REPORT FORMULATED BY THE BOARD OF DIRECTORS OF EUSKALTEL, S.A. IN CONNECTION WITH THE POSSIBLE CREATION OF A SECURITY INTEREST ON THE COMPANY'S TELECOMMUNICATIONS NETWORK WHICH IS SUBMITTED TO THE SHAREHOLDERS FOR APPROVAL AT THE ANNUAL GENERAL SHAREHOLDERS' MEETING CALLED TO BE HELD ON 27 AND 28 JUNE 2016, ON FIRST AND SECOND CALL, RESPECTIVELY, UNDER ITEM NINE ON THE AGENDA

I. Purpose of the Report

The purpose of this report formulated by the Board of Directors of Euskaltel, S.A. is to provide a rationale for the proposal to be submitted, under item nine on the agenda and pursuant to the provisions of Section 160.f) of the Companies Act (*Ley de Sociedades de Capital*) to the shareholders for approval at the Ordinary General Shareholders' Meeting called to be held on 27 June 2016, on first call, and on the following day, 28 June 2016, on second call, concerning approval, if appropriate, of a transaction consisting of the creation by the Company of a security interest in Euskaltel's telecommunications network (the "**Network**") in favour of a bank syndicate, and which is one of the possible guarantees to be provided by the Company under the Financing Agreement (as defined below) (the "**Transaction"**).

Section 160.f) of the Companies Act provides that it is within the purview of the shareholders acting at a general shareholders' meeting to deliberate and approve the acquisition, disposition or contribution of core assets to another company. This section further provides that assets are presumed to be core assets if the amount of the transaction exceeds twenty-five percent of the assets disclosed in the most recent approved balance sheet of the company in question, among other instances.

While the creation of an encumbrance (or, more specifically, a security interest) is not one instances included in the text of Section 160.f) of the Companies Act, the Company's Board of Directors has nevertheless deemed it appropriate to submit the Transaction to the shareholders for approval at the General Shareholders' Meeting, given the Transaction's significance for Euskatel if carried out.

It is therefore proposed to the shareholders at the General Shareholders' Meeting that they authorize the Transaction for the purposes of the provisions of said legal provision, and that they delegate all such powers as may be necessary or appropriate for the implementation thereof.

The Report will be available to the shareholders of the Company from the time of the call to the Annual General Shareholders' Meeting at which the proposal for approval of the Transaction is to be submitted. A more detailed description of the Transaction is provided below.

II. Report

1. Background

On 3 June 2015, Euskaltel and a bank syndicate entered into a financing agreement, which was subsequently amended on 26 June 2015 and 5 October 2015 and finally formalized in a notarial instrument dated 27 November 2015 (the "**Financing Agreement"**).

The Financing Agreement entailed an increase in Euskatel's bank financing facilities to a total of 1,400 million euros, and was implemented by means of:

(i) a tranche A in the amount of 535 million euros;

(ii) a tranche B, also in the amount of 535 million euros;

(iii) an institutional debt tranche (TLB-3) of 300 million euros, which was successfully syndicated among domestic and international institutional funds, and

(iv) a revolving credit facility in the amount of 30 million euros.

The purpose of the aforementioned Financing Agreement was two-fold: (i) the acquisition of R Cable y Telecomunicaciones Galicia, S.A. ("**R Cable**"); and (ii) the refinancing of the Company's debt and of the debt of R Cable.

Under the Financing Agreement and the security undertaking agreement signed (along with the Financing Agreement) with the financing institutions, Euskaltel was required to guarantee performance of the obligations assumed under said Financing Agreement through the creation of guarantees additional to those created upon execution of the Financing Agreement in favour of the bank syndicate.

2. Description of the security interest

For purposes of this Report, the Network comprises a number of pipelines and channels deployed by Euskaltel in the territory of the Autonomous Community of the Basque Country, which may be grouped into (i) the trunk network, and (ii) the capillary network.

(i) the trunk network consists of channels used mainly to deploy the primary fibre optic network connecting the various population centres of the Autonomous Community of the Basque Country (the "**Trunk Network**").

(ii) the capillary network consists of the channels used mainly to deploy the secondary and tertiary fibre optic networks starting from the Trunk Network, as well as customer access networks consisting of coaxial cables, copper pairs and fibre optic (the "**Capillary Network**").

As described in this Report, it is proposed to the shareholders at the General Shareholders' Meeting to authorise the possible creation by Euskaltel of a non-possessory security interest, or any other *in rem* security interest allowed by law, in the Network (which includes both the Trunk Network and the Capillary Network), which would be one of the possible guarantees to be given by the Company in accordance with the provisions of the Financing Agreement in force and of the aforementioned security undertaking agreement (the "**Security**").

3. Rationale for the transaction

Considering all of the foregoing, the Board of Directors submits for consideration of the shareholders at the General Shareholders' Meeting the proposed resolution authorising the Company to carry out the Transaction pursuant to the provisions of Section 160.f) of the Companies Act, delegating to the Board of Directors all such powers as may be necessary or appropriate to carry out the Transaction, if appropriate.

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In Derio, 24 May 2016