REPORT PREPARED BY THE BOARD OF DIRECTORS OF EUSKALTEL, S.A. RELATING TO THE PROPOSED INCREASE IN SHARE CAPITAL BY MEANS OF NON-MONETARY CONTRIBUTIONS CONSISTING OF EQUITY INTERESTS INTO WHICH THE SHARE CAPITAL OF PARSELAYA, S.L.U. OWNED BY ZEGONA LIMITED IS DIVIDED, AS REFERRED TO IN ITEM SIX OF THE AGENDA FOR THE ORDINARY GENERAL SHAREHOLDERS' MEETING OF THE COMPANY CALLED FOR 26 JUNE 2017, ON FIRST CALL, AND FOR 27 JUNE 2017, ON SECOND CALL

I. Object of the report

The Board of Directors of Euskaltel, S.A. has resolved to call an Ordinary General Shareholders' Meeting to be held on 26 June 2017 on first call and on 27 June 2017 on second call, and to submit to the shareholders at the General Meeting, under item six of the agenda, the approval of an increase in capital charged to non-monetary contributions (the "**Increase in Capital**" or the "**Proposal**").

This report is prepared in compliance with the provisions of Sections 286, 296 and 300 of the Consolidated Text of the Companies Act (the "**Companies Act**") approved by Royal Legislative Decree 1/2010 of 2 July, and Section 133 of Royal Decree 1784/1996 of 19 July approving the Regulations of the Commercial Registry (the "**Regulations of the Commercial Registry**") in order to provide detailed information regarding the Proposal and to provide a rationale for and develop the resulting bylaw amendment.

II. Description of Telecable and of the agreement with Zegona

The Increase in Capital is intended to create new shares in consideration for the non-monetary contribution of 98.5% of the equity interests into which the share capital of Parselaya, S.L.U. ("**Parselaya**") is divided.

The Increase in Capital occurs within the framework of the acquisition by Euskaltel of Telecable de Asturias, S.A.U. ("**Telecable**") through the indirect acquisition of 100% of the share capital of Telecable (the "**Transaction**"). Specifically, Euskaltel will acquire from Zegona Limited ("**Zegona**" or the "**Contributor**") 100% of the share capital of Parselaya. Parselaya, in turn, is the holder of 100% of the shares of Telecable Capital Holding, S.A.U., which in turn is the holder of 100% of the shares into which the share capital of Telecable is divided.

The enterprise value of Telecable for purposes of the Transaction has been set at 686,100,000 euros, including 245,000,000 euros of estimated net debt of Telecable as of 30 June 2017 (which will be refinanced by Euskaltel), which results in an equity value of 441,100,000 euros for 100% of the share capital of Parselaya, including the intragroup loan dated 14 August 2015 between Parselaya and Zegona (Lux) S.à r.l. (the "**Intragroup Loan**"). The consideration is subject to customary adjustments of net debt and working capital for these types of transactions.

Subject to subsequent adjustments agreed to in the purchase and exchange agreement (the "**Purchase and Exchange Agreement**"), the Transaction will be implemented by means of:

(i) an initial cash payment in the amount of 186,500,000 euros, less the net amount of the debt for all items under the Intragroup Loan and any adjustments for net debt and working capital. This first payment corresponds to the purchase from Zegona of the equity interests representing 1.5% of the share capital of Parselaya; and

(ii) the contribution of the remaining equity interests of Parselaya, representing 98.5% of the share capital of this company (and which are identified later in this report), within the framework of the Increase in Capital, with Zegona receiving a total of 26,800,000 shares of Euskaltel.

The Purchase and Exchange Agreement is subject to the conditions precedent that are described in the report of the Board of Directors relating to item five of the agenda.

Telecable is the leading telecommunications operator in Asturias, offering television, internet, mobile and fixed telephony services. Established in 1995, it was initially made up of Telecable de Oviedo, Telecable de Gijón and Telecable de Avilés, and since then has grown to become the principal telecommunications company in the Principality of Asturias.

Over the years, Telecable has evolved by virtue of the expansion of the services it offers, mainly on the basis of the technological advantage provided by some 3,000 kilometres of next-generation fibre optic network, which does not require significant additional investments, and which covers all of the main urban centres in Asturias. In the residential market, the company has a 68% share of pay-TV, 31% of fixed, 39% of broadband, and 16% of mobile.

The company is recognised not only for its major penetration in Asturias, but also for its high levels of service quality and customer service. Specifically, it currently has 39 authorised sales points throughout the Principality of Asturias, which, together with an extensive network of direct sales stores, means a highly developed sales force.

Telecable currently employs approximately 180 people, and during 2016 had turnover of 138,000,000 euros, with adjusted EBITDA reaching 65,000,000 euros.

III. Report of the Board of Directors for purposes of Sections 286 and 296 of the Companies Act

1. Terms of the Increase in Capital

The Increase in Capital will be in the nominal amount of 80,400,000 euros, by means of the issuance and flotation of a total of 26,800,000 ordinary shares, with a par value of 3.00 euros each, of the same class and series as those currently outstanding, represented by book entries.

The new shares will be issued at their par value of 3.00 euros per share plus a share premium that will be the value obtained by deducting the par value from the issue price.

The issue price is initially set at 9.50 euros per share (of which 3.00 euros would correspond to the par value and 6.5 euros would correspond to the share premium), assuming that the consideration in cash for the equity interests representing 1.5% of the share capital of Parselaya (after deducting the amount owed by Parselaya for all items under the Intragroup Loan and any adjustments for net debt and working capital) is not less than 3,877,157 euros at the time the Increase in Capital is to be implemented.

By way of exception to the foregoing, if the consideration to be paid in cash for the equity interests representing 1.5% of the share capital of Parselaya (after deducting the amount owed by Parselaya for all items under the Intragroup Loan and any adjustments for changes in actual net debt and working capital at 30 June 2017 compared to the estimated amounts, all at the time the Increase in Capital is to be implemented) is less than 3,877,157 euros, the total cash amount of the Increase in Capital (par value plus share premium) will be set at 98.5% of the result of deducting the following two amounts from the figure initially forecast for the equity value of Telecable (441,100,000 euros): (1) the amount owed by Parselaya under the Intragroup Loan for all items; and if any, (2) adjustments for debt and working capital. In this case, the issue price per share will be the result of dividing the total cash amount of the Increase in Capital (441,100,000 euros less items (1) and (2) above) by the number of Euskaltel shares to be issued (i.e. 26,800,000), with a par value of 3.00 euros for each of the new shares and the rest being the share premium.

This share price results from the valuation of Parselaya agreed to by the parties in accordance with market standards, as explained in more detail later in this report.

The par value and share premium corresponding to the new shares as determined above must be fully disbursed by Zegona through the contribution of equity interests representing 98.5% of the capital of Parselaya at the time of subscription (and which are identified later in this report).

Pursuant to the provisions of Section 304 of the Companies Act, given that the consideration for the Increase in Capital consists of non-monetary contributions, the current shareholders of Euskaltel will not have pre-emptive rights regarding the new shares to be issued by virtue of the Increase in Capital, which must be subscribed and paid for by Zegona.

2. Rationale for the Increase in Capital

The Increase in Capital is intended to be used by Euskaltel to acquire the equity interests representing 98.5% of the share capital of Parselaya, a holding company that indirectly holds all of the shares of Telecable, such that, combined with the purchase of the other equity interests representing 1.5% of the share capital of Parselaya, this company would come to be wholly owned by Euskaltel.

Euskaltel will acquire exclusive control of Telecable by virtue of the Transaction. The Company's Board of Directors believes that the acquisition and subsequent integration of Telecable's business will allow for:

(a) the creation of synergies such as (i) better access to and ability to negotiate regarding products, services and content, (ii) combining systems and technologies, (iii) optimisation of contractual relations with suppliers, and/or (iv) harmonisation of growth strategies, among others;

(b) the maximisation of the value of their customers, based on the leadership position held in their respective markets, the loyalty of their respective customers, the high value of their brands, and the positioning of the companies; and

(c) increasing their size and significance in the Spanish telecommunications market, while simultaneously maintaining their local strength in the Basque Country (Euskadi), Galicia and Asturias.

Furthermore, the Transaction will entail a strengthening of Euskaltel's equity, as it will increase its share capital and its share premium, which will reduce its relative leverage level by decreasing the proportion of indebtedness to the Company's equity, thus increasing its ability to implement its shareholder remuneration policy.

In addition, the Increase in Capital will give rise to an increase in the liquidity of the shares of Euskaltel on the market in the medium term, by increasing the number of shares issued and outstanding. In any event, the agreement between Euskaltel and Zegona includes a stability agreement whereby there is a temporary restriction on dispositions of Euskaltel shares by Zegona, as well as the safeguards required for possible dispositions of shares by Zegona to take place in an orderly manner and subject to rules mitigating the impact of possible sales of securities on the listing price of the security.

3. Adoption of the Increase in Capital, if approved by the shareholders acting at the Ordinary General Shareholders' Meeting of Euskaltel

Euskaltel's Board of Directors hereby decides to submit the Increase in Capital for approval of the shareholders at the Ordinary General Shareholders' Meeting expected to be held on 26 June 2017 on first call or 27 June 2017 on second call.

Subject to approval of the Increase in Capital by the shareholders and the subscription of and payment for the shares issued thereunder by Zegona, it is hereby proposed to delegate authority to the members of Euskaltel's Board of Directors, the non-member Secretary of the Board of Directors and the non-member Deputy Secretary of the Board of Directors, such that each of them, acting individually, may implement the Increase in Capital, determine the share price for the Increase in Capital on the date of implementation by means of the application of the mathematical formula described in point 1 above (provided that this is required due to the occurrence of the circumstances described above), amend the Bylaws of Euskaltel and perform all acts required to implement the Increase in Capital.

4. Implementation of the increase and amendment of the Bylaws

The Increase in Capital, the proposal for which is justified as indicated above, will entail the amendment of article 6 of the Bylaws of Euskaltel, which will read as follows upon implementation of the Increase in Capital:

"**Article 6. Share capital**

The share capital is 535,936,080 euros, divided into 178,645,360 shares, each having a par value of 3.00 euros, of the same class and series, numbered consecutively from 1 to 178,645,360, both inclusive, with the same political and economic rights, and which are fully subscribed and paid up."

IV. Report of the board of directors for purposes of Section 300 of the Companies Act

As the Increase in Capital is a capital increase by means of non-monetary contributions, and pursuant to the provisions of Section 300 of the Companies Act, a report must be issued describing the projected contributions, the value thereof, the persons that are to make them, the number and par value of the shares to be issued, the amount of the capital increase, and the guarantees adopted for the effectiveness of the increase based on the nature of the assets making up the contribution.

In compliance with such legal requirement, the members of the Board of Directors of Euskaltel state as follows:

1. Projected contribution and valuation thereof

The Parselaya equity interests to be included within the assets of Euskaltel consist of 193,427,260 equity interests, numbered 2,945,594 to 196,372,853, both inclusive, with a par value of 0.01 euro, free of liens and encumbrances, and representing 98.5% of the share capital of Parselaya, a Spanish company with a registered office at calle Profesor Potter, número 190, 33203 Gijón (Asturias), registered with the Commercial Registry of Oviedo at volume 4,169, folio 144, sheet AS-49,074, and bearing Tax Identification Number (N.I.F.) B-

87,273,272. Upon implementation of the Increase in Capital, and after the purchase of the remaining equity interests of Parselaya representing 1.5% of its share capital, Euskaltel will be the sole shareholder of Telecable.

For purposes of determining the total enterprise value of Telecable, and consequently, the equity value of Parselaya to be contributed by Zegona as consideration for the Euskaltel shares it subscribes and pays up within the context of the Increase in Capital, the Board of Directors has taken into account the following valuation methods, all commonly accepted by the international financial community:

(a) **Multiples for comparable companies**: this method, which is considered to have priority under international (International Financial Reporting Standards) and U.S. accounting standards, consists of estimating the total enterprise value of Telecable based on implicit multiples obtained from comparable listed companies and applied to Telecable's estimated financial metrics for 2017 and 2018.

After analysing the various ratios customarily used to establish comparisons in terms of multiples, "Enterprise value / EBITDA" and "Enterprise value / (EBITDA – Capex)" have been taken as the most relevant and trustworthy multiples, and Telenet Group Holding NV ("Telenet"), Liberty Global plc ("Liberty Global"), Tele Columbus AG ("Tele Columbus") and Com Hem Holding, AB ("Com Hem") (all, the "Comparables") have been taken as the principal companies comparable to Telecable.

(b) **Comparable transactions:** this method consists of estimating the total enterprise value of Telecable based on multiples of acquisition prices paid in similar prior transactions and that also include any value given to synergies of the transaction and the control premium implicit in acquisitions of majority or controlling interests.

As in the case above, the implicit "Enterprise value / EBITDA" multiple for prior transactions in acquisitions of majority or controlling interests between operators in the same market without overlapping business has been taken as a reference for purposes of the comparison.

(c) **Discounted free cash flow**: this basic valuation method consists of estimating the total enterprise value of Telecable, considering the company like an investment, as the sum of the free cash flows that will be generated in the future discounted and valued at the present time. This method includes the results of valuing the various factors that affect the business and financial results of Telecable, including an estimate of the synergies and implementation costs arising from the merger with Euskaltel. The estimated flows are valued at the present time based on a discount rate ("WACC") and an estimation of perpetual growth ("TGR") of Telecable in line with public estimates for comparable companies.

Of the above methods, the Board of Directors believes that the discounted free cash flow method is the most relevant for purposes of determining the total enterprise value of Telecable, having used the comparable companies multiples method and the comparable transactions method as elements for contrasting the results obtained with the first of said methods.

Based principally on this method, the Board of Directors believes that the total enterprise value, including 245,000,000 euros of estimated net debt of Telecable as of 30 June 2017 (which will be refinanced by Euskaltel), which is equal to 686,100,000 euros, and the equity value attributed to 100% of the equity interests of Parselaya within the framework of the

Increase in Capital, which is 441,100,000 euros (including the debt for all items under the Intragroup Loan and before any adjustments), agreed to by Euskaltel and Zegona, are acceptable.

For their part, Euskaltel and Zegona have agreed to value the shares of Euskaltel as described in section III.1. This value is substantially in line with the average weighted price at which they traded on the Automated Quotation System (*Sistema de Interconexión Bursátil*) of the four Spanish Stock Exchanges on which they are listed over the two-month period prior to the date of announcement of the Transaction on 16 May 2017, which was 9.48 euros. The shares of Euskaltel to be delivered will be newly issued shares, will be represented by book entries, and will have the same financial, voting and like rights as the shares already issued and outstanding, except for the right to receive the supplemental dividend with a charge to financial year 2016.

2. Identification of the Contributor

The contribution of the Parselaya equity interests will be made by Zegona, a Jersey entity, with a registered address at One Waverley Place Union Street, St. Helier, Jersey JE1 1AX, registered with the Companies Registry of Jersey under number 117602, and bearing Spanish Tax Identification Number (N.I.F.) N-8265893-A.

For its part, Zegona is wholly owned by Zegona Communications PLC, a British company, with a registered office at 20 Buckingham Street, London WC2N 6EF, organised and registered in England and Wales under number 09395163, and which is listed on the London Alternative Investment Market. Zegona Communications PLC is a holding company created to acquire businesses in the European telecommunications sector. It thus acquired Telecable on 14 August 2015.

As of the date of this report, Zegona Communications PLC is not the direct or indirect holder of shares of Euskaltel.

3. Number and par value of the shares to be issued by Euskaltel

The number of shares to be issued by Euskaltel as consideration for the equity interests representing 98.5% of the share capital of Parselaya is 26,800,000, and the par value per unit thereof is 3.00 euros. The share premium will be the difference between the par value per unit and the share price of the new shares of Euskaltel.

The total nominal amount of the increase in capital is 80,400,000 euros.

4. Guarantees adopted for the effectiveness of the contribution

In compliance with the provisions of Section 67 of the Companies Act, the Board of Directors will request the Commercial Registry of Biscay to appoint an independent expert to issue a report describing the equity interests of Parselaya and the value thereof, stating the standards used, and whether this valuation corresponds to the par value and the share premium of the shares issued as consideration.

It is proposed to authorise the members of the Board of Directors of Euskaltel, the non-member Secretary of the Board of Directors and the non-member Deputy Secretary of the Board of Directors, such that any of them, acting individually, may submit the request for appointment of an independent expert to the Commercial Registry of Biscay and take each and every one of the steps necessary or appropriate with respect to the appointment of the independent expert and the issuance of the report thereby.

V. Proposed resolution regarding the Increase in Capital

The full text of the resolution regarding the Increase in Capital that is proposed to be submitted for approval of the shareholders at the Ordinary General Shareholders' Meeting of Euskaltel is as follows:

"__ITEM SIX ON THE AGENDA__

__Approval of an increase in capital by means of non-monetary contributions, with a delegation of powers to the Board of Directors, with express power of substitution, including, among others and pursuant to the provisions of Section 297.1.a) of the Companies Act, the power to set the date on which the increases must be implemented and to amend article 6 of the Bylaws__

__PROPOSED RESOLUTION RELATING TO ITEM SIX__

It is hereby resolved to increase the share capital upon the terms set out in the report of the Board of Directors issued for said purpose and made available to the shareholders as from the call to this Ordinary General Shareholders' Meeting.

1.1. __Increase in share capital by means of non-monetary contributions__

Increase in the share capital of Euskaltel in the nominal amount of 80,400,000 euros, by means of the issuance and flotation of a total of 26,800,000 ordinary shares, with a par value of 3.00 euros each, of the same class and series as those currently outstanding, represented by book entries.

The increase in capital must be subscribed and paid in by Zegona Limited by means of the non-monetary contribution described in section 1.2 below.

1.2. __Consideration for increase in capital__

*The shares issued in implementation of this resolution will be fully paid up by means of the contribution of 193,427,260 equity interests, numbered 2,945,594 to 196,372,853, both inclusive, of Parselaya, S.L.U. ("**Parselaya**"), a Spanish company with an address at calle Profesor Potter, número 190, 33203 Gijón (Asturias), and registered with the Commercial Registry of Oviedo at volume 4,169, folio 144, sheet AS-49,074, bearing Tax Identification Number (N.I.F.) B-87,273,272, with a par value of 0.01 euro, free of liens and encumbrances, and representing 98.5% of the capital of Parselaya (the "**Parselaya Equity Interests**").*

*The contribution of the Parselaya Equity Interests will be made by Zegona Limited ("**Zegona**"), with a registered office at One Waverley Place Union Street, St. Helier. Jersey JE1 1AX, registered with the Companies Registry of Jersey under number 117602, and bearing Spanish Tax Identification Number (N.I.F.) N-8265893-A.*

1.3. __Issue price__

*The issue price (par value plus share premium) for each new share will be 9.50 euros per share, assuming that the consideration in cash for the equity interests representing 1.5% of the share capital of Parselaya (after deducting the amount owed by Parselaya for all items under the intragroup loan dated 14 August 2015 between Parselaya and Zegona (Lux) S.à r.l. (the "**Intragroup Loan**") and any adjustments for net debt and working capital) is not less than 3,877,157 euros. If, on the other hand, the consideration to be paid in cash for the equity interests representing 1.5% of the share capital of Parselaya (after deducting the amount owed by Parselaya for all items under the Intragroup Loan and any adjustments for net debt and working capital) is less than 3,877,157 euros, the total cash amount of the increase in capital (par value plus share premium) will be set at 98.5% of the result of deducting the following two amounts from the figure initially forecast for the equity value of Telecable*

(441,100,000 euros): (1) the amount owed by Parselaya under the Intragroup Loan for all items; and, if any, (2) adjustments for debt and working capital. In this case, the issue price per share will be the result of dividing the total cash amount of the Increase in Capital (441,100,000 euros less items (1) and (2) above) by the number of Euskaltel shares to be issued (i.e. 26,800,000), with a par value of 3.00 euros for each of the new shares and the rest being the share premium.

1.4. Rights corresponding to the new shares

The new shares will give the holder thereof the same financial, voting and like rights as the ordinary shares of the Company then outstanding as from the date on which the increase is declared to be subscribed and paid up, except for the right to receive the supplemental dividend with a charge to financial year 2016.

1.5. No pre-emptive rights

Pursuant to the provisions of Section 304 of the Companies Act, and as it is an increase in capital with a charge to non-monetary contributions, there is no pre-emptive right accruing to the existing shareholders of the Company.

1.6. Representation of the new shares

The new shares will be represented by book entries, the book-entry registration of which will be entrusted to Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (Iberclear) and its member entities.

1.7. Implementation of the increase

Once the full subscription of and payment for the increase in capital by Zegona has been verified, the Board of Directors, the non-member Secretary of the Board of Directors and the non-member Deputy Secretary of the Board of Directors may declare the increase in capital to be subscribed and paid up, and thus implemented, declaring the text of article 6 of the Bylaws ("Share capital") to be amended to reflect the new share capital figure and the number of resulting shares, provided that it could not be verified and implemented by the shareholders acting at this General Meeting.

1.8. Admission of the new shares to trading

Resolve to request the admission to trading of the new shares on the Bilbao, Madrid, Barcelona and Valencia Stock Exchanges, through the Automated Quotation System (Continuous Market), and proceed to request the competent bodies to include the new shares of the Company in the book-entry registers of Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (Iberclear) as well as take any other steps and perform any other acts as are required and submit the required documents to the competent bodies.

Once the increase in capital has been implemented, the Board of Directors, or any of the persons identified in section 1.10 below by delegation therefrom, may make the corresponding requests, prepare and submit all appropriate documents upon the terms they deem advisable, and perform any acts necessary for such purpose.

1.9. Amendment of the Bylaws

Upon implementation of the increase in capital, article 6 of the Bylaws of Euskaltel shall read as follows:

*"**Article 6. Share capital***

The share capital is 535,936,080 euros, divided into 178,645,360 shares, each having a par value of 3 euros, of the same class and series, numbered consecutively from 1 to 178,645,360, both inclusive, with the same political and economic rights, and which are fully subscribed and paid up."

1.10. Delegation of powers for the implementation and formalisation of the foregoing resolutions

Without prejudice to any other delegations already approved by the shareholders at the General Meeting, it is hereby resolved:

a) To delegate authority to the members of the Board of Directors, the non-member Secretary of the Board of Directors and the non-member Deputy Secretary of the Board of Directors such that any of them, acting severally, once full subscription of and payment for the increase by Zegona has been verified, may declare the increase in capital to be subscribed and paid up, and thus implemented, declaring the text of article 6 of the Bylaws ("Share capital") to be amended to reflect the new share capital figure and the number of resulting shares, provided that it could not be verified and implemented by the shareholders acting at this General Meeting.

b) To authorise the members of the Board of Directors, the non-member Secretary of the Board of Directors and the non-member Deputy Secretary of the Board of Directors, severally, such that any of them, within the time limits set out in Section 297.1.a) of the Companies Act, may perform any acts and execute any public or private documents as are necessary or appropriate in relation to the foregoing resolutions, with express powers of substitution and correction, until complete registration with the Commercial Registry of the increase in capital hereby approved, and particularly, without limitation:

(i) to perform the acts that are necessary or appropriate in any jurisdiction in which it is requested that the shares of the Company be admitted to trading in any form;

(ii) to set the date on which the resolution approving the increase in share capital must be implemented, to determine the share price on the date of implementation thereof by means of the application of the mathematical formula described in item 1.3 above (provided that this is required to meet the circumstances described therein);

(iii) to set the terms and conditions of the increase in capital to the extent not provided for in this resolution;

(iv) to request the verification or authorisation of the prospectus and other documents where approval and registration thereof by the National Securities Market Commission is required; to request the registration of the new shares in the book-entry register maintained by Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (Iberclear); and to perform such acts as are necessary or appropriate in relation to the admission to trading of the new shares of the Company; and

(v) generally, to perform the acts, submit the requests, sign the documents and take the steps necessary for the full effectiveness of and compliance with the foregoing resolutions, and for any of them to appear before a Notary and execute the corresponding notarial instrument for the capital increase and amendment of article 6 of the Bylaws regarding "Share capital" and, if applicable, to correct

and clarify this resolution upon the terms necessary to achieve full registration thereof with the Commercial Registry."

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In Derio (Biscay), on 24 May 2017