Grupo Prisa

Consolidated Director's report for 2014

1. BUSINESS PERFORMANCE

Financial result

Key highlights for 2014 include:

- Group **operating income** in 2014 amounted to EUR 1,454.7 million (-6.2%) and **EBITDA** to EUR 183.4 million (-28.8%).

- **Advertising revenue** totalled EUR 490.4 million (-1.3%), with a 2.8% decrease in advertising in Spain, but a 10.2% increase in Portugal for the year, consolidating the recovery seen in recent months.

- **Latin America and the US** represented 47.5% of the Group's revenues and 94.0% of EBITDA. Latin America posted further growth in local currency (by Santillana and in radio) despite the economic slowdown in some economies (e.g. Chile and Colombia).

- **Cost cutting** and control over capex were implemented throughout the Group, with resources allocated to growth, mainly of Santillana.

- Operating expenses in **Education** amounted to EUR 716.6 million (-2.9%), with a negative currency effect of EUR 66.7 million, and EBITDA to EUR 170.7 million, broadly in line with 2013 levels.

  Campaigns in the South area performed well in local currency for the most part, while campaigns in the North area also fared well. In Spain, the campaign drove growth compared to 2013, despite the challenges of implementing the new law on education thanks to the commercial efforts and cost control.

  Last year featured further development of the digital education systems (UNO) in Latin America, with considerably higher profitability and growth in enrolment.

- **Radio** operating expenses amounted to EUR 305.1 million (-5.8%), with a negative currency effect of EUR 11.6 million, and EBITDA to EUR 45.7 million (-2.2%). Advertising in Spain decreased 2.4%, but grew throughout Latin America in local currency except in Chile, due to the country's economic downturn.

  Noteworthy was the operating improvement in Spain, with EBITDA soaring EUR 8.6 million to EUR 11.3 million, driven by cost-cutting in recent years.

- **Press** operating income was down 7.2% at EUR 260.2 million. Advertising revenue was 2.9% lower (El País -5.2% and AS +7.0%), while traditional revenue slumped 9.6%, undermining to some extent the good performance by digital advertising revenue, which rose 18.4%.

- **Media Capital** operating income reached EUR 179.8 million (-1.1%) and EBITDA amounted to EUR 42.1 million (7.8%). Advertising revenue advanced 11.1%, with solid performances in TV (+11.4%) and radio (+9.2%).

- The Group continues to press on with its **refinancing plan** and in 2014 carried out a series of transactions under the scope of its debt-reduction commitment, such as the sale of a 13.68% of stake in Mediaset España Comunicación, S.A., the agreement with Telefónica de Contenidos, S.A.U. to sell a 56% stake in DTS and the capital increase subscribed by Consorcio Transportista Occher, S.A. de C.V.

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 an important slodown and volatility in recent years. Although from year-end 2013, a change in this trend was shown, which consolidated in 2014.

Main consumption indicators in these countries have been significantly deteriorated, and have impacted and still could impact in the future spending by customers on the products and services of the Group, including advertisers, subscribers to the pay TV platform (business that is currently in sales process, as described in the accompanying consolidated financial statemen) 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 in some of these countries. The Group's results in Latin America have been hurt by the weakness of the region's currencies since mid-2013, which eased starting in the second quarter of 2014. However, exchange rates have been fairly volatile in recent months.

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 tend to be cyclical, reflecting overall economic conditions and perspectives.

Failure by the Spanish and Portuguese economies to improve as expected could undermine prospective spending by the Group's advertisers. 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 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 businesses of audiovisual, education, radio and press in which Prisa operates are highly competitive industries. The ability to anticipate and adapt to new needs and customer demands, influences the position of the Group's businesses compared to other competitors.

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, some of which relate to DTS and could result in a future adjustment on the price of the sale purchase agreement *(see note 26)*. 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 9 *"Financial Liabilities"* of the accompanying consolidation financial statement of 2014.

As is described in that note, in the month of December of 2013 the Group 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 was derived from a new credit facility amounting of EUR 353 million signed with certain institutional investors to cover medium term liquidity needs, from the significant reduction of interests paid in cash.

The refinancing agreement included several commitments of debt reduction, for which compliance the Group has different 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, which gives stability to the capital structure of the Group.

As described in the notes to the consolidated financial statements, the Group carried out a series of transactions to deliver its debt-reduction commitment, such as the placement of a package of shares of Mediaset España Comunicación, S.A., using the proceeds to buy back EUR 643,542 thousand of financial debt at an average discount of 25.7%, and the capital increase subscribed by Transportista Occher, S.A. de C.V., using the proceeds to buy back EUR 133,133 thousand of financial debt at an average discount of 25.0%. These transactions helped the Group lower debt by EUR 776,675 thousand in 2014.

In addition, in June 2014, the Group entered into an agreement with Telefónica de Contenidos, S.A.U. for the sale of shares representing 56% of DTS's capital for EUR 750 million. This sale transaction is subject to approval by the competition authorities of Spain, who may impose conditions or commitments for the approval of the operation.

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.

As of December 31, 2014, the high levels of the Group bank debt (EUR 2,754 million), imply certain risks:

- increasing the vulnerability to general economic downturns and adverse industry conditions;
- requiring a 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.

Equity situation of the parent company of the Group-

In June 2014, as a result of the loss of EUR 750,383 thousand recognised by the Parent Company of the Group following the sale of a 56% stake in DTS, equity was negative in the amount of EUR 593,513 thousand, and therefore the Parent Company qualified for dissolution in accordance with Spain's Corporate Enterprises Act.

In order to restore the equity balance, the mechanism was used to automatically convert part of Tranche 3 of the company's debt into participating loans for a sufficient amount to offset the negative equity.

During this period, the Company repurchased debt at a discount using the proceeds of the Occher share capital increase and the sale of 10.0% of Mediaset España, which reduced the amount of the participating loan required to restore the balance of equity.

The process to convert debt into the participating loan was carried out on 15 September, in the amount of EUR 506,834 thousand, which included the impact of the transactions and the operating results up to the date of conversion. This brought the Company's equity to two thirds of share capital.

At 31 December 2014, as a result of, among other items, a review of the sale price of DTS and recognition of additional impairment of EUR 23,789 thousand, the equity of the Company with respect to the cause of dissolution and/or reduction of capital stipulated in Spain's Corporate Enterprises Act (including participating loans outstanding at year-end) stood at EUR 31,554 thousand. In a bid to restore the equity balance, the automatic mechanism was again deployed to convert Tranche 3 of company debt into participating loans in a sufficient amount to offset the equity imbalance at the conversion date.

As occurred with the automatic conversion that took place in the second half of 2014, in accordance with the Corporate Enterprises Act, the date on which the debt will be converted into participating loans will be five business days before expiry of the two-month period allowed for taking the necessary measures to restore the company's equity, calculated from the date on which the Directors became aware of the negative equity, i.e. the date on which they authorized the financial statements showing the situation of negative equity.

Sale of DTS-

The refinancing agreement of Prisa´s Tranches 2 and 3 debt contain certain automatic mechanisms that prevent its early termination if the commitments of debt reduction included in the contract are not met. Therefore, in the case the sale of DTS was not completed and the company could not meet those debt reduction commitments, these mechanisms would apply and would prevent an early termination of the agreement.

In addition, the Company would decide to implement other corporate transactions to meet Tranche 1 repayment commitment if the sale of DTS was not executed and impacted the maturity of this debt.

Finally, if the sale of DTS to Telefónica or to a third party, in accordance with the sale purchase agreement signed with Telefónica, was not executed, the financial and strategic situation of the Group could be impacted in the long term.

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, a negative evolution of the pay TV business, would directly impact its liquidity, which could result in additional financing needs that would increase in case the closing of the sale of this business is delayed.

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

Additionally, 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 education, radio and pay TV. Santillana is required to pay to its minority interests (25% of its share capital) a predetermined fixed preferred dividend.

Interest rates risk exposure-

Approximately 44.56% 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 to the extent there are undrawn credit facilities.

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 which are reviewed on a monthly basis, in order to reduce volatility in cash flows transferred to the Parent from foreign subsidiaries.

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 ability to generate sufficient taxable income to allow the recoverability of the tax credits arising from carry forward of tax losses, the limitation of the deductibility of interest and depreciation expenses and tax deductions.

3. OUTLOOK

The media industry is highly sensitive to trends in the main macroeconomic variables (i.e. GDP), consumption and, especially, the advertising cycle.

Advertising in Spain and Portugal continued to struggle in 2013, but the pace of decline in Spain slowed in the year's second quarter. This trend continued into the first quarter of 2014, which still showed declines, before ending the year with overall growth of 5.0%, according to a report by i2P. Accordingly, 2014 marked the first year of any meaningful growth in advertising spend since 2008. The same source (i2P) estimates further growth of 5.8% in 2015, with increases in all sectors. The Portuguese advertising market also rebounded in 2014.

In Latin America, GDP growth rates were mixed across countries. While the situation worsened in some, such as Brazil and Chile, growth gathered steam in others, such as Mexico and Colombia. According to IMF estimates, growth in these countries should continue to recover over the next few years. That said, the Group is exposed, in any event, to their macroeconomic parameters, where the outlook points to a potential deterioration in consumption as the scale of growth eases over the medium term.

The Group's results in Latin America in 2014 were hurt by the weakness of the region's currencies since mid 2013. The impact was attenuated from the second quarter last year, although exchange rates have showed quite volatility in recent months. Stripping out exchange-rate effects, results in Latin America showed increases in local currency in most countries.

Despite the Prisa Group's limited exposure to the performance of the advertising market given its diversified revenue mix (advertising revenues represented 33.7% of the total in 2014, excluding Canal+ revenues), those businesses that rely heavily on advertising show a higher percentage of fixed costs. Therefore, declines in advertising revenue for these companies have major implications for their earnings, leading to an erosion of the Group's margins and to deterioration in its cash position.

In Spain, the Group's advertising revenues slipped 2.8% in 2014, but excluding extraordinary items, they were stable and showed a positive change in trend in the fourth quarter. In Portugal, Media Capital delivered a 11.1% increase in advertising revenue from 2013 and consolidated the recovery of the advertising market that started in Portugal in the fourth quarter of 2013 (+4.3% in the fourth quarter).

In 2014, Latin America and the US represented 47.5% of the Group's revenues and 94.0% of its EBITDA (65.8% of the Group's adjusted EBITDA).

Prisa has other, less cyclical businesses that still show scope for growth, especially in Latin America. One example is Education, which contributed 49.3% of the Group's total revenues and 93.1% of its EBITDA in 2014 (65.2% of the Group's adjusted EBITDA). Revenue in Latin America fell 5.5% in the year (+6.4% assuming constant exchange rates). Efforts in the publishing business remain focused on expanding the digital education systems, above all in Mexico, Colombia and Brazil, whose revenues and EBITDA grew significantly in 2014. Campaigns in the South area on the whole were positive in local currency terms. The campaign in Spain delivered increases compared to 2013 despite the problems deriving from the implementation of the new law on education, thanks to commercial efforts and cost control.

Digital audience numbers rose sharply (94.3 million unique browsers at end-December 2014, up 12.8% from the year earlier). Going forward, the Company will continue efforts to boost digital growth in all its business lines. Specifically, in Press the focus will remain on fully leveraging the leadership positions of the El País and As newspapers, not only in Spain, but also in the American market.

Digital advertising revenues rose by 13.9% in 2014, with Press increasing its share of total advertising revenues to 29% (from 23% in December 2013).

Revenues from the pay TV business (recognised in the consolidated income statement under "Profit (loss) from discontinued operations") were stable in 2014, with growth in subscriber revenues from other platforms making up for the fall in revenues from satellite subscribers. EBITDA was down 15.6%, due mostly to higher football costs.

Against a backdrop of improvement in the economic situation in Spain and Portugal and growth in Latin America, despite a certain slowdown in some countries, cost cutting and control over capex remain a key priority for the Group. The aim is to minimise opex and use the resources freed up for growth businesses, such as Santillana, maintaining a strict cost-control policy and adapting productive structures to revenue performance in order to maintain the liquidity and profitability of the businesses.

The Group also continues to focus on executing its refinancing plan, and in 2014 carried out a series of transactions under the scope of its debt-reduction commitment, such as the placement of a package of shares of Mediaset España Comunicación, S.A., the capital increase subscribed by Consorcio Transportista Occher, S.A. de C.V., and debt buy backs at a discount of around 25% that led to a debt reduction of EUR 777 million. In 2014 the Group also reached an agreement to sell 56% of its stake in DTS. This sale transaction is subject to approval by the Spanish competition authorities who may impose conditions or commitments for the approval of the operation.

4. EVENTS AFTER THE BALANCE SHEET DATE

In February 2015, Prisa announced the reduction of its stake in Mediaset below 3%. Part of the proceeds from these sales has been used to buy back a portion of its financial debt at a discount. This has been done by way of a Dutch auction process, aimed at its creditor banks, at an average discount of 25%.

The Board of Directors of PRISA held on February 27, 2015 has approved a capital increase for a total value of Euro 74,999,999.49, with an issue price (nominal value and share premium) of Euro 0.53 per share. The share capital increase will be subscribed by International Media Group ("International Media Group") and fully disbursed by means of a capital contribution at the time of the subscription.

The capital increase will be formalized through the issuance of a total of 141,509,433 Class A shares, of Euro 0.10 nominal value each with a share premium of Euro 0.43 per share and excluding the pre-emption right for subscription of shares. This price represents a premium of 104 percent, approximately, on the average weighted price of the shares of PRISA during the last three months.

International Media Group Ltd. is a company fully owned by Sultan Ghanim Alhodaifi Al-Kuwari.

The capital increase is subject to (i) the obtaining of the obligatory report from the accounts auditor appointed by the Commercial Registry on the fair value of the shares, the book value ("valor teórico") of the pre-emption right for subscription of shares proposed to be excluded and the reasonableness of the data contained in the directors' report drafted for these purposes, and (ii) the completion of a legal and finance due diligence.