Euskaltel, S.A.

and

Subsidiaries

Condensed Consolidated Interim Financial Statements
30 June 2017

(Prepared in accordance with the international Financial Reporting Standards adopted by the European Union)

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

Limited review report on the condensed consolidated interim financial statements

To the Shareholders of
Euskaltel, S.A, at the request of Management:

Report on the condensed consolidated interim financial statements

Introduction

We have conducted a limited review of the accompanying condensed consolidated interim financial statements (the "interim financial statements") of Euskaltel, S.A. (the "Company") and subsidiaries (the "Group"), which comprise the statement of financial position at 30 June 2017 and the income statement, the statement of comprehensive income, the statement of changes in equity, the statement of cash flows and the notes thereto, all of which are consolidated and condensed, corresponding to the six-month period ended 30 June 2017. The Company's directors are responsible for preparing the interim financial statements in accordance with International Accounting Standard (IAS) 34 "Interim Financial Reporting", as adopted by the European Union and covering the preparation of condensed interim financial information, pursuant to article 12 of Royal Decree 1362/2007. Our responsibility is to express a conclusion on the interim financial statements based on our limited review.

Scope of the review

We have carried out our limited review in accordance with International Standard on Review Engagements (ISRE) 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A limited review of interim financial statements comprises posing questions, primarily to personnel responsible for financial and accounting matters, and applying analytical procedures and other review procedures. The scope of a limited review is substantially less than that of an audit performed in accordance with prevailing auditing standards in Spain and, therefore, we are unable to provide assurance that all significant matters that would have been identified in an audit have come to our attention. Consequently, we do not express an audit opinion on the accompanying interim financial statements.

Conclusion

As a result of our limited review, which under no circumstances may be understood to be an audit, we did not become aware of any matters that would lead us to conclude that the accompanying interim financial statements for the six-month period ended 30 June 2017 were not prepared, in all significant aspects, in accordance with International Accounting Standard (IAS) 34, as adopted by the European Union, pursuant to article 12 of Royal Decree 1362/2007 on the preparation of condensed interim financial statements.

Emphasis of matter

We cite the accompanying note 2, which indicates that the accompanying interim financial statements do not include all the information that would be required in complete consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union, and that accordingly the accompanying interim financial statements should be read in conjunction with the Group's consolidated annual accounts for the year ended 31 December 2016. This matter does not modify our conclusion.

Report on other legal and regulatory requirements

The accompanying consolidated interim Directors' Report for the six-month period ended 30 June 2017 sets out the explanations that the Company's directors consider relevant in respect of the significant events occurred during the period and their impact on the interim financial statements presented, of which it does not form part, as well as the information required in accordance with article 15 of Royal Decree 1362/2007. We have verified that the accounting information set out in the aforementioned Directors' Report is consistent with that disclosed in the interim financial statements for the six-month period ended 30 June 2017. Our work is limited to the verification of the consolidated interim 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.

Other matters

This report was prepared at the request of Management in connection with the disclosure of the interim financial report required under article 119 of the consolidated text of the Spanish Securities Market Law, implemented through Royal Decree 1362/2007 of 19 October.

KPMG Auditores, S.L.

(Signed on original in Spanish)

Cosme Carral López-Tapia

24 July 2017

Condensed Consolidated Interim Financial Statements
for
the six-month period
ended 30 June 2017

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

EUSKALTEL, S.A. AND SUBSIDIARIES

Consolidated Condensed Statements of Financial Position at 30 June 2017 and 31 December 2016

(expressed in thousands of euros)

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

ASSETS	Notes	30.06.2017	31.12.2016
NON-CURRENT ASSETS		2,086,090	2,119,220
Goodwill		591,442	591,442
Intangible assets	5	174,686	181,327
Property, plant and equipment	6	1,169,198	1,192,345
Financial assets	7	6,778	7,226
Deferred tax assets		143,986	146,880
CURRENT ASSETS		271,382	221,118
Inventories		4,518	4,134
Trade and other receivables	7	49,048	47,765
Current tax assets		5,664	5,777
Other current assets		11,970	6,152
Cash and cash equivalents	7	200,182	157,290
TOTAL ASSETS		2,357,472	2,340,338

EQUITY AND LIABILITIES	Notes	30.06.2017	31.12.2016
EQUITY			
Capital and reserves	8	730,713	741,735
Capital		455,536	455,536
Share premium		207,604	207,604
Retained earnings		69,282	102,735
(Own shares)		(1,709)	(1,363)
Interim dividend paid during the year		-	(22,777)
Other comprehensive income		(64)	(64)
Equity attributable to equity holders of the Parent		730,649	741,671
Non-controlling interests		415	423
		731,064	742,094
NON-CURRENT LIABILITIES		1,405,375	1,388,140
Non-current payables	9	1,317,539	1,302,235
Provisions		1,613	1,741
Other financial liabilities	9	12,786	7,537
Other non-current liabilities		500	-
Deferred tax liabilities		72,937	76,627
CURRENT LIABILITIES		221,033	210,104
Current payables	9	45,936	59,362
Trade and other payables	9	108,888	109,288
Current tax liabilities		10,062	2,032
Provisions	12	7,936	1,059
Other current liabilities		48,211	38,363
TOTAL EQUITY AND LIABILITIES		2,357,472	2,340,338

EUSKALTEL, S.A. AND SUBSIDIARIES

Consolidated Condensed Income Statements for the six-month periods ended 30 June 2017 and 30 June 2016

(expressed in thousands of euros)

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

	Notes	30.06.2017	30.06.2016
Revenues	4	274,138	280,295
Work performed by the entity and capitalised		5,187	5,520
Supplies	10	(55,635)	(64,879)
Other operating income		14	208
Personnel expenses	10	(19,804)	(19,554)
Other operating expenses	10	(76,408)	(65,160)
Amortisation and depreciation	5 & 6	(75,876)	(73,457)
RESULTS FROM OPERATING ACTIVITIES		51,616	62,973
Finance income		1	31
Finance cost		(23,213)	(24,260)
NET FINANCE COST	10	(23,212)	(24,229)
PROFIT BEFORE INCOME TAX		28,404	38,744
Income tax	11	(7,289)	(8,548)
PROFIT FOR THE YEAR		21,115	30,196
Profit for the year attributable to equity holders of the Parent		21,123	30,208
Profit for the period attributable to non-controlling interests		(8)	(12)
		21,115	30,196
Earnings/(loss) per share		0.14	0.20

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EUSKALTEL, S.A. AND SUBSIDIARIES

Consolidated Condensed Statements of Comprehensive Income for the six-month periods ended 30 June 2017 and 30 June 2016

(expressed in thousands of euros)

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

	Notes	30.06.2017	30.06.2016
a) Consolidated profit/(loss) for the period		21,115	30,196
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		21,115	30,196
Attributable to equity holders of the Parent		21,123	30,208
Attributable to non-controlling interests		(8)	(12)
		21,115	30,196

EUSKALTEL, S.A. AND SUBSIDIARIES

Consolidated Condensed Statements of Changes in Equity for the six-month periods ended 30 June 2017 and 30 June 2016

(expressed in thousands of euros)

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

	Registered capital	Share premium	Retained earnings	Own shares	Other comprehensive income	Interim dividend	Sub-total	Non-controlling interests	Total
Balance at 1 January 2016	**455,536**	**207,604**	**40,858**	**(1,429)**	**(64)**	**-**	**702,505**	**419**	**702,924**
Other comprehensive income	-	-	30,208		-	-	30,208	(12)	30,196
Transactions with shareholders									
Own shares	-	-	(268)	(134)	-	-	(402)	-	(402)
Dividends	-	-	-	-	-	-	-	-	-
Other	-	-	15	-	-	-	15	4	19
Balance at 30 June 2016	**455,536**	**207,604**	**70,813**	**(1,563)**	**(64)**	**-**	**732,326**	**411**	**732,737**
Balance at 1 January 2017	**455,536**	**207,604**	**102,735**	**(1,363)**	**(64)**	**(22,777)**	**741,671**	**423**	**742,094**
Other comprehensive income	-	-	21,123	-	-	-	21,123	(8)	21,115
Transactions with shareholders									
Own shares	-	-	67	(346)	-	-	(279)	-	(279)
Dividends	-	-	(54,643)	-	-	22,777	(31,866)	-	(31,866)
Balance at 30 June 2017	**455,536**	**207,604**	**69,282**	**(1,709)**	**(64)**	**-**	**730,649**	**415**	**731,064**

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EUSKALTEL, S.A. AND SUBSIDIARIES

Consolidated Condensed Statements of Cash Flow for the six-month periods ended 30 June 2017 and 30 June 2016

(expressed in thousands of euros)

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

		30.06.2017	30.06.2016
Profit for the year before tax		**28,404**	**38,744**
Adjustments for		**97,878**	**95,909**
Amortisation and depreciation	Notes 5 & 6	75,876	73,457
Impairment allowances		1,340	1,789
Other income and expenses		(2,550)	(3,566)
Impairment and gains/(losses) on disposals of financial instruments	Note 10.4	21	(383)
Finance income	Note 10.4	(1)	(31)
Finance cost	Note 10.4	22,661	24,669
Exchange gains/(losses)	Note 10.4	(33)	(26)
Change in fair value of financial instruments	Note 10.4	564	-
Changes in operating assets and liabilities		**3,417**	**(12,953)**
Inventories		(384)	(380)
Trade and other receivables		(2,564)	(2,127)
Other current assets		(2,585)	(2,305)
Trade and other payables		9,060	(13,354)
Other current liabilities		(110)	5,213
Other cash flows used in operating activities		**(23,396)**	**(16,970)**
Interest paid		(20,591)	(17,001)
Interest received		-	31
Income tax paid		(2,805)	-
Cash flows from/(used in) operating activities		**106,303**	**104,730**

EUSKALTEL, S.A. AND SUBSIDIARIES

Consolidated Condensed Statements of Cash Flow for the six-month periods ended 30 June 2017 and 30 June 2016

(expressed in thousands of euros)

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

		30.06.2017	30.06.2016
Payments for investments		**(46,088)**	**(52,560)**
Intangible assets	Note 5	(12,230)	(17,494)
Property, plant and equipment	Note 6	(33,858)	(35,066)
Proceeds from sale of investments		**-**	**30**
Other financial assets		-	30
Cash flows from/(used in) investing activities		**(46,088)**	**(52,530)**
Proceeds from and payment for equity instruments		**(257)**	**(383)**
Acquisition of own equity instruments		(257)	(383)
Proceeds from and payments for financial liability instruments		**(17,066)**	**(238)**
Issue of:		5,749	-
Loans and borrowings		5,749	-
Repayment of:		-	(238)
Loans and borrowings		-	(14)
Other payables		-	(224)
Dividends and interest on other equity instruments paid		(22,815)	-
Dividends		(22,815)	-
Cash flows from/(used in) financing activities		**(17,323)**	**(621)**
Cash and cash equivalents at beginning of period		157,290	23,371
Cash and cash equivalents at end of period		200,182	74,950
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**42,892**	**51,579**

EUSKALTEL, S.A. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS FOR THE SIX-MONTH PERIOD ENDED 30 June 2017

(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), 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 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.

The Company, together with Zegona Limited (hereinafter Zegona) has signed a sale and purchase contract whereby Euskaltel acquires full control of Telecable de Asturias, S.A.U. ("Telecable") by acquiring 100% of the shares held by Zegona in Parselaya, S.L., indirect owner of the entire share capital of Telecable de Asturias, S.A. At 30 June 2017, the value of Telecable has been estimated at €686 million, including €245 million in net liabilities. However, Zegona may be entitled to a contingent consideration, up to a limit of €15 million, equivalent to 35% of the equity value of certain assets which may emerge under certain conditions. The acquisition cost will be paid through a cash payment of €186.5 million (subject to the normal net debt and working capital adjustments for this type of transaction) and by issuing €26.8 million new issue ordinary shares in Euskaltel, to be fully subscribed by Zegona. The completion of the transaction is subject to certain conditions precedent which are standard to transactions of this type, including the approval thereof by the General Shareholders' Meeting of Euskaltel, which took place at the General Meeting held on 26 June 2017; the authorisation of the CNMC (Spanish competition authority), which was obtained on 30 June 2017; the increase of the members of the Board of Directors of Euskaltel; and the issuance of a favourable report by an independent expert in relation to the non-monetary contribution of shares in Parselaya, S.L. in exchange for the newly issued shares in Euskaltel. Once the pending milestones are met, the Governing Board of Parselaya, S.L. will be appointed by Euskaltel, triggering the takeover of Parselaya, S.L. At the date of these interim consolidated financial statements, not all of the milestones have been met yet and, therefore, the business merger has not been completed.

Telecable is the leading telecommunications operator in Asturias, offering television, internet, mobile and fixed-line telephone services. Incorporated in 1995, it was initially formed by Telecable de Oviedo, Telecable de Gijón and Telecable de Avilés, and has since grown to consolidate itself as the main telecommunications sector company in the Principality of Asturias. Throughout these years, Telecable has evolved by expanding its service offering, mainly based on the technological advantage made possible by the close to 3,000 kilometres of latest generation fibre-optic network, which does not require significant additional investments and which runs through all of the main urban centres in the territory of Asturias. The company has a residential market with 68% of the Pay TV market share, 31% of fixed-line telephones, 39% of broadband and 16% of mobiles. The company is renowned not just for its significant penetration in the territory of Asturias, but also for its high levels of service quality and customer care. Telecable currently has 39 authorised points of sale throughout

Asturias, which, together with an extensive network of direct sales staff, represents a highly developed sales force.

The companies that, along with Euskaltel, S.A., comprise the Euskaltel Group and the percentage ownership of the Parent in each (direct and/or indirect) at 30 June 2017 are as follows: R Cable y Telecomunicaciones Galicia, S.A. (100%) and Cinfo, Contenidos Informativos Personalizados, S.L. (67.2%).

NOTE 2.- Basis of presentation

2.1. True and fair view

The accompanying condensed consolidated interim financial statements have been prepared on the basis of the accounting records of Euskaltel, S.A. and its subsidiaries. The condensed consolidated interim financial statements for the six-month period ended 30 June 2017 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and, in particular, with IAS 34 Interim Financial Reporting, 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 30 June 2017 and the consolidated results of operations and changes in consolidated equity and cash flows of the Group for the six-month period then ended.

In accordance with IAS 34, interim financial information is intended to provide an update on the latest complete set of annual financial statements published by the Group. Accordingly, it focuses on new activities, events, and circumstances occurred during the six-month period ended 30 June 2017. Bearing in mind that the condensed consolidated interim financial statements do not contain all information required for the preparation of the annual statements, in order to have a proper understanding of the information set out herein, these statements should be read in conjunction with the consolidated annual accounts for the year ended 31 December 2016 in accordance with IFRS-EU.

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 consolidated financial statements of the Group for the year ended 31 December 2016 were approved by the shareholders of the Company at the general meeting held on 26 June 2017.

On 21 July 2017, the directors of the Parent authorised for issue the condensed consolidated interim financial statements for the six-month period ended 30 June 2017.

The information set out in these notes is expressed in thousands of euros, except where otherwise indicated.

2.2. Comparative information

The figures stated in the comparative Interim Financial Statements correspond to the six-month periods ended 30 June 2016, except for those relating to the Consolidated Condensed Statement of Financial Position, which correspond to 31 December 2016 and identical to those contained in the 2016 consolidated annual accounts.

2.3. Critical issues regarding the valuation and estimation of uncertainties

Preparation of the condensed consolidated interim financial statements 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.

The primary judgements made by the directors in applying the accounting policies and the main sources of uncertainties are the same as those considered in the preparation of the consolidated annual accounts for 2016.

NOTE 3.- Accounting principles

In preparing the condensed consolidated interim financial statements, the same accounting principles and standards were followed as those set out in the Group's consolidated annual accounts for the year ended 31 December 2016.

NOTE 4.- Segment reporting

The activity of the companies comprising the Group primarily includes: the provision of combined broadband, Pay TV, mobile and fixed-line telephone services to residential customers, self-employed workers ("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 market and others

Details of revenues by type of customer at 30 June are as follows:

	30.06.2017	30.06.2016
Residential	185,697	184,986
Business		
SOHOs	*34,945*	*34,986*
SMEs	*15,293*	*16,164*
Large accounts	*27,391*	*34,076*
Wholesale and other	16,013	15,811
Total	**279,339**	**286,023**
Work performed by the entity and capitalised	*(5,187)*	*(5,520)*
Other operating income	(14)	(208)
Revenues	**274,138**	**280,295**

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 a 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, among other aspects, 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 sell include, inter alia, 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. 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 market and others

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 whom 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. As a result of the agreements with the Catalonia Automobile Association (RACC) we offer mobile telephone services in the Catalan market under the brand "RACC Móvil".

NOTE 5.- Intangible assets

During the six-month period ended 30 June 2017, additions totalled €12,230 thousand (€17,494 thousand at 30 June 2016) and primarily related to the capitalisation of costs incurred on the acquisition of customers and the capitalisation of internal costs. There were no significant disposals during the first half of 2017.

Amortisation of intangible assets stood at €18,871 thousand in the period (€18,903 thousand at 30 June 2016).

NOTE 6.- Property, plant and equipment

Investments in items of property, plant and equipment during the period totalled €33,985 thousand (€28,088 thousand at June 2016) and mainly related to roll-out of the network. There were no significant disposals during the first half of 2017.

Depreciation came to €57,005 thousand in the period (€54,614 thousand at 30 June 2016). Reversals of impairment at 30 June 2016 came to €60 thousand.

At 30 June 2017, the estimated value of commitments to acquire items of property, plant and equipment amounted to €11,425 thousand (€9,017 thousand at 30 June 2016).

NOTE 7.- Financial assets

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

	Loans and receivables		Available-for-sale financial assets		Total	
	30.06.2017	31.12.2016	30.06.2017	31.12.2016	30.06.2017	31.12.2016
Non-current						
Equity instruments	-	-	1,299	1,456	1,299	1,456
Loans extended	4,959	5,256	-	-	4,959	5,256
Other non-current assets	520	514	-	-	520	514
	5,479	5,770	1,299	1,456	6,778	7,226
Current						
Trade receivables	49,048	47,765	-	-	49,048	47,765
Investments	557	468	-	-	557	468
Cash and cash equivalents	200,182	157,290	-	-	200,182	157,290
	249,787	205,523	-	-	249,787	205,523

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

NOTE 8.- Equity

At their general meeting held on 26 June 2017, the shareholders resolved to distribute a complementary dividend of €31,388 thousand (€0.21 per share), as follows:

Basis of application	
Profit for the year	75,324
Distribution	
Legal reserve	7,532
Voluntary reserves	13,127
Interim dividend	22,777
Complementary dividend	31,888
	75,324

The interim dividend payable amounting to €31,888 thousand, is recorded under other financial liabilities.

Furthermore, on 26 June 2017 the General Shareholders' Meeting approved a share capital increase of €80,400,000 by means of the issuance and circulation of a total of 26,800,000 ordinary shares of €3 par value each. These shares are fully paid by Zegona Limited by means of a contribution of 193,427,260 shares in Parselaya, S.L., equivalent to 98.5% of the share capital of same (see note 1).

At 30 June 2017, the Company held 177,818 own shares. During the six-month period, a total of 2,470,149 shares were acquired and 2,454,364 were sold.

NOTE 9.- Financial liabilities

Details of financial liabilities classified by category are as follows:

	Debts and payables		Hedging derivatives
	30.06.2017	**31.12.2016**	**30.06.2017**
Non-current			
Loans received	1,316,975	1,302,235	-
Finance leases	-	-	-
Derivatives	-	-	564
Other financial liabilities	12,786	7,537	-
	1,329,761	1,309,772	564
Current			
Loans received	45,868	59,275	-
Finance leases	68	87	-
Dividend payable	31,850	22,777	-
Other liabilities	668	1,207	-
Suppliers	85,175	75,938	-
Asset purchase payables	23,713	33,350	-
Salaries payable	4,094	4,522	-
	191,436	197,155	-

During 2017 the Company has taken out interest rate hedges, paying a fixed monthly premium to cover possible variations in interest rates of over 1%. These hedges mature in February 2021 and the notional amount covered comes to €510,000 thousand.

Details of non-current payables are as follows:

Tranche	30.06.2017	31.12.2016	Nominal	Interest	Maturity
A-1	233,415	233,241	235,000	2.25%	30/06/2021
B-1	233,299	233,135	235,000	3.175%	30/06/2022
A-2	297,424	297,132	300,000	2.25%	30/06/2021
B-2	297,261	296,955	300,000	3.175%	30/06/2022
B-3	294,851	294,382	300,000	3.75%	27/11/2022
Credit facility			30,000	(a)	30/06/2022
(a) Not drawn down at 30 June 2017					
Finance lease payables	68	87			
	1,356,318	1,354,932			
Current portion	39,343	52,737			
	1,316,975	1,302,235			

At 30 June 2017 and 2016, the consolidated Group held an undrawn non-current revolving credit facility for €30 million, and undrawn current credit facilities totalling €50 million.

During the six months ended 30 June 2017, the maturity of the A1 and A2 tranches was modified, having extended the interest-free period for repayment of the principal by one additional year, i.e. until 30 June 2018 and increasing the value of the repayments to be made in the period between 30 June 2018 and 31 December 2020. These modifications do not represent a significant change to payables.

Accrued interest payable at 30 June 2017 and 31 December 2016 stood at €6,593 thousand and €6,625 thousand, respectively.

Interest 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. 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
144	178	269	560	304	1,455

For the six-month period ended 30 June 2017, had interest rates risen by 100 basis points, with other variables remaining constant, consolidated profit (after tax) would have fallen by €3.31 million (€4.93 million for the year ended 31 December 2016).

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 R, the loan granted thereto and its bank accounts. Moreover, during 2016, a collateral right was lodged over the Company's telecommunications network.

Other non-current and current financial liabilities include loans carried at amortised cost granted by different public administrations for network roll-out work in certain population centres. The nominal value of the loans at 30 June 2017 comes to €15,444 thousand (€10,574 thousand at 31 December 2016).

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.

NOTE 10.- Income and expenses

10.1. Supplies

Details are as follows:

	30.06.2017	30.06.2016
Merchandise used		
Purchases	11,106	16,854
Changes in inventories	(384)	(380)
	10,722	16,474
Subcontracted work		
Interconnection expenses	35,586	39,113
Other supplies	9,327	9,498
	44,913	48,611
Impairment of merchandise	-	(206)
	55,635	64,879

Interconnection expenses include certain discounts in connection with services rendered by third parties, for an amount of €16,476 thousand (€3,566 thousand in the comparative period). The contract modifications negotiated during 2017 have led to a significant increase in the amount of merchandise used that could be subject to such discounts.

Discounts pending collection amount to €21,569 thousand (€15,617 thousand at 31 December 2016).

10.2. Personnel expenses

Details are as follows:

	30.06.2017	30.06.2016
Salaries and wages	16,085	15,762
Employee benefits expense (other employee benefits expense)	3,719	3,792
Total	19,804	19,554

The distribution by gender of the headcount at 31 December 2017 and 2016 is as follows:

	Average headcount	
	30.06.2017	30.06.2016
Female	254	244
Male	312	323
	566	567

10.3. Other operating expenses

Details are as follows:

	30.06.2017	30.06.2016
Advertising	5,257	4,777
Repairs and maintenance	25,786	22,366
Services provided by third parties	16,918	20,394
Other external services and utilities	10,369	11,761
Taxes	6,349	2,193
Losses, impairment and changes in trade provisions	1,340	1,609
Other gains/(losses)	10,389	2,060
	76,408	65,160

Other results include at 30 June 2017 an amount of €4,628 thousand corresponding to the allocation to the provision for risks and liabilities (see note 13), consulting expenses of €399 thousand relating to the acquisition of Telecable described in Note 1, indemnities for € 2,776 thousand, and provisions for labour risks of €1.1 million.

10.4. Net finance income/(cost)

Details are as follows:

	30.06.2017	30.06.2016
Finance income		
Third parties	1	31
Finance cost		
On third party loans	(22,661)	(24,669)
	(22,660)	(24,669)
Exchange gains/(losses)	33	26
Change in fair value of financial instruments	(564)	-
Impairment and gains/(losses) on disposal of financial instruments	(21)	383
	(23,213)	**(24,229)**

NOTE 11.- Income tax

Income tax expense is calculated based on the directors' best estimation of the weighted tax rate corresponding to the full year, multiplied by the consolidated pre-tax profit for the half-year period.

The estimated effective tax rate for the first six months ended 30 June 2017 and 2016 is 26%.

Furthermore, during the six-month period ended 30 June 2017 tax credits amounting to €2,030 thousand have been applied.

NOTE 12.- Related party transactions

Transactions and balances with key personnel

Details of transactions with key Company personnel during the six-month periods ended 30 June 2017 and 30 June 2016 are as follows:

	30.06.2017		30.06.2016	
	Board members	Senior management	Board members	Senior management
Salaries and wages	519	858	243	1,112
Other remuneration	335	-	304	1,000
	854	**858**	**547**	**2,112**

12.2 Transactions and balances with other related parties

Details of transactions and balances with significant shareholders during the six-month periods ended 30 June 2017 and 30 June 2016 are as follows:

	30.06.2017	30.06.2016
Sales	7,545	8,398
Services	(1,537)	(1,388)
Finance cost	(2,948)	(3,425)
	3,060	**3,585**

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

	30.06.2017		31.12.2016	
	Current	Non-current	Current	Non-current
Receivables	562	-	628	-
Current account	130,692	-	45,527	-
Loans extended	(6,839)	(179,664)	(4,489)	(181,704)
Payables	(1,420)	-	(1,322)	-
	122,975	**(179,664)**	**40,344**	**(181,704)**

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.

NOTE 13.- Provisions

During 2017 notification has been received from the Secretary of State for Information Society and the Digital Agenda, notifying of a limited verification procedure regarding the obligation to contribute to the funding of CRTVE (Corporación de Radio y Televisión Española). The Secretary of State deems Euskaltel to be obligated to pay this charge since, as a result of the acquisition of R Cable, its geographical scope is state-wide or beyond that of an autonomous community. This interpretation is made based on a stipulation of the Regulations which extends the taxable event to be applicable when the services are rendered in Spanish territory directly or through a company in the same group in the terms of article 42 of the Code of Commerce. This interpretation is contrary to that previously and currently applied by the Parent Company. This contingent liability amounts to €6,877 thousand at 30 June 2017, approximately, and in any event the Directors consider that the provisions allocated adequately cover the best estimation of the future payments to be made on this account and any other contingent liability that may arise.

NOTE 14.- Subsequent events

During July 2017 certain conditions of the financing agreements detailed in note 9 have been changed, as follows:

- Decrease in the margin of tranches B1 and B2, reducing the spread in tranche A to 50 basis points.
- 1-year extension, until June 2021, in the maturity of the long-term credit facility.
- Consideration as admissible financial debt within the long-term financing contract of the short-term ECP scheme (Euro Commercial Paper) presented to the market on 14 March 2017, up to a maximum limit of €200,00 thousand.

At the date of these interim financial statements, regarding the sale and purchase agreement described in Note 1, although all the necessary milestones have not yet been reached for the completion of the transaction, the conditions precedent that were dependent upon actions to be carried out by the Company have all been met.

On 10 July 2017, in accordance with Circular 1/2017 of 26 April of the Spanish National Securities Market Commission, a new Liquidity Contract was signed with Norbolsa, S.V., S.A., which entered into effect on 11 July 2017.

On 26 June 2017, the General Meeting of Shareholders agreed to pay an interim dividend against 2016 results for a gross amount of €0.21 per share outstanding with dividend rights (which amounts to a maximum dividend of €31.88 million). This interim dividend, totalling €31.88 million, was paid to shareholders on 5 July 2017.

Directors' Report
for the six-month period ended 30 June 2017
EUSKALTEL, S.A. and subsidiaries

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

CONTENTS

1.- Introduction

Firstly, we should highlight the matter mentioned in note 1 regarding the purchase and sale contract whereby Euskaltel acquired total control over Telecable de Asturias, S.A.U. ("Telecable").

Telecable is the leading telecommunications operator in Asturias, offering television, internet, mobile and fixed-line telephone services. Incorporated in 1995, it was initially formed by Telecable de Oviedo, Telecable de Gijón and Telecable de Avilés, and has since grown to consolidate itself as the main telecommunications sector company in the Principality of Asturias. Throughout these years, Telecable has evolved by expanding its service offering, mainly based on the technological advantage made possible by the close to 3,000 kilometres of latest generation fibre-optic network, which does not require significant additional investments and which runs through all of the main urban centres in the territory of Asturias. The company has a residential market with 68% of the Pay TV market share, 31% of fixed-line telephones, 39% of broadband and 16% of mobiles. The company is renowned not just for its significant penetration in the territory of Asturias, but also for its high levels of service quality and customer care. Telecable currently has 39 authorised points of sale throughout Asturias, which, together with an extensive network of direct sales staff, represents a highly developed sales force. Telecable currently employs approximately 180 staff.

The Transaction is of the utmost strategic importance in the telecommunications sector in northern Spain, representing a fundamental and definitive step in the consolidation of the three main cable operators in the northern region. This will make the Group stronger, more effective and provide share synergies and growth capacity, among other things. In this regard, the plan is to maintain the local nature of Euskaltel and Telecable, ensuring the continuity of the respective trademarks, local structures and management teams, since all of this as a whole is considered to have been a key element for the success and expansion of these operators in recent years. The acquisition of Telecable's business will consolidate the Company's positioning and stability in the telecommunications market.

This interim directors' report sets forth the main events and key figures of the activity of Grupo Euskaltel, S.A. during the period from January to June 2017, in which the aforementioned transaction has not been fully completed.

2.-Commercial activity and customer relations

<u>Residential market</u>

During the year ended 31 December 2017 we continued our strategy of directing our new and existing customer bases towards convergent bundles with the highest added value. In 2016, the convergent product offering was renewed, resulting in improvements, especially in the mobile phone and TV services. Flexibility is what distinguishes our convergent product, allowing customers to configure their services according to their needs. This strategy has brought our portfolio of customers on 3P or 4P contracts to 66.7% of the total at the end of June 2017, compared to 65.8% for these high added-value customers at the end of 2016.

The residential market has decreased by 5,530 during the period (4,185 in Fixed-line and 1,345 in the mobile network), due to several factors, the most significant of which was the tough competition, the host migration process in Galicia and the usual seasonality of the student collective (who join in September and cancel in June).

Despite this, churn levels have remained in line with 2016 (15.0% at June 2017 compared to 15.1% at December 2016). To mitigate and correct the effect of the host migration, plans are underway to expand coverage with more BTS, match 4G to 3G and 3G to 2G coverage, and roll out in inland and coastal areas. This, in addition to a proactive migration of 3G to 4G clients, enabling an improved service experience by increasing data flow. In addition, the launch of new services should bolster client loyalty. These new services include home automation devices, Internet conmigo (up to 10Gb of free mobile data in two 15-day periods throughout the year) and faster street WiFi speeds.

In spite of the drop in customers, an increase has been recorded in the volume of products contracted, by 7,879 products, bring the total number of products sold in this market segment to almost one million nine-hundred thousand. This growth is backed up by the strong performance of mobile phones (6,793 more customers and 15,243 new lines) and a significant increase in Pay TV, by 3,806 products.

In the case of fixed-line phone customers who have also contracted a mobile service, the increase was 2.4% (79.6% in 2017 compared to 77.2% at December 2016). In the other driving force of bundling growth, Pay TV, the improved offerings introduced in 2016 have had positive effects, with new content bundling, improved functionalities with the launch of Replay and Rebobina, a better user interface, the consolidation of Everywhere TV, and an increase in video library content. In the case of fixed-line phone customers who have also contracted the Pay TV service, the increase was 1.3% (58.9% in 2017 compared to 57.6% at December 2016). Contracted Pay TV products have increased from 270,333 in 2016 to 274,139 at June 2017.

As a result, the product/customer ratio is up slightly in 2017 (3.51 at June 2017 compared to 3.46 in 2016).

This bundling policy and convergent product offering is reflected in the positive ARPU performance of our fixed-line customers, which has continued to grow, up by Euros 0.24 during the period, from Euros 58.44 in 2016 to Euros 58.68 at June 2017.

One of the leverage points for increasing this ARPU has been value-focused customer campaigns, gearing sales efforts to the customer offerings with more bundling, with tactical price increases based on the "much more for more" mindset, monetising our customers' increasing demand for speed and data volume, and facilitating upgrading while also considering the value of cancellations.

Business market

The SOHO segment has responded positively to our strategy of maximising bundles and 3P and 4P offerings. Thus, the number of business customers in this collective has grown by 2.5% with respect to last year (56.4% at June 2017, compared to 53.9% at December 2016) and the total number of products contracted by customers is up with respect to the end of 2016 by 3,173 clients, from 300,713 at December 2016 to 303,886 at June 2017, with an increase in the number of products contracted per client (3.43 at June 2017 compared to 3.37 at December 2016).

SOHO dynamics are very similar to those of the residential market.

The slight drop in the ARPU was caused by the greater volume of promotions geared towards retaining customers, deriving from the host migration process in Galicia, which ended in March 2017. Measures will be put in place to redress this situation supported by the new customer attraction campaigns available since June.

In the increasingly competitive setting of fibre-optic networks commercial aggressiveness is on the rise and the host migration process has led to a greater number of contract cancellations, affecting the churn, which went from 20.3% in 2016 to 21.2% at June 2017.

In spite of all of this, the total turnover for the period has remained steady in relation to income for the same period of last year.

In the SME and Large Account segments, the separation between communications and information technologies is becoming increasingly vague, with companies seeking integrated solutions including communications, but also security, cloud services. Similarly, corporate globalisation makes it necessary to avail of solutions to reach any point with these services in both the Basque Country and Galicia and the rest of the world, calling for the necessary agreements at international level to cater for this demand.

Taking into account these trends, we have continued to promote the launch of new security services commenced in 2016, with products such as the shared cloud-based firewall, antimalware security, web server protection, security consulting and support, improving our positioning in the new expanding market. In addition, we have reinforced our broadband options with the launch of new speeds and internet access options.

Within SMEs, we have accelerated plans to roll on in industrial estates (blank areas with low speed broadband subsidised with public grants), which will allow services to be commercialised in the coming months.

In the Large Accounts segment, several significant accounts have been secured during this period, and significant clients, such as Xunta de Galicia, Applus, Bilbao City Council, Lantik and local councils in Gipuzkoa (single adjudication from the DFG), among others, have been renewed.

However, one of the most relevant events impacting revenue was the loss of the Basque Government account, which completed migration of services to its new contractor at the end of 2016. The impact of this during the period from January to June 2017 represented approximately Euros 5 million less income that in the corresponding prior year period.

Workshops are being carried out with a number of our main clients to share our approach to and experience with big data and machine learning applied to advanced network monitoring and our 4.0 digital home and industry platform.

In the organisational sphere, the sales and customer engineering team has been reinforced to provide the necessary resources for growth in this segment.

3.- Marketing activity

The first six months of 2017 continue to record ongoing growth in the use of telecommunications services and the adopting of new technologies, especially in mobility. There have been many new tariffing features introduced, both in terms of built-in features and price benefits, in order to adapt tariffing to the current demands of our customers. The following in particular stand out:

- In June 2017 the WiFi Vacaciones service was launched (Internet Conmigo in Galicia), which allows Euskaltel and R customers to bring their WiFi away on holiday or outside of their home. This service entails a mobile data bundle valid for any client line, or a MiFi device for use in the home.

- In June the mobile phone offering has been adapted to the European regulations for the use of telecommunications services in Europe.

- Home automation services available in Galicia since March, to be launched in the Basque Country in September. A first step towards surrounding the customer with a self-managed experience in their immediate surroundings, which will evolve into mobility in the near future.

- As a result of bringing new products to a large number of our customers based on the “much more for more” premise, average increases of €2 to €3 per customer have been recorded. Furthermore, new pricing policies have been introduced for additional mobile data bundles.

This has enabled us to:

- Increase the percentage of homes with Mobiles to 79%, and TV from 55% to 57%.
- Bring the percentage of post-paid mobile lines with 4G data from 9% to 39%.
- The market share in 2017 of the different bundles contracted is as follows:
  - 47% in 4P.
  - 14% in Duos.
  - 30% in 3P.

The main trends detected in the residential segment are as follows:

- Competition is leading to a significant investment in the roll-out of fibre-optic networks and it has, in turn, become hugely aggressive to “fill” these networks with new clients. This means that although nominal prices are going up, attracting new customers comes with extremely aggressive promotions.

- Furthermore, the lowest-value segment is becoming more aggressive on the basis of two different leverage points:

  - Commercial expansion of low-cost operators
  - Generation of low-cost convergent product offerings through secondary brands by certain significant operators

- The value segment continues to leverage itself with TV contents, with football in the high end and TV Shows in the medium-to-high. In the mobile phone segment, family plans are being reinforced with extra data.

In terms of activities planned, we would highlight the following:

- A new TV decoder is being launched in July, based on Android TV, with 4k quality. This device will enable us to offer a completely unique TV experience, integrating the classical audio-visual world with the Internet world. Together with improved continuity in advanced functions and in the catalogue of content included, this device will help us convey the message of the qualitative leap taken in TV in the last twelve months.

- In July 2017, the convergent product offering was renewed, resulting in improvements, especially in the mobile phone and TV services. It stands out due to its flexibility, allowing customers to configure their services according to their needs. Being able to choose between:
    - Two BA speeds: 50 and 200 Mbps. There remains one basic option without TV and one 350 Mega Premium option.
    - New mobile phone proposal in which the customer decides whether they want unlimited talk minutes or they prefer to limit their bundle to 200 minutes talk time in exchange for extra GBs of data.

4.- Economic-financial activity and key business indicators

Key performance indicators (KPIs)

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

Residential

KPI	Unit	31.12.2016	30.06.2017 Euskaltel	30.06.2017 R	30.06.2017 Consolidated
Homes passed	#	1,707,558	888,555	821,216	1,709,771
Household coverage	%	*65%*	*87%*	*51%*	*65%*
Residential subs	#	546,040	297,157	243,353	540,510
fixed services	#	469,662	274,956	190,521	465,477
mobile only subs	#	76,378	22,201	52,832	75,033
1P (%)	%	21.7%	16.3%	26.6%	20.9%
2P (%)	%	12.5%	13.6%	10.8%	12.4%
3P (%)	%	26.4%	30.0%	20.9%	25.9%
4P (%)	%	39.4%	40.0%	41.6%	40.8%
Total RGUs	#	1,891,653	1,076,113	823,419	1,899,532
RGUs / sub	#	*3.5*	*3.6*	*3.4*	*3.5*
Residential churn fixed customers	%	15.1%	14.4%	15.8%	15.0%
Global ARPU fixed customers	€/month	58.44	58.46	59.00	58.68

KPI	Unit	31.12.2016	30.06.2017 Euskaltel	30.06.2017 R	30.06.2017 Consolidated
Fixed voice RGUs	#	462,827	271,870	181,951	453,821
as % fixed customers	%	*98.5%*	*98.9%*	*95.5%*	*97.5%*
BB RGUs	#	394,810	225,173	167,473	392,646
as % fixed customers	%	*84.1%*	*81.9%*	*87.9%*	*84.4%*
TV RGUs	#	270,333	154,866	119,273	274,139
as % fixed customers	%	*57.6%*	*56.3%*	*62.6%*	*58.9%*
Postpaid lines	#	763,683	424,204	354,722	778,926
Postpaid customers	#	438,953	232,767	212,979	445,746
as % fixed customers (only mobile excluded)	%	*77.2%*	*76.6%*	*84.1%*	*79.6%*
Mobile lines / customer	#	*1.7*	*1.8*	*1.7*	*1.7*

The roll-out, relaunched in 2015, continues under way both in terms of general roll-out (geared towards the Residential segment) and roll-out in industrial parks (geared towards the Business segment). In the residential segment, in addition to continuing with the expansion into 51,000 homes in the Basque Country, we have been awarded grants as part of the new generation broadband expansion schemes to build a fibre-optic network in the Basque Country (5K) and in Galicia (40K). In the business segment, we have rolled out the network into new business parks after receiving grants for broadband expansion in industrial areas (SPRI, Xunta de Galicia, Ministry of Industry).

In mobile communications, growth is bolstered by an improved mobile telephone offering (higher data capacity and more competitive option for customers to contract additional lines), the possibility of purchasing terminals in instalments and the evolution of our 3G data customers to 4G services. This positive performance is seen in the growth of residential bill-pay mobile contract customers, with an increase in products from 763,683 in 2016 to 778,926 in 2017, and in the higher percentage of customers with mobile services (77.2% in 2016 compared to 79.6% in 2017). And this was despite the impact of the host migration in Galicia, which has generated more mobile contract cancellations (2,122 in the first half of the year).

During 2017, we also secured growth in Pay TV (3,806 more residential Pay TV products than in 2016, which is a 1.04% increase), despite the impact of not showing football coverage in the 2016-2017 season.

In spite of pressure from the competition and the host migration process in Galicia, the churn is better than in 2016 (15.0% in 2017 compared to 15.1% in 2016). These effects give rise to a drop in broadband products with respect to 2016 (392,646 in 2017 versus 394,810 in 2016), however, we still secured an improvement in the number of customers contracting these services (84.4% in 2017 compared to 84.1% in 2016).

Furthermore, we are still achieving increases in the number of clients with greater added value (clients with 3 or 4 products), (from 65.8% in 2016 to 66.7% in 2017).

ARPU has grown by Euros 0.24 (+0.42%) in 2017. New repositioned product offerings launched in 2016, higher-added value services (upgrading), and offering additional services to existing customers (up-selling), have contributed to this growth.

Business

KPI	Unit	31.12.2016	30.06.2017 Euskaltel	30.06.2017 R	30.06.2017 Consolidated
Trade receivables	#	89,322	48,951	39,725	88,676
1P (%)	%	29.7%	24.3%	32.6%	28.0%
2P (%)	%	16.4%	13.4%	18.2%	15.5%
3P (%)	%	39.7%	40.9%	40.1%	40.5%
4P (%)	%	14.2%	21.4%	9.1%	15.9%
Total RGUs	#	300,713	182,408	121,478	303,886
RGUs / sub	#	3.4	3.7	3.1	3.4
Residential churn fixed customers	%	20.3%	23.4%	18.5%	21.2%
Global ARPU fixed customers	€/month	65.2	66.9	62.2	64.9

The Group's commercial strategy in the business market is in line with that of the residential segment. The churn rate is slightly up despite greater commercial aggressiveness by the competition and the impact of host migration in Galicia (21.2% churn in 2017 versus 20.3% in 2016), bringing the turnover down with respect to 2016 (88,676 in 2017 versus 89,322 in 2016). Even so, product offering actions and upgrading and upselling policies implemented have pushed up the number of products contracted on the business segment (303,886 in 2017 compared to 300,713 in 2016) and continued to boost the number of higher-value customers (customers with 3 and 4 products go from 53.9% of the customer base in 2016 to 56.4% in 2017).

The ARPU is down with respect to 2016 (€64.9 in 2017 compared to €65.2 in 2016) due to more customer attraction and loyalty promotions run in response to greater competition in the first half of the year.

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Selected financial data					
	Unit	Jan-June 2016	Jan-June 2017 Euskaltel	Jan-June 2017 R	Jan-June 2017 Consolidated
Total revenues	**€m**	**286.0**	**156.4**	**122.9**	**279.3**
Y-o-y change	%		*-3.0%*	*-1.4%*	*-2.3%*
Residential	€m	185.0	104.1	81.6	185.7
Y-o-y change	%		*1.1%*	*-0.5%*	*0.4%*
Businesses	€m	85.2	39.8	37.8	77.6
Y-o-y change	%		*-13.6%*	*-3.4%*	*-8.9%*
Wholesale and other	€m	15.8	12.5	3.5	16.0
Y-o-y change	%		*2.4%*	*0.4%*	*1.3%*
Other revenues	€m	0.0	0.0	0.0	0.0
Y-o-y change	%				
Adjusted EBITDA	**€m**	**139.3**	**76.7**	**61.0**	**137.9**
Y-o-y change	%		*-5.5%*	*5.1%*	*-1.0%*
Margin	%	*48.7%*	*49.1%*	*49.7%*	*49.4%*
Capital expenditures	**€m**	**(45.7)**	**(28.1)**	**(18.2)**	**(46.2)**
Y-o-y change	%		*25.6%*	*-21.4%*	*1.2%*
% total revenues	%	*-16.0%*	*-18.0%*	*-14.8%*	*-16.5%*
Adjusted operating cash flow:	**€m**	**93.7**	**48.7**	**42.8**	**91.7**
Y-o-y change	%		*-17.3%*	*22.6%*	*-2.1%*
% adjusted EBITDA	%	*67.2%*	*63.4%*	*70.2%*	*66.5%*

Residential revenues rose slightly by 0.4% compared to the prior year. Income in R fell slightly in the first half of the year (Euros 81.6 million in 2017 compared to Euros 82.07 million in 2016), as a result of the competitive pressure (more customer attraction and loyalty promotions to secure the customer base) and the host migration process. In Euskaltel individual income is up by 1.1% with respect to the first half of 2016 (Euros 104.06 million in 2017 compared to Euros 102.9 million in 2016), caused mainly by the positive evolution of the ARPU (+1.04 euros increase compared to 2016).

Revenue from the business market amounted to Euros 77.6 million, down on 2016. This situation is mainly due to the reduction in income on the Large Account segment, largely caused by the loss of revenue from the Basque Government (drop of Euros 5 million in the first half of the year with respect to the same period of 2016) and the slight fall in income from SME customers (Euros 2.5 million in 2017 compared to Euros 2.77 million in 2016), as a result of price wars from the competition. Business segment evolution (SOHO) has been positive during the period, keeping in line with the same period of 2016.

Wholesale and other revenue has grown by 1.3% with respect to the first half of 2016, with wholesale revenue up on the prior year (Euros 4.5 million in 2017 compared to Euros 4.14 million in 2016).

Adjusted EBITDA, which does not include the effect of expenses relating to the integration process of companies or the effect of other non-recurring expenses, amounts to Euros 137.9 million, with an increase in the profit margin of 0.7 percentage points respect to the first half of 2016 (49.4% in 2017 compared to 48.7% in 2016). Despite the drop in revenue in the first half of the year, the efficiency measures implemented in previous years (elimination of mobile terminal grant, renegotiation of TV content) and the management of operating costs (renegotiation of mobile host), have kept EBITDA slightly lower than the same period of the prior year.

Investments for the period have amounted to Euros 46.2 million, similar to the investments carried out last year (increase of Euros 0.5 million compared to Euros 45.7 million in 2016). The roll-out plan for 51,000 homes and industrial estates, the repositioning of the broadband speeds and the new TV platform with 4K services have contributed to this increase. These projects involve technological, customer-oriented innovations allowing users to enjoy better quality services and customer experience and increasing our commercial offering and revenues in the coming years.

Operating cash flow, defined as the difference between EBITDA and investments, resulted in a conversion rate of over 66.5%, maintaining our leading position in comparison with similar sector companies in Europe.

Profit after tax is down from Euros 30.2 million in the same period of 2016 to Euros 21.12 million at 30 June 2017, basically due to the rise in amortisation and depreciation expenses and other operating expenses, which include non-recurring expenses in the period (booking of the RTVE charge for 2016 and 2017 totalling Euros 6.9 million; provisions relating to labour risks for Euros 1.1 million; and employee indemnity pay-outs of Euros 2.8 million) (see notes 10 and 13). This is reflected in the profit per share, which is down by €0.06/share (€0.14/share at 30 June 2017, compared to €0.20/share in the first half of 2016.

5.- 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:

<u>Credit risk</u>

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 profit and loss impact at 30 June 2017 of bad trade debts was Euros 1.34 million (Euros 1.61 million in the first half of 2016), equivalent to 0.49% of turnover in the first half of 2017 (0.57% in the first half of 2016).

<u>Liquidity risk</u>

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 30 June 2017 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 30 June 2017, cash and cash equivalents amounted to Euros 200.18 million (Euros 157.29 million at the end of 2016).

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 periodic analyses of our financial position, which includes long-term projections, together with daily monitoring of bank balances and transactions.

Furthermore, in March 2017 Euskaltel set up a EuroCommercial Paper Programme -ECP-, “the Programme”), registered on the Irish Stock Exchange. The maximum overall limit of the Programme is Euros 200 million, representing an alternative to bank financing to meet working capital needs.

<u>Market risk</u>

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 the Group 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. To mitigate the risk of the effect of a potential rise in interest rates, on 18 and 19 January the Company finalised agreements with certain financial institutions to hedge against increases in the Euribor, over a nominal amount of Euros 510 million, equivalent to over 40% of total net financial liabilities on the Company’s balance sheet to date.

For the six-month period ended 30 June 2017, had interest rates risen by 100 basis points, with other variables remaining constant, consolidated profit (after tax) would have fallen by Euros 3.3 million (Euros 4.93 million for same period of 2016).

6.- Legal factors and regulatory framework

Euskaltel operates in a sector subject to regulation of retail and wholesale services, universal services, privacy, tariffing and network neutrality.

The rendering of services is exposed to decisions or measures that may be adopted by the Administration, as well as economic sanctions for breaches in the rendering of services.

<u>Regulation of wholesale access markets</u>

In 2017 decisions were taken by the Administration that may have an impact on the Company.

- Regulation of NEBA Local prices.

  On 10 January, the CNMC (Spanish competition authority) approved the new wholesale fibre-optic offering, which sets forth the technical conditions of Telefónica's new wholesale fibre-optic network access service, NEBA local. This wholesale service is one of the obligations that the CNMC imposed on Telefónica after approving the regulation of wholesale broadband markets.

  Wholesale regulating of broadband markets, approved in November 2016, enables, among other things, access by other fibre-optic network operators to the Telefónica network in areas where there is insufficient competition in this type of network.

  The new regulation obliged Telefónica to provide a wholesale offering of virtual access to its fibre-optic network (NEBA Local) for those regions declared as non-competitive. These are all of Telefónica's FFTH accesses, except those located in 66 Spanish municipalities, which the CNMC deemed competitive. In the rest of the areas (35% of the population, in the 66 municipal areas), the CNMC considered that there was sufficient competitiveness, having a minimum of three operators simultaneously rolling out new generation networks (NGA).

  Thus, the new virtual access service (NEBA Local) will guarantee that the alternative operators can offer fibre-optic-based services to users through the Telefónica network and by interconnection in the main centres of the operator in the regions deemed as non-competitive. This is the fibre-optic equivalent of local loop unbundling, which ADSL competition has been traditionally based upon.

- Regulation of wholesale and retail fixed-line phone markets 1 and 2

  On 17 January 2017 the CNMC approved the final measure to regulate the retail and wholesale fixed-line access markets (markets 1 and 2 of the 2007 European Commission Recommendation). The measure covers regulating the conditions of access to the fixed-line phone network for end users (market 1) and also, at wholesale level, for alternative operators to Telefónica (market 2).

  After studying the competitive conditions of these markets, the CNMC has decided to keep up the wholesale regulating of Telefónica in order to promote competition in fixed-line telephone services, particularly, offering Wholesale Access to the Telefónica Line (AMLT) at cost-based prices.
  The regulation of the isolated operator pre-selection service is withdrawn (i.e. without AMLT).

  In the case of the retail access market (market 1), the most significant obligations of which were withdrawn in 2012 (regulation of subscription and connection prices), the CNMC has decided to do away with the few obligations that remained.

- MVNO wholesale mobile market regulation

  On 12 April 2017 the Resolution approving the definition and analysis of the wholesale access market and origination on mobile networks was published in the Spanish Official State Gazette.

  This resolution does away with the current obligations applicable to Telefónica Móviles de España, S.A.U., Vodafone España, S.A.U. And Orange Espagne, S.A.U. regarding the provision of wholesale mobile access and origination services, taking effect from six months after the publication of the Resolution.

  From October 2017 the obligations established for these operators, mainly relating to the application of fair prices, will disappear.

- Regulatory wholesale obligations pertaining to business for Telefónica.

According to the obligations imposed on Telefónica, given its position as a significantly dominant operator on the market, the company is obliged to present offers to large account customers without cutting prices in breach of sector regulations. This means the obligation to present retail offerings that can be economically matched by efficient competing operators in the business segment.

This also means that Telefónica has the obligation to ensure that the wholesale offerings on the market enable alternative operators to render retail services equivalent to those it renders itself.

European Data Protection Regulations

After the European Parliament approved a set of Data Protection Regulations on 14 April 2016, to come into effect from 25 May 2018, the Justice Ministry has opened the Draft Data Protection Act to public consultation for adaptation to Spanish legislation.
Regulations in this area establish obligations for companies that will require organisational, technical, economic and human resources efforts to implement. It may also make the rendering of services difficult due to its intensive data usage.

Cost of the universal service for 2014

In June 2017, the CNMC issued a Report by the Department of Telecommunications and the Audio-visual Sector regarding the procedure to enforce a financing mechanism to share the net cost of the universal service incurred by Telefónica de España, S.A.U. (hereinafter, Telefónica) and by Telefónica Telecomunicaciones Públicas, S.A.U. (hereinafter, TTP) in 2014.

This report, subject to possible allegations by the operators, proposes to declare Euskaltel and R among the operators obligated to contribute to the National Universal Service Fund (FNSU) for 2014, and sets the amount of their contributions.
From the entry into force of Law 9/2014 of 11 May 2014, the obligation was established for all operators with a gross annual operating income of over Euros 100 million to contribute to the FNSU.

Revised telecommunications regulatory framework

On 14 September 2016 the European Commission published a proposal to revise the telecommunications regulatory framework. The main issues proposed for revision are:

- Promoting regulation of NGA networks,
- Improving use of radio frequencies,
- Modifying universal service content and funding under general budgets, Redefining electronic communication services (internet and personal communications with/without use of numeration) and applying standards to new online agents offering equivalent services to traditional operators, and
- Numbering.

This regulation may have implications for the Company's activity in these areas. However, the process of negotiating the telecommunications bundle will be long, as it must go through the European Council and the Parliament and will then have to be transposed into national policy.
Furthermore, the European Commission has presented a 5G plan of action with a timeline target of 2020.

Access to content

In accordance with the resolution authorising Telefónica/DTS concentration, Telefónica is obliged to offer Premiums channels in wholesale. In principle, access to this is guaranteed for the 5-year period up to 2020 as a result of the conditions imposed in the resolution authorising concentration.

Both Companies (Euskaltel and R Cable) filed appeals in May 2016 against the resolution authorising the Telefónica/DTS concentration. The grounds for these appeals are that the conditions imposed do not guarantee the existence of fair competition in the access to content and specifically access to football coverage, based on the model established in the authorised conditions.

Definition of regulatory risks

- Copyright Regulation

  In the area of televised content, copyright regulations establish a series of payment obligations on account of ownership rights. In some circumstances, negotiating and determining these rights is controversial and may have an impact on the cost of content to be acquired.

  - Renegotiating copyrights -management companies
    At the date of this report, fees chargeable by management companies for public broadcasting rights and content reproduction rights are being renegotiated. This renegotiation is ongoing in accordance with the methodology of the Order published in December 2015.
  - Private copying levy
    On 3 July 2017, Royal Decree Law 12/2017 of 3 July was approved, modifying the rewritten text of the Spanish Intellectual Property Act approved by Royal Legislative Decree 1/1996 of 12 April, regarding the private copying levy system. This regulation establishes a new private copying levy is intended to be established aimed at paying the authors for private use of songs, films or books. Distributors, wholesalers and retailers who in turn acquire the aforementioned equipment and hard copies are jointly responsible for the payment of the levy to the respective suppliers, unless they can provide proof that the levy was settled in effect.

- Obligations deriving from information security

  The Company's network sand systems carry and store large volumes of information, confidential data both pertaining to private individuals and companies, as well as personal data. The Company also renders Internet access and online storage services. Since telecommunications companies are dependent on these networks, systems and services, they face increased cybersecurity threats in this field. This can entail hacking of networks and systems or installation of viruses or malware, and thus the Company must adopt certain physical and logical security measures.

  Furthermore, legislation exists regarding these issues requiring risk management practices to be adopted and significant security incidents to be reported.

  The European Commission is to review its cybersecurity strategy in September 2017 and is currently working on additional measures with regard to cybersecurity standards and certification.

Other issues

- RTVE charge

The obligation to pay the RTVE charge is governed by Law 8/2009 of 28 August (the RTVE charge law), developed by the Regulations set forth in Royal Decree 1004/2010 of 5 August (the Regulations), which establish that electronic communications operators (rendering audio-visual services including any form of advertising) and companies rendering high-end audio-visual services in an autonomous community are obliged to make a contribution to the financing of RTVE.

To date, it was undisputed that none of the Companies were subject to the RTVE charge obligation since it was considered that the scope of the services rendered by both Companies was limited to one Autonomous Community, whilst one of the conditions of the obligation is that services be rendered in more than one Autonomous Community.

According to resolutions issued by the CNMC (prior to 2017), both Euskaltel and R Cable are not obliged to pay the aforementioned charge. These resolutions establish that certain operators are not obliged to pay the charge, in the following terms: "when 75% or more of the electronic communications operator's gross operating income comes from customers domiciled in a single Autonomous Community, the scope of their operation shall be understood to be restricted to one Autonomous Community".

On 9 March 2017 the Secretary of State for the Information Society and the Digital Agenda notified Euskaltel of the commencement of a limited verification procedure regarding the obligation to contribute to the funding of CRTVE. This verification procedure corresponds to the year 2016.

In June 2017, after the aforementioned verification had commenced, the RTVE charge obligations were modified both in terms of their wording and interpretation.

These modifications were made as follows:

- On 14 and 19 June 2017 a series of sentences were issued by Chamber Three of the Spanish Supreme Court, resolving a series of appeals filed against Law 8/2009 and its Regulations by REDTEL (Association of operators made up of Telefónica, Vodafone and Orange), as well as by Distribuidora de Televisión Digital and Vodafone.
- On 28 June 2017, General State Budget Law 3/2017 of 28 June was published in the Spanish Official State Gazette, modifying Law 8/2009 with effect from 29 June 2017.

The Secretary of State deems Euskaltel to be obligated to pay this charge since, as a result of the acquisition of R Cable, its geographical scope is state-wide or beyond that of an autonomous community. This interpretation is made based on a stipulation of the Regulations which extends the taxable event to be applicable when the services are rendered in Spanish territory directly or through a company in the same group in the terms of article 42 of the Code of Commerce. The impact of this interpretation is detailed in note 13 of the interim financial statements.

7.- Corporate governance

Changes in the Board of Directors

During the first half of 2017, the following changes occurred in the Company's Board of Directors. These changes were formally adopted at the ordinary general shareholders' meeting held, on first call, on 26 June 2017:

- End of the term of office of Mr. Alfonso Basagoiti Zavala as Director, his appointment of 8 March 2013 having expired when the Ordinary Meeting of Shareholders for 2017 was held.

- Appointment of Mr. Luis Ramón Arrieta Durana, a new proprietary Director of the Company.

8.- Events after the reporting period

Below we describe the most significant events occurred during the first weeks of 2017 up to the date of preparation of these interim financial statements.

During July 2017 certain conditions of the financing agreements detailed in note 9 have been changed, as follows:

- Decrease in the margin of tranches B1 and B2, reducing the spread in tranche A to 50 basis points.
- 1-year extension, until June 2021, in the maturity of the long-term credit facility.
- Consideration as admissible financial debt within the long-term financing contract of the short-term ECP scheme (Euro Commercial Paper) presented to the market on 14 March 2017, up to a maximum limit of Euros 200,00 thousand.

At the date of these interim financial statements, regarding the sale and purchase agreement described in Note 1, although all the necessary milestones have not yet been reached for the completion of the transaction, the conditions precedent that were dependent upon actions to be carried out by the Company have all been met.

On 10 July 2017, in accordance with Circular 1/2017 of 26 April of the Spanish National Securities Market Commission, a new Liquidity Contract was signed with Norbolsa, S.V., S.A., which entered into effect on 11 July 2017.

On 26 June 2017, the General Meeting of Shareholders agreed to pay an interim dividend against 2016 results for a gross amount of Euros 0.21 per share outstanding with dividend rights (which amounts to a maximum dividend of Euros 31.88 million). This interim dividend, totalling Euros 31.88 million, was paid to shareholders on 5 July 2017.

9.- Definition of alternative performance measures

An explanation of the alternative performance measures used in this Directors' Report is as follows:

- EBITDA: Net income + depreciation and amortisation +/- impairment
- Adjusted EBITDA: EBITDA + other results.
- Operating cash flow: EBITDA - Investments
- Conversion rate: Operating cash flow / EBITDA
- Adjusted operating cash flow: Adjusted EBITDA - Investments
- Adjusted conversion rate: Adjusted operating cash flow / adjusted EBITDA
- Investments: Additions of intangible assets and property, plant and equipment

- NFD (Net Financial Debt): nominal values payable on bank borrowings and other loans - liquid funds available at financial entities (cash and cash equivalents)

Derio, 21 July 2017

In compliance with prevailing legislation, the directors of Euskaltel, S.A. have authorised for issue the condensed consolidated interim financial statements (comprising the statement of financial position, income statement, statement of comprehensive income, statement of changes in equity, statement of cash flows and the notes thereto) and the consolidated interim Directors' Report for the six-month period ended 30 June 2017.

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

Signed:

Mr. Alberto García Erauzkin **(Chairman)**	**Mr. Francisco Manuel Arteche Fernández - Miranda** **(Chief Executive Officer)**
Mr. José Ángel Corres Abasolo **(Vice Chairman)**	**Kartera 1, S.L., represented by** **Ms. Alicia Vivanco González** **(Board member)**
Mr. Luis Ramón Arrieta Durana **(Board member)**	**Mr. Javier Fernández Alonso** **(Board member)**
Ms. Belén Amatriaín Corbi **(Board member)**	**Mr. Iñaki Alzaga Etxeita** **(Board member)**
Ms. Elisabetta Castiglioni **(Board member)**	**Mr. Miguel Ángel Lujua Murga** **(Board member)**