmental Management System. Requisites.
- EMAS III: EU Eco-Management and Audit Scheme
- Global Pact (10 principles).

Our social activity is twofold: internally, through people management, and society-wise, through institutional and sponsorship activity. We are aware that one of the pillars underpinning the sustainability of our business is our people. Their knowledge, competencies and skills are key to guaranteeing corporate competitiveness. Euskaltel, faithful to its foundation criteria, remains committed to the stability and continuity of its people. 100% of our workforce are on fixed, indefinite, full-time contracts.

Loyal to its vision, Euskaltel considers that its institutional and sponsorship activities are a tool for realising its undertaking as a company with strong territorial ties, in order to remain a caring, committed company with a clear vocation, and to form a part of the technological progress of the Basque Country, its natural market.

## 7. Financial risks

Our activities are exposed to credit risk, liquidity risk, and market risk, the latter of which includes currency and interest rate risk.

We use financial risk evaluation and mitigation methods suited to our activity and scope of operations, which are sufficient to adequately manage risks.

A summary of the main financial risks affecting us, and the measures in place to mitigate their potential affect, is as follows:

### a) Credit risk

Credit risk is the risk of financial loss to which we are exposed in the event that a customer or counterparty to a financial instrument fails to discharge a contractual obligation. This risk is mainly concentrated in receivables.

The probability of customer credit risk materialising is mitigated by the application of different policies, and the high level of dispersion of receivables. Among the different policies and specific practices are the customer acceptance policy, continual monitoring of customer credit, which reduces the possibility of default on the main receivables, and collection management.

The impact of bad trade debts on the income statement in 2015 was Euros 2.33 million (Euros 2.01 million in 2014), equivalent to 0.67% of turnover (0.64% in 2014). Aged, non-impaired receivables past due by more than 90 days at 31 December 2015 amount to Euros 3.49 million (Euros 0.82 million at the end of 2014, when R Cable was not included).

### b) Liquidity risk

Liquidity risk is the risk that the we will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets. Our approach to managing liquidity risk is to ensure, as far as possible, that it has enough liquidity to settle its debts as they fall due, in both normal and stressed conditions, without incurring unacceptable losses or compromising its reputation.

At the end of 2015 the consolidated Group had a non-current undrawn revolving credit facility of Euros 30 million, and current undrawn credit facilities totalling Euros 50 million.

Cash and cash equivalents reflect the amounts available with financial institutions that have high credit ratings.

At 31 December 2015, cash and cash equivalents amounted to Euros 23.37 million (Euros 10.65 million at the end of 2014).

We adjust the maturities of our debts to our capacity to generate cash flows to settle them. To do this, we have implemented a seven-year financing plan with annual reviews and regular analyses of our financial position, which includes long-term projections, together with daily monitoring of bank balances and transactions.

Although our working capital, defined as the difference between current assets and current liabilities (maturing in less than 12 months in both cases), is negative, this is mainly because of the way the business operates, resulting in the average collection period being shorter than the average payment period, which is common practice in the sector in which we operate. Another reason is the low level of merchandise and inventories on our balance sheet, which amounted to Euros 3.53 million at 31 December 2015 (Euros 2.31 million in 2014, when R Cable was not included).

### c) Market risk

Market risk is the risk that changes in prices could affect our revenue or the value of our financial instruments. The objective of managing market risk is to control exposure to this risk, within parameters we consider reasonable, and optimise returns.

Our scope of operations barely exposes us to currency or price risks, which may arise from occasional purchases in foreign currency of insignificant amounts.

Interest rate risks arises on variable-rate loans from financial institutions and related parties, which expose us to fluctuations in future cash flows.

We regularly revise our interest rate hedging policy. Under this policy, we assess the need to contract interest rate hedges.

We settle interest on a monthly basis, which allows us to closely monitor the performance of interest rates in the financial market.

For the year ended 31 December 2015, had interest rates risen by 100 basis points, with other variables remaining constant, consolidated profit (after tax) would have fallen by Euros 2,765,000 (Euros 2,475,000 for the year ended 31 December 2014).

## 8. Share price

### 8.1 Share price



Since the Company was floated on the stock exchange, its share price has risen by +21.89%. The Ibex 35 however dropped by -11.38% during the same period.

The share prices of other comparable telecommunications operators during the period July-December 2015 fluctuated by between -27.3% and +2%.

## 8.2 Volume of trading

### Volume of shares traded July to December 2015

<u>Period (1-Jul/31-Dec)</u>	<u>Volume of shares</u>	<u>Average daily</u>
Ordinary trading	50,616,370	386,385
Block trading	79,421,386	606,270
	<b>130,037,756</b>	<b>992,655</b>

### Trading days peak and trough for the period

<u>Date</u>	<u>Close</u>	<u>Volume of shares</u>
1-Jul-15	10.05 €	16,695,817
20-Aug-15	11.00 €	11,080

## 9.- Outlook and events after the reporting period

The signs of recovery in economic activity, and more specifically, the forecast growth in revenues announced by the main players in the telecommunications sector, lead us to believe that a sustained recovery is highly likely, which will raise our current operating revenues.

In addition, forecast improvements from the complementary strengths being discovered and implemented as a result of incorporating the knowledge and experience of R Cable Telecomunicaciones de Galicia, S.A. people, mean we can expect a period of expansion and development with excellent prospects of profitability for our shareholders.

Focusing on 2016, projects which commenced in 2015 and which are still producing results, together with those in the pipeline for next year, particularly as regards expansion to new houses and industrial areas and technological developments designed to improve our services and mobile solutions, will enable us to surpass all relevant economic indicators achieved in 2015.

Finally, no significant events after the 2015 reporting period have arisen.

## 10.- Acquisition of own shares

At 31 December 2015 we held 139,806 own shares. During the year a total of 2,031,891 shares were acquired, and 1,892,085 were sold or delivered.

The acquisition of own shares is part of the liquidity contract that Euskaltel signed on 17 September 2015 with Norbolsa, Sociedad de Valores, S.A. (Norbolsa), to manage its own share portfolio.

Under this contract, Norbolsa will trade Euskaltel shares on the Spanish securities markets with a view to achieving the following:

- a) Favour liquidity in transactions.
- b) Share price stability.

The liquidity contract has a duration of 12 months, and is tacitly renewable for a further 12 months. 125,000 shares have been earmarked for the securities account associated with the contract, and Euros 1,375,000 for the cash account.

This contract is based on the liquidity contract model included in Spanish National Securities Market Commission Circular 3/2007 of 19 December 2007 on liquidity contracts, so that it will be accepted as market practice.

## 11.- R+D+i

In this section we refer to activities carried out at Euskaltel. We have opted to omit reference to R Cable's activity as it is difficult to confine it exclusively to the month of December. What is evident is that R Cable's research and development activity is very significant and intense in light of the progress made in this area, and details will be included in subsequent complete accounting periods.

### R&D activities

Euskaltel pays particular attention to research and development as these are the foundations on which service offerings to the market will be built in the near future. With a vocation of constant innovation in the market, an effort must be made in this regard. The research and development projects in which Euskaltel is involved are based on emerging technologies that are not yet a commercial reality and for which no business case yardsticks exist, but which have great potential.

The fundamental objectives are twofold: firstly, get to know and familiarise ourselves with the new technology and its possible applications, and, secondly get to know, through the project consortium, an ecosystem of companies with which to build a possible business case in the near future.

Throughout 2015, Euskaltel actively participated in a series of R&D projects centred mainly on the following:

- Health and tele-assistance (EBIZI)
- Smart cities and community WiFi (EMENHIR)
- Knowledge of television use (NORU)

For each of these projects a consortium of various field-related companies was set up, which included Technology Centres of the Basque Science, Technology and Innovation Network. These three projects in 2015 were part of the official research and development programmes promoted by the Basque Government through SPRI.

### Innovation activities

Euskaltel focuses its technological innovation activity on the development of new systems and processes and the creation of new telecommunications products and services.

The projects for developing new systems and processes cover the design and development of tools in Euskaltel's integral management system, which allow us to manage each aspect of offering telecommunication services, and which involves the incorporation of new technology and functionalities of customer management and service systems, internal support and operations, and different marketing and sales processes for the company.



Work during the year involved developing customer marketing, sales and service systems (developed in the CRM to incorporate new functionalities and services, improving our web channel as a platform for communication and interaction with our customers, progress in sales information systems, etc.); business support systems (automation and improvement of product migration systems, improvements in logistics processes associated with customer order management, migration of our geographical information system, progress in billing systems etc.) and improvements in network diagnostics (monitoring of equipment at customers).

In relation to our products and services, we strive to promote the development of the information society, working to offer users the most advanced telecommunications solutions on the market through directly managed proprietary networks, and taking advantage of all the service possibilities that new technologies have to offer.

Work during the year involved developing new products and services (new digital television, new corporate solutions for customers, and broadband service requirements etc.), new processes and innovations in products and services (new VoIP solution, Euskaltel WiFi, launch of 4G/LTE etc.) and new strategic projects for the future (integration of services in the digital home etc.).

## 12.- Average supplier payment period

Details of the average payment period referred to in the Spanish Institute of Accounting and Auditing's Resolution of 29 January 2016 are as follows:

	2015
Average supplier payment period (in days)	41.08
Transactions paid ratio	46.83
Transactions payable ratio	35.60
Total payments made (thousands of Euros)	253,377
Total payments payable (thousands of Euros)	104,832

The average payment period is the time between delivery of the goods or provision of the services by the supplier and payment of the transaction in accordance with the methodology described in article 5 of the Resolution.

## 13. Annual Corporate Governance Report

The 2015 Annual Corporate Governance Report, which forms part of the consolidated directors' report, was approved by the board of directors of Euskaltel, S.A. on 24 February 2016 and is available on the Company's website ([www.euskaltel.com](http://www.euskaltel.com)) and that of the Spanish National Securities Market Commission ([www.cnmv.es](http://www.cnmv.es)).

Derio, 24 February 2016

In compliance with prevailing legislation, the directors of Euskaltel, S.A. have authorised for issue the consolidated annual accounts (comprising the consolidated balance sheet, consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and the notes thereto) and the consolidated directors' report for the period ended 31 December 2015.

The directors declare that they have signed each of the above-mentioned documents in their own hand, and in witness thereof sign below

Signed:

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**Mr. Alberto García Erauzkin**  
(Chairman)

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**Mr. José Ángel Corres Abasolo**  
(Vice-chairman)

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**Ms. Alicia Vivanco González**  
(Board member)

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**Mr. Alfonso Basagoiti Zavala**  
(Board member)

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**Mr. Javier Fernández Alonso**  
(Board member)

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**Ms. Bridget Cosgrave**  
(Board member)

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**Mr. Richard Alden**  
(Board member)

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**Ms. Belén Amatriaín Corbi**  
(Board member)

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**Mr. Iñaki Alzaga Etxeita**  
(Board member)