Grupo Prisa

Consolidated Director's report for 2013

1. BUSINESS PERFORMANCE

The ***most significant events*** in the period from January to December 2013 were as follows:

- Group **revenues** totaled EUR 2,725.7 million (+2.3%) and **Ebitda** reached EUR 296.2 million (-30.6%).

- Prisa's total **advertising revenues** in 2013 reach EUR 543.8 million, 2.3% less than 2012, and account for 19.9% of total Group revenues (20.8% in 2012). In the fourth quarter standalone, the evolution of advertising revenues continues to show an important improvement compared to previous quarters (+7.2% compared to +2.2% in 3Q, -8.4% in 2Q and -10.4% in 1Q of 2013).

    - In Spain, advertising revenues fell by 2.4% in 2013. In the fourth quarter, the advertising revenues in Spain grew by 12.3% compared to the growth of 5.2% in the Third quarter and the falls of 9.6% in the second and 15.7% in the first quarters of the year.

    - Growth in Latin American advertising reached +2.8% (26.6% of the Group's advertising revenues). Advertising revenues in Radio in Latam in local currency increased by 11.1%.

- **Latam** revenues increase by 3.4%. Latam represented 27.7% of the Group's revenues (26.7% in 2012) and 67.5% of the Group's Ebitda (45.0% in 2012).

- The company maintained during 2013 **its cost control** effort given the weakness of the macro-economic environment. Operating expenses including amortizations and provisions, reached EUR 3,526.8 million (+24.2%), mainly by extraordinary effects arising from asset impairments and the new football exploitation agreement. Purchases (EUR 1,130.0 million) increase by 27.1% compared to the 2012, while adjusting to the impact of the new agreement of the football would have been reduced in a 9.0% (-16.8% in Spain; +4.5% international mainly due to the development of digital education systems in education area). Costs of staff (EUR 539.6 million) fell a 10.8%.

- **Pay TV** revenues reached EUR 1,166.2 million (+9.2%), explained by the growth in revenues from subscribers of other platforms thanks to multi-distribution agreements which offset the fall in revenue of satellite subscribers. EBITDA reaches EUR 28.02 million (-84.5%).

  Subscriber performance was considerably affected in 2013 due to the general decrease in consumption, the VAT rise from 8% to 21% and the recent changes in the strategy of certain competitors in terms of content acquisition and the integration and subsidies of pay TV in their service offering.

  Net adds in satellite subscribers fell by 99,179, while net adds in subscribers from other operators of Canal+1 (including OTT) grew by 12,973. Satellite ARPU stood at EUR 43.5 on average in the quarter (44.2 in 4Q 2012). iPlus subscribers reached 38.9% or 630,005 (42,674 more than in 2012). YOMVI subscribers reach a penetration of 29.0% of Satellite subscribers. Canal+ maintains its leadership in the market with a market share of 44.3 according to internal estimates.

  Media Capital registered in 2013 revenues of 181.7 million Euros (-1.4%) and EBITDA of 39.1 million Euros (-6.6%) managing to partly compensate the weak economic environment and weak advertising market in Portugal, which are reflected in a fall of advertising revenues of 7.4% and on the back of its strategy to develop additional revenues and a strict cost control. TVI maintains the leadership in Prime time with a daily average audience share of 28.6% in 2013.

- **Education** revenues (EUR 738.3 million) remain stable compared to previous year on the back of the negative FX impact. At constant currency they grow by 10.8%. We highlight the growth in Digital Learning Systems, which in 2013 reached +61.3%. Latin America shows increasing revenues by +4.1% (+17.2% at constant currency). We highlight the growth of Colombia (+21.9%), Mexico (+6.1%), Ecuador (+9.2%) and Argentina (+6.9%). In Brazil (+12.3%) FX has a very negative impact (at constant currency, revenues increase by 31.3%). Spain sees its revenues fall by 11.8% as 2013 is a year with little new materials. General Publishing shows a negative performance with its revenues falling by 5.8%. EBITDA reaches EUR 170.9 million, a 7.2% fall, given the important investment effort in Digital Education Systems.

- **Radio** showed a strong growth in Latin America and weakness in Spain. Revenues (EUR 342.9 million) remains flat (+0.1%) versus 2012, mainly on the back of the lower advertising in Spain (-6.7%) although we highlight the improvement in advertising revenues throughout 2013, especially in the fourth quarter standalone, with a growth of +8.6%. We also highlight the improvement of Latin America advertising (+3.4%) (+11.1% in local currency) with a strong performance in Colombia (+3.1%), Chile (+4.2%) and Mexico (+13.0%).

- **Press** revenues (EUR 282.5 million) fell by 10.2% compared to 2012. This is explained by the weakness in advertising (-4.0%) which has shown an important improvement in the third and fourth quarters standalone (+6.2% and +20.2% respectively compared to -16.3% and -20.8% of the second and first quarters respectively), and the lower circulation numbers (down by -16.3%). EBITDA reached EUR 17.0 million (compared to a loss of EUR 13.8 million in 2012, as a consequence of restructuring process and impairments of assets).

- **Digital** advertising showed a growth of 10.0% in 2013 compared to a market fall of 2.5% (according to i2P). In Press (+15.3%), digital advertising accounts for 24% of total advertising revenues. In 2013, total number of unique browsers of the Group’s web pages reached 83.7 million (+17%) where we highlight ElPais.com (+13%), International Radio (+32%) and As.com (+36%).

- In December 2013, the Group signed an agreement to **roll over its financial debt,** thus extending the maturities, making the reduction process more flexible and enhancing its liquidity profile. In the refinancing context, the Group obtained an additional credit line of EUR 353 million, signed with certain institutional investors to meet its medium-term liquidity needs, and a significant reduction in interest payments in cash. The refinancing agreement includes a number of commitments to reduce the debt; to meet them, the Group will have several strategic options such as selling non-core assets, buying back debt at a discount in the market, leveraging operating assets, transferring debt between tranches and carrying out other M&A transactions. The contract has automatic mechanisms that, under certain circumstances, prevent an early termination if such commitments are not met, thus providing stability to the Group's capital structure.

2. PRINCIPAL RISKS ASSOCIATED WITH THE BUSINESS

The activities of the subsidiaries of the Group and therefore its operations and results are subject to risks that can be grouped into the following categories:

- Strategic and operational risks.
- Financial risks.

Strategic and operational risks of the business of the Group

Macroeconomic risks-

The economic situation of Spain and Portugal has experienced slowdowns and volatility in recent years. Specifically, main consumption indicators in these countries have been significantly deteriorated, and have impacted and still could impact in the future the spending by customers on the products and services of the Group, including advertisers, subscribers to our pay TV platform and other consumers of the content offerings of Prisa.

Furthermore, the activities and investments of Prisa in Latin America are exposed to the evolution of the various macroeconomic parameters of each country including a potential decline in consumption as a result of a slowdown in the growth rate of these countries in the medium term.

Decline in advertising markets-

A relevant portion of the operating income (revenues) comes from advertising revenues through the press, radio, audiovisual and digital businesses. Expenditures by advertisers trend to be cyclical, reflecting overall economic conditions and perspectives. A decline of the macroeconomic situation in Spain and Portugal could alter current or prospective advertisers spending priorities. In view of the grate component of fixed costs associated with business with a high component of advertising revenue (mainly radio and press), a drop in advertising revenues directly impacts operating profit and therefore the ability to generate cash flow of the Group, forcing business units to perform frequent reviews and adjustments in its cost base.

Piracy-

Revenue from the exploitation of content and royalties owned by the Group are affected by illicit access to them via the internet or copy, which primarily affects the pay Tv business and book publishing.

Competition risk-

The business of audiovisual, education, radio and press in those which Prisa operates are highly competitive industries. In the same way, regarding to the business of pay Tv, activities of competition may affect the ability of the Group's businesses in this segment to attract new subscribers and increase the penetration rate, and may also lead to an increased subscriber acquisition cost or in the audiovisual rights acquisition, which might result in a significant negative impact on the financial position and results of this line of activity.

Drop of circulation-

Press revenues from copy sales and subscriptions continue being negatively affected by the growth of alternative means of distribution, including free Internet sites for news and other contents.

Sector regulation-

Prisa operates in regulated industries and is therefore exposed to regulatory and administrative risks that could adversely impact its business.

Specifically, the Group businesses are subject to comprehensive regulations including the requirement to maintain concessions and licenses for the operations in Audiovisual and Radio segments, while the business of education is subject to the applicable law on national or regional education cycles.

Country risk-

The Group operations and investments in Latin America may be affected by various risks typical to investments in countries with emerging economies, the most significant of which include devaluation of foreign currencies, introduction of exchange restrictions, inflation, expropriation or nationalization of foreign assets, changes in applicable foreign tax levels, changes in policies and regulations or economic instability.

Litigation risks-

Prisa is involved in significant litigations, mainly in the Audiovisual area. Additionally, Prisa is exposed to liabilities for the content of their publications and programs.

Digital activity and safety net systems-

Digital activities depend on internet service providers, online service providers and on systems infrastructure. Significant system failures or security breaches could have an adverse effect on operating results and financial condition of the Group.

Technological risks-

In order to maintain and increase its businesses and competitiveness, Prisa must adapt to technological advances, for which research and development are key factors. Technological changes may facilitate the entry of new competitors and potential market share decrease of the Group.

Financial Risks

Financing risks -

The financial obligations of the Group are described in note 10 *"Financial Liabilities"* of the Prisa explanatory notes for 2013.

As is described in that note, in the month of December of 2013 the Group has signed a debt refinancing agreement which represents an extension of maturities, improving the flexibility in the process of debt reduction and enhancing its liquidity profile.

The improvement in the liquidity profile derives from a new credit facility amounting of EUR 353 million signed with certain institutional investors to cover medium term liquidity needs, and from the significant reduction of interests paid in cash.

The refinancing agreement includes several commitments of debt reduction, for which compliance the Group has different strategic alternatives including the sale of non-strategic assets, repurchase debt at a discount in the market, the leverage of operating assets, transfers debt between tranches and other corporate transactions. The contract contains automatic mechanisms that prevent its early termination, in certain situations, in case of such commitments are not met.

According to the contracts governing borrowing conditions and stipulated requirements, Prisa must meet certain commitments and financial leverage ratios (covenants). These contracts also include cross-default disposals. Additionally, the current refinancing incorporates legal decision making mechanisms by qualified majorities in negotiation processes that previously were subject to unanimous consent of the financial institutions.

At 31 December 2013 the Group's bank borrowings amounted to 3,401 million euros. The Group borrowing levels poses significant risks, including:

- increasing the vulnerability to general economic downturns and adverse industry conditions;
- requiring a substantial portion of cash flow from operations to be dedicated to the payment of interest on the indebtedness, therefore reducing the ability to use cash flow to fund short term operations, working capital requirements, capital expenditures and future business operations;
- exposing the Group to the risk of increased interest rates, as a part of the borrowings are at variable rates of interest; and
- limiting the ability to adjust to changing market conditions and placing the Group at a disadvantage compared to competitors who have less debt.

Liquidity Risk-

The adverse macroeconomic situation, with significant drops in advertising, circulation and pay Tv subscribers, is having a negative impact on the ability of the Group's cash generation in the last years, mainly in Spain. The advertising-dependent businesses have a high percentage of fixed costs and drop in advertising revenue significantly impact on margins and cash position, hindering the implementation of additional measures to improve the operational efficiency of the Group. Similarly, in pay Tv business, in a context of increasing costs associated with new exploitations model of football and growing competence in the content acquisition, and aggressive marketing strategies by certain operators, offering free contents under multi-element arrangements, falling subscriber revenues necessarily increase the period of time required to capitalize those costs. This would affect directly the liquidity of the business, what might raise additional financing needs.

As part of the debt refinancing agreement signed last December, the Group obtained additional credit facilities amounting EUR 353 million to meet its liquidity requirements in the medium term.

The Group thoroughly analyzes receivables and payments of its activities and maturity of financial and comercial debt. In relation with the commercial credit risk, the Group evaluates the aging of the debt and constantly manages receivables.

Additionaly, the group analyzes on a recurrent basis other financing sources to cover short and medium term liquidity needs.

Minority interests -

There are significant minority interests in some cash generating companies, to highlight pay Tv and Education. Santillana is required to pay to its minority interests (25% of its share capital) a predetermined fixed preferred dividend. The Group has access to pay Tv cash, in which there are 44% minority interests, through dividends.

Interest rates risk exposure-

Approximately 35% of its bank borrowings terms are at variable interest rates, and therefore the Group is exposed to fluctuations in interest rates. Consequently, in order to reduce its exposure, the Group arranges interest rate hedges.

Fluctuations in foreign exchange rates-

The Group is exposed to fluctuations in the exchange rates mainly in the financial investments in Latin American subsidiaries, and for the revenues and results from those investments.

In order to mitigate this risk, as far as there are available credit facilities, the Group arranges hedges to cover the risk of changes in exchange rates (mainly foreign currency hedges and forwards) on the basis of projections and budgets, in order to reduce volatility in cash flows transferred to the Parent.

Tax risks-

Tax risks the Group are related to a possible different interpretation of the rules that could make the competent tax authorities, as well as the generation of taxable income to allow the recoverability of the tax credits. Additionally, as a result of various tax reforms in Spain, has been limited the deductibility of interest and depreciation expenses, so additional tax credits have been generated.

Shareholders control group changes-

It is reasonable to consider that on February 21, 2014, the stake of the controlling shareholder group of Prisa in the share capital of Prisa was reduced below 30%. In case this was confirmed, the right awarded by the shareholders agreement of DTS to Telefónica de Contenidos and Mediaset España to acquire the stake held by Prisa in DTS will be exercisable for a period of fifteen calendar days following the date on which Prisa notifies this fact to the Board of Directors of DTS and the aforementioned entities. The regulation of this right of acquisition includes a mechanism and procedure of valuation of the DTS´s shares owned by Prisa.

Since there is no certainty about the eventual exercise of the aforementioned right, the accompanying financial statements do not contemplate the impact of this execution, which may involve, in case the right was exercised and the transaction was closed, the exit of Prisa from DTS´s share capital.

3. OUTLOOK

In 2013, Prisa continued to have differing performances between in its activities in Spain and Portugal and those in Latin America.

The media industry is highly sensitive to the performance of the main macroeconomic variables (GDP), consumer spending and, especially, the advertising cycle. Advertising in Spain and Portugal continued to perform negatively in 2013, although there has been a deceleration in the pace of decline since the second quarter in Spain and the main market sources suggest that there may be stability or even a slight growth in 2014.

Conversely, in Latin America, GDP performed positively and the countries where the Group operates recovered the pre-world crisis levels, although the Group has exposure to interest rate fluctuations and to the performance of those countries' macroeconomic parameters, including a potential decrease in consumer spending as a result of a slowdown in the pace of growth in the medium term.

Although the Prisa Group's exposure to advertising is limited as a result of diversification (only 19.9% of total revenues in 2013), the businesses that depend on this have a large percentage of fixed costs and the fall in advertising revenues has a significant effect on results, narrowing the Group's margins and worsening its cash position. In Spain, the Group's advertising revenues decreased by 2.4% in 2013, although there was an improvement during the year, which accelerated in the fourth quarter, with 12.3% growth (+5.2% in 3Q, -9.6% in 2Q and -15.7% 1Q). In Latin America, advertising revenues (26.6% of the Group's total) grew by 2.8%.

In 2013, Latin America accounted for 27.7% of the Group's revenues (3.4%) and 67.5% of EBITDA (+6.2%).

Prisa has other businesses that are less dependent on the economic cycle which continue to grow, especially in Latin America, such as textbooks, which accounted for 27.1% of the Group's total revenues and 57.7% of EBITDA in 2013. In Latin America, revenues rose by 4.1% in 2013 (+17.2% at constant exchange rates). The publishing business continues to focus on expanding the digital education systems, especially in countries such as Mexico, Colombia and Brazil. It had a negative performance in Spain in 2013 since there were few new releases. However, as a result of the new education reform which will enter into force in summer 2014, Santillana expects to increase revenues with the publication of new books.

Digital viewing grew significantly (83.7 million unique visitors at December 2013, i.e. +16.9% year-on-year). The company will continue to focus on increasing digital development in all its business units. Specifically, the press area will continue to focus on making as much profit as possible with the leadership of its newspapers such as El País and As not only in Spain but also in the Latin American market.

The pay TV revenues rose by 18.3% in 2013, although EBITDA declined by 64.5% due mainly to the new football operating model. Although this model substantially improves the quality of the content, it also increases the costs, which must be offset in the long run through multidistribution sales to third parties and a necessary boost in the subscriber base. Subscriber numbers were hard hit by the general fall in consumer spending and the rise in VAT from 8% to 21%. Also, recently there has been intense competition since some operators have been subsidizing their pay TV offering and the competition in acquiring content has increased. All of this has impacted the business's profitability.

In this difficult economic situation in Spain and Portugal, Prisa has maintained a strict cost control policy. In 2013, apart from the football costs, all the operating expenses fell significantly. The Group will continue to reduce costs and adapt its production structures to business performance with the aim of maintaining its liquidity and profitability and keeping an appropriate position so that it can take advantage of the market recovery. The Group will be able to meet this challenge with a more stabilized financial position thanks to its recent debt restructuring signed in December 2013.