Annual Report

2011

Content

Introduction

We are pleased that
more than 7 out of 10.5 million
Czechs trust in our services.

Independent auditor's report

To the Shareholders of Telefónica Czech Republic, a.s.:

I. We have audited the consolidated financial statements of Telefónica Czech Republic, a.s. and its subsidiaries ("the Group") as at 31 December 2011 presented in the annual report of Telefónica Czech Republic, a.s. ("the Company") on pages 105–169 where we have issued an auditors' report dated 17 February 2012 presented in the annual report on pages 108–109. We have also audited the separate financial statements of the Company as at 31 December 2011, which are presented in the annual report of the Company on pages 171–233 on which we have issued an auditors' report dated 17 February 2012, presented in the annual report of the Company on pages 174–175 (both referred further as "financial statements").

II. We have also audited the consistency of the annual report with the financial statements described above. The management of Telefónica Czech Republic, a.s. is responsible for the accuracy of the annual report. Our responsibility is to express, based on our audit, an opinion on the consistency of the annual report with the financial statements.

We conducted our audit in accordance with International Standards on Auditing and the related implementation guidance issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the information presented in the annual report that describes the facts reflected in the financial statements is consistent, in all material respects, with the financial statements. We have checked that the accounting information presented in the annual report on pages 7–103 and 235–241 is consistent with that contained in the audited financial statements as at 31 December 2011. Our work as auditors was confined to checking the annual report with the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. We believe that our audit provides a reasonable basis for our opinion.

Based on our audit, the accounting information presented in the annual report is consistent, in all material respects, with the financial statements described above.

III. In addition, we have reviewed the accuracy of the information contained in the report on related parties of Telefónica Czech Republic, a.s. for the year ended 31 December 2011 presented in the annual report of the Company on pages 243–254. The management of Telefónica Czech Republic, a.s. is responsible for the preparation and accuracy of the report on related parties. Our responsibility is to issue a report based on our review.

We conducted our review in accordance with the applicable International Standard on Review Engagements and the related Czech standard No. 56 issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the review to obtain moderate assurance as to whether the report on related parties is free from material misstatement. The review is limited primarily to enquiries of company personnel, to analytical procedures applied to financial data and to examining, on a test basis, the accuracy of information, and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the report on related parties of Telefónica Czech Republic, a.s. for the year ended 31 December 2011 is materially misstated.

Ernst & Young

Ernst & Young Audit, s.r.o.
License No. 401
Represented by

Brian Welsh
Partner

Petr Vácha
Auditor, License No. 1948

5 March 2012
Prague, Czech Republic

Interview with Luis Antonio Malvido, the Chairman of the Board of Directors

What was the year 2011 like for the company?

The year 2011 was full of challenges, but for us – also successes. We managed to reach several important milestones. One of the most important, in my view, is that during the year we captured over 50% market share in mobile contract customers' net additions and close to 50% market share in fixed broadband customers' net additions. We also significantly exceeded our own target in the coverage of the country with the 3rd generation mobile network signal. Whereas at the end of 2010, our 3G network reached 43% of the population, last year on the New Year's Eve, it was already 73%. Of course, we are planning to continue in the fast network rollout also in 2012. I also consider the prestigious award from Via Bona Foundation as a great achievement – we earned it for 17 years of uninterrupted partnership with the Safety Line and the start of Think Big, a social programme for young people, in the Czech Republic.

Investments in mobile networks and fast data services are considered as key, especially as the penetration of smartphones and mobile data services in the Czech Republic is lagging behind the western countries. How successful was the year 2011 in this particular area?

Together with the expansion of our 3G network coverage, we focused on promoting the benefits of smartphones to the people. In June we joined forces with leading industry partners and together launched the campaign 'Now I Know Why', in which we demonstrated to our customers the various advantages of using smart devices and mobile internet. The campaign helped to increase the penetration of smartphones in our customer base to almost 20% and led to a significant upturn in the sales of internet access in the mobile.

The year 2011 was not as kind to the Czech economy as the business sector would have wished. How did you cope with the challenging environment?

The year that has passed was a difficult one for all sectors; the sector of telecommunications was, however, among those that were hit the hardest. The financial results of the Telefónica Czech Republic Group were marked by the increasingly fiercer competition in the corporate and SME segments in particular, and by the cuts in mobile termination rates. Despite this, we delivered on our goals and achieved a robust level of financial performance. We continue to be highly profitable.

Would you say you are satisfied then?

Things can always be better, but we are doing well in a highly competitive market place and we have a number of accomplishments to show for it. It is a very good result, in my view, especially if you consider the 140% SIM card penetration.

How many new customers did you have?

We added more than 100 thousand new mobile customers, whereas in 2010 it was only about five thousand. At the end of the year we had 4.9 million customers, which is about two percent more than the year before. The xDSL internet over a fixed line did also well – despite the fierce competition from cable television providers and local WiFi providers, we added 66 thousand new clients, which is a year-on-year growth of more than eight percent. The launch and subsequent improvements of the VDSL technology, which gives customers twice as fast home internet as before, played a major part in that. That more than a hundred thousand customers, the majority of whom were existing customers, took the opportunity to subscribe the service by the end of 2011 – this helped us relieve some of the ARPU pressure and reduced customer churn. This is something I regard as essential, especially at the current level of competition in the marketplace.

Speaking of fixed access, is it possible to slow down the ongoing rate of decline due to people cancelling fixed lines and keeping only mobile phones? How well did you do in 2011 in this respect?

The fixed access results were satisfactory. Compared to the previous year we succeeded with slowing down the rate of decline – whilst in 2010, more than one hundred thousand accesses were lost; in 2011 it was under ninety thousand. At the end of the year, just fewer than 1.6 million Czech customers kept a fixed line. The slowdown was aided the O2TV proposition becoming even more attractive, in addition to improvements to our xDSL service. Bundling of O2TV with a fixed O2 internet service proved to be very effective due to the economical pricing. People who took up on the offer saved hundreds of crowns off their monthly bill.

During the year we saw a massive campaign to promote telecommunications services to businesses. Is it then a new focus of your company?

Our business clients have always been on the forefront of interest for Telefónica Czech Republic as no other operator can offer such a range of services as we can. Still, the business segment saw several major changes in the last year. In the middle of the year we launched O2 Exclusive, a commercial brand under which we offer converged fixed and mobile voice and data service to business customers. As part of our ongoing effort to improve the quality of customer service in the segment, we phased out the automated voice IVR systems, so that business customers, who are often pressed for time, are put directly through to a live operator. Thirdly, we substantially expanded our portfolio of ICT services.

The success of Telefónica Czech Republic Group is partly down to the subsidiary Telefónica Slovakia. How would you rate its performance in 2011?

The company's results in 2011 positively helped the overall group financial performance. In the fourth quarter of the year, the total number of customers in Slovakia grew 85.1 thousand, which was the largest quarterly gain in 2011; most of the growth was in the contract segment. At the end of 2011, the total number of customers reached 1.164 million, which is a growth of almost one third. In 2011 the share of contract customers continued to rally, reaching 43 % in December. Our share of the Slovak mobile market reached almost 20%.

The year 2012 is expected to be a 'turning point' in the telecommunications sector – which major developments are you expecting personally?

The auction of frequencies for the fourth generation mobile networks (LTE) will be, without doubt, the biggest milestone of the year. The technology allows for a much more efficient infrastructure rollout, with several times faster mobile internet than the present 3G networks, with a much better coverage in the rural areas. We see LTE as a huge opportunity to leapfrog the whole sector of mobile communication forward, and, help Czech business, for example, become much more competitive. We see LTE as a key technology for the future – one that has a lot of potential to affect the whole economy of a country. But whether we succeed depends largely on the conditions which the market regulator, the Czech Telecommunications Office, attaches to the auction. If done right, the frequency auction can help with spreading fast mobile internet to all corners of the Czech Republic – otherwise, if the conditions are not calibrated right, the whole telecommunications market could slow down as a result.

Are you prepared to start building the LTE network already in 2012?

If the auction is fair and conditions permit, then yes. We are interested in the licences and prepared to invest in the new and viable technology. In 2011 Telefónica Czech Republic Group invested a total of CZK 5.6 billion and in 2012 we are prepared to commit for even higher level of investment.

Which factors will influence the results of 2012?

We expect that revenues from fixed and mobile broadband internet, in conjunction with the growing revenues from Slovakia, will be the main drivers of revenue growth in 2012 compared to 2011. At the same time, our performance will be negatively impacted by the expected cuts in mobile interconnection rates and the highly competitive marketplace. We will continue to focus on efficient operating expenditure (simplifying and making more efficient our organisation structure and processes, consolidation and optimisation of our call centre operations), with the view to maintain the best levels of the operating margin. We will also continue to channel our investments to improvements to our broadband data network and increasing the network capacity, in the interest of future growth.

Financial and operational highlights

Financial data is based on audited consolidated financial statements prepared in accordance with International Financial Reporting Standards.

All figures, unless otherwise stated, are in CZK millions as at 31 December of each year.

Financials	**2011**	**2010**
Revenues	52,388	55,562
OIBDA – Operating income before finance costs, tax, depreciation and amortization[1]	21,790	27,380
Operating income	10,139	15,524
Income before taxes	10,008	15,318
Net income	8,684	12,280
Total assets	88,892	92,792
Property, plant and equipment	51,525	56,651
Total equity	69,097	73,176
Financial debts	3,061	3,024
Capital expenditure	5,856	5,664

[1] Including impairment reversal/loss. In 2010, the Group posted an impairment reversalof CZK 4,344 million attributable to the fixed-line segment assets, and an impairment loss of CZK 18 million, while in 2011, it recorded an impairment loss of CZK 21 million.

Operations (end of period)		
Fixed accesses (x 1,000)	1,582	1,669
xDSL connections (x 1,000)	872	806
Pay TV – O2 TV (x 1,000)	136	129
Mobile registered customers in Czech Republic (x 1,000)	4,942	4,839
— of which contract	3,049	2,864
pre-paid	1,893	1,975
Active mobile customers in Slovakia (x 1,000)	1,164	880
Group headcount (end of period)	6,890	7,522

Ratios (in %)		
OIBDA margin (OIBDA/Revenues)	41.6	49.1
Net income/Revenues	16.6	22.0
Capital expenditure/Revenues	11.2	10.2
ROA (Net income/Total assets)	9.8	13.2
ROE (Net income/Equity)	12.6	16.8
Gross gearing (Financial debts/Total equity)	4.4	4.1

Macroeconomic indicators[1]		
Population (in millions)	10.5	10.5
GDP growth (in %)[2]	1.7	2.2
Inflation (in %)	1.9	1.5
Unemployment (end of period, in %)	8.6	9.6
CZK/USD exchange rate – average over the period	17.7	19.1
CZK/USD exchange rate – end of period	19.9	18.8
CZK/EUR exchange rate – average over the period	24.6	25.3
CZK/EUR exchange rate – end of period	25.8	25.1

[1] Sources: Czech Statistical Office, Czech National Bank, Ministry of Labour and Social Affairs.
[2] At constant 1995 prices, preliminary figure.

Calendar of key events in 2011

January

Telefónica CR went live with its redesigned website www.o2.cz. Together with the redesign, Telefónica CR also introduced the electronic bill feature.

February

Telefónica CR published its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2010. Consolidated revenues reached CZK 55.6 billion; net profit was up to CZK 12.3 billion.

Vladimír Dlouhý was cooped as member of the Supervisory Board, having succeeded Jaime Smith Basterra who had tendered his resignation.

Telefónica CR and T-Mobile Czech Republic signed a 3G network sharing agreement. The agreement concerned the areas not yet covered with signal. The sharing arrangement facilitated the network rollout and significantly improved the 3G coverage of both operators.

Telefónica CR took over more than 11,000 residential ADSL customers from VOLNÝ.

Telefónica CR came on board of Think Big, the ongoing pan-European social programme of Telefónica. The programme helps young people make a reality their ideas and projects to aid the communities in which they live.

March

Telefónica CR's Network Demarcation project was recognised as the IT Project of the Year 2010 by the Czech Association of Information Technology Managers.

Employees of Telefónica CR raised CZK 394,265 in aid of the victims of the earthquake and tsunami disaster in Japan. The Company matched this amount 100% to the total of CZK 788,350, and the donation was made to the humanitarian assistance organisation ADRA.

On its online portal www.chcidoo2.cz, Telefónica CR launched a Momma and Poppa application aimed at helping employees who are also parents to return back to work after maternity and parental leave.

April

According to a survey by Ipsos Tambor, Telefónica CR had the best mobile data service and the best mobile internet coverage, which made it the leader in the field of Czech mobile internet.
Telefónica CR launched VDSL, a new technology giving up to three times faster home internet.

Telefónica CR went live with its new campaign 'Martin and Lucie' for business and SME customers, which presented the benefits of products designed for this segment and improvements in customer care.

Telefónica Slovakia launched a new tariff O2 Filip with unlimited free calls within the network of O2 Slovakia.

An Ordinary General Meeting of shareholders of Telefónica CR was held. The shareholders approved, among other things, a proposal of the Board of Directors for the payment of a dividend of CZK 40 per share, before tax. Vladimír Dlouhý was elected substitute member of the Audit Committee and his co-optation as member of the Supervisory Board was confirmed.

May

Telefónica's operation in the Czech Republic changed its corporate identity to Telefónica Czech Republic, a. s. (from Telefónica O2 Czech Republic, a. s.). Analogously, Telefónica O2 Slovakia, s.r.o., changed its name to Telefónica Slovakia, s.r.o.

Dana Dvořáková joined as Director of Corporate Communications.

Telefónica CR formed a special team to assist O2 customers via social networks. The official facebook page and twitter feed, as well as the O2YouTube channel, in section O2 Guru, offer professional assistance, tips and replies to questions.

June

Telefónica CR reduced its carbon footprint by 5 thousand tons of CO2 and recycled 269 tons of waste electrical and electronic equipment.

The Company launched its 'Now I Know Why' campaign which explained to customers how to make the best use of having internet in their mobile devices.

July

Ctirad Lolek was appointed new Director, Human Resources Division.

Telefónica CR, Komerční banka, Citibank Europe, Globus ČR and VISA Europe, in collaboration with Globus hypermarket in Čakovice, Prague, debuted a pilot project of near-field mobile payments with real users.

The Czech public voted, for the second time running, that Telefónica CR had the best mobile data service and the best mobile data coverage in the country in an independent survey by Ipsos Tambor.

August

Employees of Telefónica CR raised CZK 280,000 to help the people in Somalia who, due to long-lasting drought, water and food shortages, had to take refuge from their homes. The Company matched this amount 100%, and the donation was made to the humanitarian assistance organisation People in Need.

Customers with the prepaid O2 cards could start topping up their credit at the post office. Telefónica CR now operates a network of 30,000 top-up points, the largest in the Czech Republic.

Telefónica CR expanded the features of its My O2 portal and opened an online self-service shop for its residential customers.

Home broadband internet customers can now use the function of fully automated home WiFi network configuration. The whole family can go online at the same time, without the inconvenience of cables.

Telefónica CR and Telefónica Germany signed a joint project for fixed and mobile network management, to go until 2015.

September

Telefónica CR celebrated its the 5th anniversary of the O2 brand in the Czech market.

The first 100 young teams from 276 entries were selected to receive a grant in the first round of Think Big; the call for projects was opened in May by the O2 Foundation in collaboration with the Civil Society Development Foundation. The projects received a total of CZK 5.3 million among them.

At a ceremony in the residence of the US Ambassador, Telefónica CR was presented with the prestigious Via Bona Award for its patronage, financial, material and professional help to the Safety Line. Telefónica CR has been Safety Line's general partner already for 17 years.

October

The new website www.o2.cz came first in its category (Telecommunications) in WebTop100 and came second in the open category.

In collaboration with the Czech Union of the Deaf, Telefónica CR presented the outreach programme that drew attention to issues of communication of children and young people with full or partial loss of hearing.

Almost 600 employees of Telefónica CR became volunteers for the day on the occasion of the International Volunteer Day, helping in 18 organisations of public benefits across the country. The Telefónica Group celebrates the International Volunteer Day every year in all countries where it has a presence.

November

The advertising campaign 'Smart Network from O2' won the 2011 Effie Award for the most effective advertising campaign in the category Other Services.

Luis Aldo Martin succeeded Tony Hanway as Director, Consumer Division, Telefónica CR. Tony Hanway became CEO Telefónica Ireland.

Ramiro Lafarga Brollo was appointed new CEO of Telefónica Slovakia.

December

Telefónica CR officially started offering DNSSEC, a secure domain name system, in its network, thus significantly improving the protection and security of its customers online.

Telefónica CR vastly improved its 3G network coverage, reaching 71% of the population with its signal.

As part of its Christmas campaign, Telefónica CR offered its prepaid customers calls for CZK 3.50 and SMS for CZK 1.50. Contract customers received double the amount of free units (calls, SMS) to all networks.

Telefónica CR, VISA Europe, Komerční banka, Citibank Europe and Globus ČR evaluated the six-month pilot operation of near-field mobile payments, with the unequivocal conclusion that the Czech market – customers and retailers alike – are ready for the technology.

The committee of A Greener Festival Awards gave again its global recognition to the Czech Open Air Festival.

About Telefónica Group

01

We celebrate 5 years on the Czech market.

About Telefónica Group 01

Telefónica is one of the world's leading integrated operators in the telecommunications sector, a provider of communication, information and entertainment solutions with presence in Europe, Africa and Latin America. The group operates in 25 countries. As of December 2011, Telefónica's total number of customers was 307 millions. Telefónica's growth strategy is focused on the markets in which it has a strong foothold: Spain, Europe and Latin America.

The Group stands in sixth position in the Telco sector worldwide in terms of market capitalisation, in first among European integrated operators and in tenth position in the Eurostoxx 50 rankings, composed of Europe's blue chip companies (February 2011).

Telefónica is a 100% private company with more than 1.5 million direct shareholders. Its stock trades on the continuous market on the Spanish Stock Exchanges and on those in London, Tokyo, New York, Lima, Buenos Aires and São Paulo.

Telefónica has one of the most international profiles in the sector with more than 72% of its business outside its home market and a reference point in the Spanish and Portuguese speaking market.

In Latin America, Telefónica served more than 200 million customers as of the end of 2011, thus becoming the leading operator in Brazil, Argentina, Chile and Peru. The group also has substantial operations in Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Puerto Rico, Uruguay and Venezuela. In Europe, the group owns operating companies in Spain, the United Kingdom, Ireland, Germany, Czech Republic and Slovakia, providing services to 105 million customers as of the end of 2011.

Telefónica in figures

- 307 million accesses (105 million in Europe; 200 million in Latin America) (December 2011)
- Presence in 25 countries of the world (6 in Europe[1]; 14 in Latin America[2]; the group is active in three other countries through its strategic alliances[3])
- 291,000 employees (39% in Europe; 70% in Latin America; 1% in other countries) (December 2011)
- Revenues: EUR 62,837 mil. (2011)
- OIBDA: EUR 20,210 mil. (2011)
- Net profit: EUR 5,403 mil. (2011)
- The world's largest integrated telecommunications operator measured by number of accesses
- The largest integrated operator in Europe measured by market capitalisation
- Dow Jones Sustainability Index
- Among the world's 100 largest companies measured by market capitalisation
- Among the world's 75 largest companies measured by revenues (Fortune Global 500)

[1] Including Morocco
[2] Including the USA and Puerto Rico
[3] China, Italy, Portugal

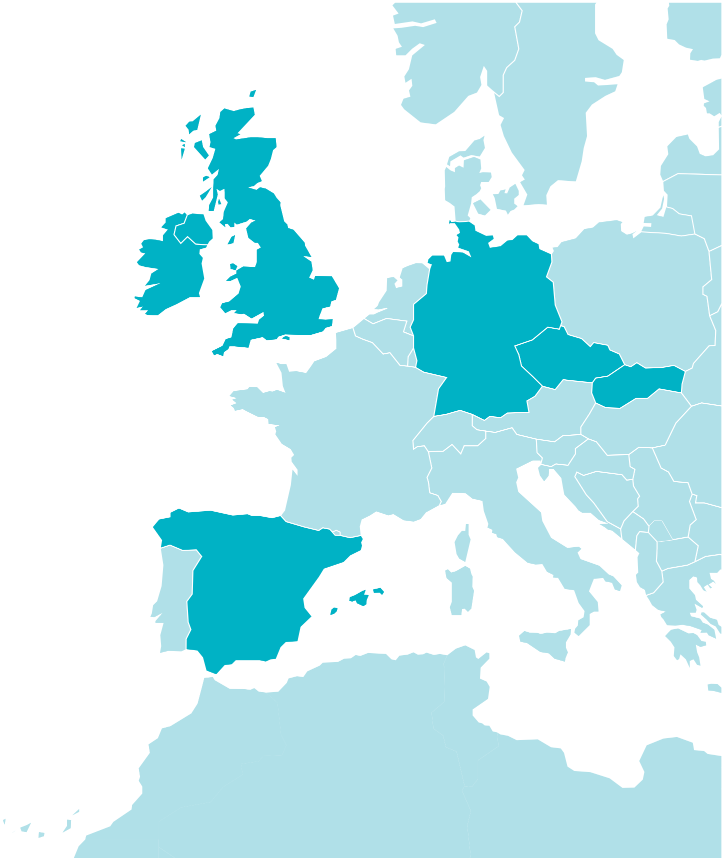
Telefónica – leader in the telecommunications market in Latin America

Argentina	
Number of accesses	23 mil.
Fixed line market	1.
Mobile market	2.
Brazil	
Number of accesses	87.2 mil.
Fixed line market	2.
Mobile market	1.
Central America	
Number of accesses	8.1 mil.
Fixed line market	–
Mobile market	3.
Colombia	
Number of accesses	13.8 mil.
Fixed line market	2.
Mobile market	2.
Chile	
Number of accesses	12.7 mil.
Fixed line market	1.
Mobile market	1.
Ecuador	
Number of accesses	4.5 mil.
Fixed line market	–
Mobile market	2.
Mexico	
Number of accesses	20.5 mil.
Fixed line market	–
Mobile market	2.
Peru	
Number of accesses	18.8 mil.
Fixed line market	1.
Mobile market	1.
Uruguay	
Number of accesses	1.8 mil.
Fixed line market	–
Mobile market	2.
Venezuela	
Number of accesses	10.4 mil.
Fixed line market	–
Mobile market	2.
Total number of accesses	**201 mil.**

* Data from December 2011

Note: Central America includes Guatemala, Panama, El Salvador, Nicaragua and Costa Rica. The number of accesses includes a narrowband service provided by Terra Brasil and Terra Colombia and a broadband service provided by Terra Brasil, Telefónica de Argentina, Terra Guatemala and Terra México.

Telefónica – a strong player on the European market



Spain	
Number of accesses	47.1 mil.
Fixed line market	1.
Mobile market	1.
United Kingdom	
Number of accesses	23 mil.
Fixed line market	–
Mobile market	2.
Germany	
Number of accesses	24.5 mil.
Fixed line market	4.
Mobile market	4.
Ireland	
Number of accesses	1.6 mil.
Fixed line market	–
Mobile market	2.
Czech Republic	
Number of accesses	7.8 mil.
Fixed line market	1.
Mobile market	2.
Slovakia	
Number of accesses	1.2 mil.
Fixed line market	–
Mobile market	3.
Total number of accesses	**105 mil.**

* Data from December 2011

Telefónica was founded in 1924 in Spain and has grown global. Telefónica has a regional and integrated management model. The key to the company's structure lies in extending its client focus, leveraging its scale and in its strategic and industrial alliances.

The different operations of the Telefónica Group in 25 countries are organised into two geographical regions, Europe and Latin America, and the global business unit, Telefónica Digital.

Corporate Centre

Within this organisational structure, Telefónica's Corporate Centre is responsible for its global and organisational strategies, its corporate policies, management of common activities, and coordinating the activity of business units.

Telefónica Europe

Includes operations in Germany, Slovakia, Spain, Ireland, the UK and the Czech Republic.

Telefónica Latinoamérica

Includes operations in Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Peru, Uruguay and Venezuela.

Telefónica Digital

Telefónica Digital is a global business division of Telefónica. Its mission is to seize the opportunities within the digital world and deliver new growth for Telefónica through research & development, venture capital, global partnerships and digital services such as cloud computing, mobile advertising, M2M and eHealth. Telefónica Digital has 100% ownership of Jajah, Terra, Tuenti and giffgaff. It is headquartered in London with regional centres in Silicon Valley, São Paolo, Madrid, Barcelona and Tel Aviv.

Alliances and other shareholdings

Telefónica operates in China and Italy through shareholdings China Unicom and Telecom Italia.

Other companies

Atento offers customer relation management services through its contact centres. It operates in Spain, Argentina, Brazil, Central America, Chile, Colombia, the USA, Morocco, Mexico, Peru, Puerto Rico, the Czech Republic, Uruguay and Venezuela.

Integrated decentralised model of governance

It is Telefónica's goal to maximise the value of its activities at all levels – global, regional and local. The model of organisation puts the customer at the heart of the company's focus, sets out the role of innovation in revenue generation and in the transformation into a better-performing enterprise.

Local

Spain, Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Peru, Uruguay, Venezuela, Germany, Ireland, United Kingdom, Czech Republic, Slovakia
- Customer Experience Model
- Single Point of Sales Model
- Integrated Production Model

Regional

Telefónica Europe, Telefónica Latinoamérica, Telefónica España
- Support, governance, synergy

Global

Telefónica
- New Engaged Corporate Model
- Innovation
- Transformation

Group structure

Key Holdings of the Telefónica Group detailed by regional business units

Telefónica España	
Telefónica de España	100%
Telefónica Móviles España	100%
Telyco	100%
Telefónica Telecomunic. Públicas	100%
T. Soluciones de Informatica y Comunicaciones de España	100%
Acens Technologies	100%
Iberbanda	100%
Tuenti	91.4%

Telefónica Latinoamérica	
Telefónica Móviles Perú	100%
Telefónica de Argentina	100%
Telefónica Móviles Argentina	100%
Telefónica Móviles Chile	100%
Telefónica Móviles México	100%
Telefónica Móviles Guatemala	100%
Telefónica Venezolana	100%
Telefónica Móviles Colombia	100%
Otecel	100%
Telefónica Móviles Panamá	100%
Telefónica Móviles Uruguay	100%
Telefonía Celular Nicaragua	100%
Telefónica Costa Rica	100%
Telefónica Móviles El Salvador	99.2%
Telefónica del Perú	98.3%
Telefónica Chile	97.9%
Telefónica Brasil [1]	73.9%

[1] Includes 100% of Vivo

Telefónica Europe	
Telefónica United Kingdom	100%
Telefónica Germany	100%
Telefónica Ireland	100%
Be	100%
T. Intern. Wholesale Serv. (TIWS)	100%
Jajah	100%
Telefónica Czech Republic [1]	69.4%
Tesco Mobile	50%

[1] Includes 100% of Telefónica Slovakia

Other stakes	
Atento Group	100%
Telefónica de Contenidos (Spain)	100%
Telco SpA (Italy) [1]	46.2%
DTS, Distribuidora de Televisión Digital	22%
Hispasat	13.2%
Portugal Telecom [2]	2%
China Unicom (Hong Kong) Limited (China)	9.6%
ZON Multimedia [3]	5.3%
BBVA	1%
Amper	5.8%

[1] Through Telco, Telefónica holds an indirect stake in Telecom Italia of approximately 10.36% in ordinary shares (with voting rights). After discounting saving shares (azioni di risparmio), which do not confer control rights, the indirect interest of Telefónica in Telecom Italia was 7.15%.

[2] Real interest of the Telefónica Group. With minority shareholdings disregarded, Telefónica's interest would be in the range of 10%.

[3] Telefónica's Group effective stake. Telefónica Group stake would be 5.46% if we exclude the minority interests.

Board of Directors' Report on Business Activity

02

We cover more than 1,500 cities and towns in the Czech Republic with 3G mobile networks.

Board of Directors' Report on Business Activity

02

Telefónica Czech Republic Group

Overview of the Group and the main changes in 2011

The group of Telefónica Czech Republic (Telefónica Group) comprises Telefónica Czech Republic, a.s. (Telefónica or Company) and several other subsidiaries. In 2011, the Group's services were provided mostly on the territory of the Czech Republic and in Slovakia. Through a wholly-owned subsidiary Telefónica Slovakia, the Group has been operating in Slovakia since 2007.

In the first half of 2011, some companies in the Telefónica CR Group changed their company name. With effect from 10 May 2011, the company name of Telefónica O2 Slovakia, s.r.o., was changed to Telefónica Slovakia, s.r.o. Following that, with effect from 16 May 2011, the company name of Telefónica O2 Czech Republic, a.s., was changed to Telefónica Czech Republic, a.s. Other companies in the Group did not change. The changes were required to harmonise the company names in all European markets of the group Telefónica, S.A. In addition to the Czech Republic and Slovakia, Telefónica will be the single corporate brand in the United Kingdom, Germany and Ireland. O2 remains the commercial brand of Telefónica CR.

In June 2011, the Board of Directors of Telefónica CR approved a project to transform its subsidiary Telefónica O2 Business Solutions, spol. s r.o., through demerger by spin-off. The project sought to spin off a part of the assets of the demerged company into a newly incorporated subsidiary Internethome, s.r.o., whose business it is to provide electronic communications services. The change and the spin-off became legally effective as of 1 October 2011, when Internethome, s.r.o., was registered in the Commercial Register. The demerged company Telefónica O2 Business Solutions, spol. s r.o., whose core business continues to be the provision of information and communication technologies, was not dissolved in the process of the transformation.

On 1 January 2012, Telefónica CR incorporated a new subsidiary by the name of Informační linky, a.s.; the incorporation was registered in the Commercial Register as of the same date. The subsidiary was founded by contributing a part of the assets of the organisation unit Information and Assistance Services, which operates directory and assistance services on the numbers 1180, 1181 and 1188. The spin-off process transferred all units of the division (including employees) to the subsidiary.

Telefónica CR is the largest integrated telecommunications operator and offers a comprehensive range of both fixed and mobile voice, data and internet services in the Czech Republic. In September 2006 it also started offering a digital television service (O2 TV), and in 2007 it significantly expanded its IT and ICT operations (comprehensive business communications solutions). It also offers its network infrastructure for lease by other operators of public and private networks and services.

The retail business in the Czech Republic focused on two main customer segments: business and consumers. The business segment included medium business and corporate customers, and public and government institutions. Telefónica CR also provides services on wholesale basis to other public telecommunications network providers and to providers of public telecommunications services both in the Czech Republic and abroad.

As at 31 December 2011, Telefónica Group comprised the following subsidiary companies and affiliates:

Company	Registered address	Area of business	Company identification number	Registered capital	Company's share in the registered capital of the subsidiary expressed in %
Subsidiary companies					
Telefónica O2 Business Solutions, spol. s r.o.	Praha 4 – Michle Za Brumlovkou 266/2 postal code 140 00 Czech Republic	Data services and consultancy in the field of telecommunications, IT/ICT services	45797111	CZK 10,000,000	100%
CZECH TELECOM Austria GmbH	c/o Vienna CityTax Steuerberater GmbH Wagramer St, Sien, postal code 1220 Austria	Public service of lease of lines in the fixed telecommunication network	FN 229578s	EUR 35,000	100%
CZECH TELECOM Germany GmbH	Kennedyallee 97a Frankfurt am Main postal code 60596 Germany	Lease of telecommunication lines	HRB 51503	EUR 25,000	100%
Telefónica Slovakia, s.r.o.	Einsteinova 24 Bratislava postal code: 851 01 Slovakia	Operation of a public telecommunication network; public service of lease of lines	35848863	EUR 240,000,000	100%
Internethome, s.r.o.	Praha 4 – Michle Za Brumlovkou 266/2 postal code 140 00 Czech Republic	WiFi internet access services	24161357	CZK 200,000	100%
Affiliate companies					
AUGUSTUS spol. s r.o.	Praha 10 – Vinohrady Na Zájezdu 1935/5 postal code 101 00 Czech Republic	Consultancy and agency in the field of telecommunications	49356160	CZK 166,000	39.76%
První certifikační autorita, a.s.	Praha 9 – Libeň Podvinný mlýn 2178/6 postal code 190 00 Czech Republic	Certification services in the area of digital signature	26439395	CZK 20,000,000	23.25%
MOPET CZ a.s.	Praha 4 – Nusle Hvězdova 1716/2b postal code 140 78 Czech Republic	Real-time mobile payment services	24759023	CZK 104,000,000	14.29%

Restructuring programme

As in the previous year, also in 2011 the Company strived to improve its operating efficiency. To this end, it embarked on the next phase of its restructuring programme. Restructuring projects focused, among other things, on the consolidation and optimisation of the call centre operations, resulting in a Group headcount reduction by 631 down to 6,890 in 2011. In connection with the Company posted restructuring costs of CZK 174 million in 2011.

Number of employees of the Telefónica Group by region:

Telefónica Europe	As at 31 December 2011	As at 31 December 2010
Telefónica Czech Republic, a.s.	6,340	6,936
Telefónica O2 Business Solutions, spol. s r.o.	154	178
Employees in the Czech Republic	**6,494**	**7,114**
Telefónica Slovakia, s.r.o.	396	408
Employees in Slovakia	**396**	**408**
Employees of the Group in total	**6,890**	**7,522**

Telefónica Slovakia

As at 31 December 2011, Telefónica Slovakia had a total of 1,164 thousand customers, of which approximately 498 thousand were contract customers. This represents a year-on-year growth of 32.2%. Since the free number portability was enabled in November 2007, customers of Telefónica Slovakia ported more than 387 thousand numbers to the network of Telefónica Slovakia.

Also in 2011 Telefónica Slovakia continued to market its successful tariffs O2 Fér and O2 Moja Firma designed for small and medium businesses. In early April the company launched O2 Filip, a new tariff for individual customers, which comes in three price point variants.

During the course of 2011, Telefónica Slovakia worked intensively on rolling out its own 3G network to new areas. The company put the commercial proposition of new data bundles on the market at the start of the second half of the year, when the network reached approximately 30% of the Slovak population. At the end of 2011, the coverage extended to one third of the population, and in December the company announced its plan to expand the network to cover 50% of the population in autumn 2012.

As part of its endeavour to improve customer care, in autumn 2011 Telefónica Slovakia introduced O2 Super, a new loyalty programme which included diverse benefits – culinary, travel, entertainment, home furnishings or body care. The company also brought to Slovakia a successful concept tried and tested in other Telefónica companies: O2 Guru. A specially trained O2 Guru team assists customers in particular with new technology. The project was started in Slovakia in mid-July 2011.

At the end of December 2011, Telefónica Slovakia reached already 94.9% of the Slovak population. The coverage already supported 90% of all calls carried within the company's own network. The remaining 10% of traffic was carried using national roaming.

An independent survey carried out by Ipsos Tambor jointly with Telefónica Slovakia showed that the company was again ahead of the field of Slovak mobile operators in terms of customer experience, and that it also leads the customer experience index among the Telefónica Group companies.

Risk management

Risk management is one of the primary management tools for effective governance of companies in the Group. Its purpose is to render support in accomplishing the Company's vision and strategy. All companies in the Telefónica Group apply the same risk management model which fully conforms to the best international practice in the field of corporate governance and the COSO II framework (Committee of Sponsoring Organizations of the Treadway Commission). Close cooperation with other members of the Telefónica Group contributes to further development of the risk management system, which is an integral part of the Group's internal control system.

Risks are identified based on an assessment of the relevant management levels and suggestions made by the division Risk Management and Internal Audit and other units of the Group, and are evaluated in terms of their potential financial impact and likelihood of materialisation. Where the value of a risk exceeds a set limit, the risk is included in the risk catalogue of the Company.

Also in 2011, the Risk Management unit was responsible for the methodology and risk management system on the Group level. The governing bodies – the Board of Directors and the Supervisory Board, or, where appropriate, the Audit Committee – were informed on a monthly basis of all major risks to which the Group was exposed, and of the ways the risks were mitigated.

The Risk Management unit also handles the risks of Telefónica O2 Slovakia; the risks are managed according to the common methodology of the Telefónica Group.

The Company may encounter the following risks associated with the conduct of its business:

Commercial (market) risks

Possible losses caused by market uncertainty, developments in the market, austerity measures adopted by the government and the public sector, competitive pressures, changes due to regulatory actions (including those taken by the European Commission) and changes in the legislation.

Financial risks

Possible losses stemming from the fluctuations in the value of financial instruments, in particular the exchange rates of currencies or interest rates.

Credit risks

Risks of exposure to defaulting business partners or customers, e.g. receivables from customers or distributors.

Operating risks

Risks of possible losses caused by incidents relating to processes, human resources, network elements and information systems, or by external factors, namely litigation against the Company.

The above risks are regularly monitored and managed in a way that corresponds to the nature of the risk.

The telecommunications market in the Czech Republic

In the first half of 2011, the telecommunications market in the Czech Republic saw a decline. The reasons included the difficult economic environment in the marketplace including a fierce competition, and further cuts in the mobile termination rates. The situation improved slightly in the second half of the year, particularly as the consumption of mobile customers in the residential segment stabilised.

Despite the challenges of the environment, Telefónica CR managed to maintain a solid growth in the number of customers, especially in the area of mobile services and broadband internet.

In 2011, the number of mobile customers increased by 103 thousand to 4,942 thousand. As T-Mobile Czech Republic (T-Mobile) and Vodafone Czech Republic (Vodafone) use a different methodology of accounting for mobile customers, a true comparison is not possible; still, Telefónica CR significantly strengthened its market position as measured by the number of contract customers with an increase of 186 thousand, which represents a 49.5% share in the total additions of contract customers in the Czech mobile market in 2011. At the end of the year, the Company's market share stood at 39.4%, up 0.5 percentage point year on year.

All mobile operators directed their investments at improving their broadband data networks and increasing the network capacity, to prepare for future growth.

The modernisation and expansion of the 3G network in all parts of the Czech Republic continued in the first half of the year. In February, Telefónica CR and T-Mobile signed an agreement to share their 3G networks in the rural areas. The shared infrastructure should, in the future, include 1,000 BTS, with each of the two operators building a half of them. Telefónica CR committed to covering the eastern part of the Czech Republic with the network, while T-Mobile will roll out the network in the western part.

As part of the 3G network sharing arrangement, T-Mobile and Telefónica CR harmonised their methodologies for the calculation of the population coverage. At the end of December, the Company covered 73% of the population with signal.

Telefónica CR also continued to roll out its optical networks and pursued further investments in the WiFi segment, with a view to strengthening its market position.

Two new virtual operators started up in the Czech market in 2011. OpenCall uses the CDMA network of U:fon operated by MobilKom and offers wireless fixed access and a mobile service with a prepaid card. The other one, Mujoperator, also uses the network of U:fon to carry its service.

Trends on the fixed internet access market

Several changes occurred during 2011 in the ownership structure of market players.

In January, the Office for the Protection of Economic Competition gave permission to sell České Radiokomunikace to funds managed by the Macquarie Group of Australia. The seller was Falcon Group, which also owns close to 40% of T-Mobile.

In February, MobilKom, which operates the U:fon network, announced a change of ownership: Penta sold its 100% interest in the company to Divenno Holdings, the mother company of Dial Telecom.

Also in February, UPC Česká republika (UPC) took over Sloane Park Property Trust, which allowed UPC to integrate the optical backbone networks of the two companies. A new unit, UPC Business, was created, with a sole focus on the business segment. UPC opened its first data centre in Prague in December.

In early June, České Radiokomunikace (ČRa) merged with Morava Czech Communication Holdings, which had owned close to 100% of all ČRa's stock.

In the fixed access segment, VOLNÝ made a strategic decision top offering ADSL internet connectivity using other operators' infrastructure to residential customers. Telefónica CR took over close to 11 thousand non-business customers. The migration started in mid-March 2011; the price and service parameters remained the same.

Telefónica CR continued with improvements to its fixed internet access service by expanding the VDSL reach and increasing speeds to existing customers.

In early May, Telefónica CR premiered a new technology, VDSL (Very High Speed DSL), which allows up to two times faster home internet. Existing customers were given a speed increase without a price hike. The technology is available to approximately 45% of homes that are within a 1.3 km radius from the exchange. The new technology also ushered in changes to the fixed internet tariff structure – customers could benefit from a promotion offering new tariffs at reduced rates. The attractiveness of the technology is attested by the fact that more than 100 thousand customers, both existing and new, opted for VDSL by the end of 2011.

Trends in the mobile data market

A number of significant events happened in 2011, which affected the whole telecommunications market. The mobile market was dominated largely by the news of innovated or new data services. Below we list those events that we regard as most influential.

From March 2011, Telefónica CR cut the prices of its basic data roaming service for all zones; the biggest price cut was in the EU zone, with the price going down from CZK 240/MB to CZK 24/MB, i.e. by approximately 90%. Roaming data bundles also saw major price slashing.

Telefónica CR continued to strengthen its leadership in the 3G network coverage. The Company added 126 locations in June 2011. The advantages of fast mobile data were available to the residents of 1,699 towns and villages at the end of 2011, which represents 73% coverage of the Czech population.

The Company raised awareness of the advantages and extent of 3G network coverage through its 'Smart Network' campaign, which explained to the public the benefits of having internet in a mobile and of mobile internet.

A survey by Ipsos Tambor showed that Telefónica CR had the best mobile data and the most extensive coverage. The respondents confirmed that, compared to the competition, Telefónica CR offered the best mobile internet service.

Regulation

Several changes occurred in 2011 in the regulatory environment which governs the field of electronic communications in the Czech Republic. The most material changes included the following:

1) changes in the legislation;
2) changes in the areas of markets analysis and product regulation;
3) changes in the Universal Service provision and in the government's policy and support of broadband internet access.

Below are the main changes to the legislation in the area of electronic communications:

- Promulgation of the Act No. 468/2011 Coll., amending the Act No.127/2005 Coll., on electronic communications, and on the amendment to some related laws (Electronic Communications Act), as amended, and some other laws;
- Promulgation of the Judgement of the Constitutional Court No. Pl.ÚS 24/11 dated 20 December 2011, cancelling the provision of Section 88a of the Act No. 141/1961 Coll., on criminal procedure (Code of Criminal Procedure), as amended, by expiration on 20 September 2012, which relates to the treatment of records of telecommunications traffic by law enforcement authorities;
- Promulgation of the Judgement of the Constitutional Court No. Pl. ÚS 24/10, cancelling the provision of Section 97(3) and Section 97(4) of the Act No. 127/2005 Coll., on electronic communications, and on the amendment to some related laws (Electronic Communications Act), as amended, and Decree No. 485/2005 Coll., on the extent of traffic and location data, the time of retention thereof, and the form and method of the transmission thereof to bodies authorised to use such data;
- Promulgation of the Government Regulation No. 156/2011 Coll., amending the Government Regulation No. 154/2005 Coll., on the determination of the amounts and the method of calculation of the charges for the use of radio frequencies and numbers, as amended;
- Promulgation of the Decree No. 53/2011 Coll., amending the Decree No. 117/2007 Coll., on the numbering plans of electronic communications networks and services, as amended;
- Promulgation of the Decree No. 22/2011 Coll., on the method of determination of coverage of terrestrial radio broadcasting over selected frequencies;
- Continuation of the implementation of the revised regulatory framework for electronic communications networks in the Czech law:
    - Directive 2009/136/EC of the European Parliament and of the Council amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services; Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) No 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws;
    - Directive 2009/140/EC of the European Parliament and of the Council amending Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and Directive 2002/20/EC on the authorisation of electronic communications networks and services;
    - Regulation (EC) No 1211/2009 of the European Parliament and of the Council establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office.

Telefónica CR was involved in the preparation of the above legislation by providing consultation either directly or on the platform of industry associations of telecommunications operators or through its parent company Telefónica.

Relevant markets analysis and product regulation

Telefónica CR continued to meet its duties with which it was tasked based on the relevant markets analysis undertaken by the Czech Telecommunication Office (CTO) in previous periods.

In January 2011, the CTO published its selection of Ernst & Young, s.r.o., to produce the LRIC methodology, including a model for call termination in fixed public networks. The outputs of this model are expected to be used by the CTO to set the maximum call termination rates in fixed public networks in late 2012 and early 2013.

Also in January 2011, the CTO decided to appoint the Asset Valuation Institute of the University of Economics in Prague to deliver a calculation of a WACC value for the purposes of regulation in the sector of electronic communications. Telefónica expects that the updated WACC will be used for the determination of regulated prices from next year onwards.

In February 2011, the CTO commenced the third round of analysis of the relevant market No. 5 – wholesale broadband access in electronic communications networks. Telefónica expects that the analysis will be published in the form of a general measure by the end of the year.

In April 2011, the CTO issued a decision, reflecting on the results of its analysis of the relevant market No. 6 – wholesale terminating segments of leased lines irrespective of the technology used for the provision of leased or reserved capacity, which changed the regulatory measures applicable to Telefónica in this market. Based on the decisions, pricing regulation no longer applies to the wholesale service; however the imposed regulatory measures now apply also to Ethernet leased lines.

Effective from 1 July 2011, the regulated wholesale price for mobile termination was reduced to CZK 1.08 per minute.

Regulation of international roaming

In keeping with the presently applicable regulatory framework, the regulated international roaming rates went down effective from 1 July 2011 as had been planned.

The retail rates for incoming calls went down on 1 July 2011 to EUR 0.11 per minute; the price for an outgoing call was brought down to EUR 0.35 per minute. The price for an SMS stayed at the level of EUR 0.11. The prices, expressed in Czech crowns, were adjusted based on the applicable exchange rate.

On 6 July 2011, the European Commission published a proposal encapsulating its vision for Phase III of mobile roaming regulation. The proposal foresees the regulation to apply also after 31 July 2012 (when the so-called Phase II of roaming regulation expires). The proposal expects that regulatory action in the area of international roaming will be expanded; the regulatory measures applied to date (price regulation) are to be joined from 1 July 2014 by giving customers the option to choose a different roaming provider to the provider of their national mobile service. The proposal is subject to approval by the European Parliament and the Council of Ministers of the EU.

Imposition of duties related to the provision of the Universal Service

Telefónica provided the following services during 2011 as part of meeting its duties imposed by the CTO in relation to the Universal Service provision:

(a) the public payphone service;
(b) access to the public telephone service, of the same quality as for other end users, for people with disabilities, namely by means of special terminal equipment;
(c) special price plans for persons with disabilities, which are different from the regular price plans provided under the standard commercial terms and conditions.

As to the service under (a), a CTO decision from 2009 led to a significant reduction in the number of public payphones operated as part of the Universal Service in 2011; the duty to operate public payphones as part of the Universal Service concerns municipalities with 4,999 or more residents. The CTO reviewed the service under (a) and decided to uphold the Universal Service obligation until the end of 2013 for municipalities with 4,999 or more residents, and, for municipalities with a population under 1,999, until the end of 2014. The CTO also commenced the process to select a provider of the public payphone service under the Universal Service, which is expected to conclude in mid-2012.

As to the services under (c), the Czech Telecommunications Office imposed on Telefónica CR the duty to offer special pricing under the Universal Service obligation, for a period of three years commencing on 2 July 2011.

Funding of the Universal Service

Telefónica CR submitted its claim for compensation for the loss incurred as a result of Universal Service provision (including the loss incurred as a result of offering special price plans for people with disabilities) in 2010. The CTO then proceeded with verifying the amount of the loss and examining the supporting documents, and made the payment in December 2011.

The CTO published a final and conclusive decision determining the amount of the loss incurred as a result of Universal Service provision in 2009, and the loss incurred as a result of Universal Service provision (including the loss incurred as a result of offering special price plans for people with disabilities) in 2010.

State policy and support in the area of broadband internet

In January 2011, the Czech government approved a State Policy in the Area of Electronic Communications – Digital Czech Republic. The strategy deals with the development of ICT, with a special emphasis on bridging the digital divide between urban and rural areas. The document set the following objectives:

1. to ensure that broadband internet with the minimum (downlink) speed of 2 Mb/s, and 10 Mb/s in towns, is available in all populated locations in the Czech Republic by 2013;
2. to ensure that, by 2015, broadband internet is available in all rural settlements, with a speed which will equal at least 50% of the average broadband speed in towns. 30% of homes and businesses in towns should have internet with a speed of at least 30 Mb/s available to them.

As part of delivering on the above objectives, the Ministry of Industry and Trade released a draft paper setting out the development criteria for the planned auction of frequencies in the range of the so-called digital dividend in September 2011.

Also in September 2011, the CTO published guiding principles for the upcoming unction of 800 MHz, 1 800 MHz and 2.6 GHz frequencies.

Structural funding from the EU continued to support various projects in the area of ICT development in public institutions. The support went in the direction of mainly regional networks connecting public institutions, as well as the private sector.

In April 2011, the European Commission called a public consultation on the Community Guidelines concerning the state aid rules with regard to fast roll-out of broadband networks.

Telefónica CR is a member of prominent industry associations that work to develop the market in electronic communications in the Czech Republic: ICTU (Association for Information Technologies and Telecommunications), APMS (Association of Mobile Network Operators), ČAT (Czech Telecommunications Association) and ČAEK (Czech Association of Electronic Communications).

The Company is also a member of several other structures that are important for Telefónica's activities: HK ČR (Chamber of Commerce of the Czech Republic), SDT (Association for Telematics in Transport) and others.

The Government of the Czech Republic started the process of programming the EU Structural Funds for the period 2014–2020. With regard to the overall objectives of the EU, as expressed in the policy paper Digital Agenda for Europe 2020, we can expect that support will focus also on the field of ICT.

Telefónica CR submitted its comments on the proposed development criteria and on the guiding principles of the planned frequency auction – on its own behalf and also jointly as a member of the above associations.

The Company is constantly monitoring options offered to customers by structural funds, and modifies its products and services so that they are eligible for subsidies. A special attention was paid to Call 8 under the Integrated Operational Programme for the development of eGovernment services in the regions. Telefónica successfully participated in tenders for projects co-funded from Structural Funds.

Consumer segment

In 2011, Telefónica CR launched its first awareness-building campaign focusing on the uses of internet in a mobile. The campaign featured ways of using smartphones and how a regular user can benefit from having a smartphone. The campaign was executed jointly with Google, and helped to significantly boost the uptake of mobile internet.

As in the previous years, also in 2011 the customers benefited from the programme Reward for Top-up, a loyalty scheme for prepaid customers. The popularity of the programme shows also in the fact that other partners (Seat, GE Money Bank) have joined it.

Another important event was the CSI Leadership customer satisfaction survey in the prepaid segment, which was conducted in the fourth quarter of 2011, for the first time in the Company's history.

In 2011, Telefónica CR had a lot of successes also in the online sphere. The revamped website www.O2.cz won the Web Top 100. An online self-service zone, My O2, opened, giving the customers control over the configuration of their services, billing reports, and payments, which they can now review or make online.

The online activities of the Company were now, however, limited to the website www.O2.cz. In 2011, Telefónica CR was very active on social networks such as Twitter, Facebook or YouTube. O2 Guru was one of such noteworthy projects, which gave customers support and assistance via social networks and video tutorials, all on the platform of the dedicated portal www.O2guru.cz.

A special portal for smartphones was launched in an online and mobile version. Applications can be downloaded for iOS, Android and Windows Phone operating systems.

Online activities also included the testing of new online sales channels. To this end, an affiliate programme was debuted in 2011, with rewards for selling O2 products and services via third party websites.

Thirty new brand stores opened in 2011. In more than fifty brand stores, Telefónica CR offered the services of a dedicated sales associate specialising in data services and smartphones. The dummy smartphone models were replaced with real devices for customers to try.

Mobile internet and prepaid voice cards were offered also in the indirect sales channels of O2, such as ALZA.cz, CZC.cz, eD'system Czech, 100MEGA distribution, Billa and many others. New providers of direct top-up for prepaid services were acquired: Česká pošta, Fortuna and Unipay. Last but not least, the capacity indirect sales, namely in the area of contract voice and data acquisition, was significantly enhanced.

As for the call centres, a notable event of the year was the consolidation of call centre activities in the consumer segment. A new organisation and the consolidation in 2011 produced substantial savings, lower staff turnover in the expanded locations, and gave career prospects and the option to switch departments to competent employees.

Internet

Telefónica CR made the billing for mobile data more advantageous. The first hour of connection cost CZK 15, and the full day of access was capped at CZK 30 (FUP 30 MB/day), which was appreciated mainly be those customers who go online only from time to time.

The key event in the area of fixed internet access was the launch of the VDSL technology, which brought faster data transmission. The launch and expansion of the VDSL technology allowed up to two times faster home internet for many customers – this is also why the key motif of the successful communication campaign was a runner. People could test the availability and the possible speed of their home internet at www.zrychlujeme.cz, where, after a brief questionnaire, they could enter a competition for prizes, which included also choice of discounts from the partners in the O2 Extra programme.

In 2011, Telefónica CR continued with an aggressive expansion of its 3G network coverage and strengthened its leadership in this area.

The campaign 'Smart Network from O2' explained the benefits of fast mobile data to customers; it was recognised as the 'best advertising campaign of 2011' in its category (Other Services) and claimed a Golden Effie at the prestigious 2011 Effie Awards.

Fixed access and IP TV

As in the previous quarters, also in the fourth quarter of 2011 the Company saw a solid growth in the number of broadband customers and a slowdown in the rate of decline in the number of fixed lines.

In February, Telefónica CR debuted its economy tariffs and bundles featuring fixed calls to all mobile networks in the Czech Republic and to fixed numbers abroad. The new tariffs and bundles, O2 Calling and O2 Calling International, can be combined based on the most frequent calling destinations of the customer.

From July until the end of the year, Telefónica CR ran an acquisition promotion of its internet tariffs. New customers of Internet Optimal or Internet Aktiv, who committed for 12 months, regardless whether they were natural or legal persons, enjoyed reduced subscription for the duration of their commitment. Starting from the 13th month, standard listed prices apply (CZK 750 for Internet Optimal and CZK 850 for Internet Aktiv).

Between 1 September and 31 October 2011 Telefónica CR ran a special acquisition promotion for new customers who subscribed to Internet Optimal and the digital television O2 TV Flexi and committed for 12 months. The promotional price of Internet Optimal was CZK 400 per month and CZK 250 for O2 TV Flexi per month, during the first 12 months of service. Starting from the 13th month, standard listed prices apply.

During 2011, the number of O2 TV customers went up 5% to 136 thousand; in the fourth quarter alone it was an increase by 5 thousand, which is credited to the successful Christmas campaign that promoted the service in an economy-priced bundle together with broadband internet.

Mobile services

From July 2011, Telefónica CR offered its prepaid customers free calls, SMS and MMS to one O2 number of choice.

O2 Nejbližší, a new service for friends and families with free or preferentially billed calls to a select group of numbers, was launched in September 2011. What made it unique was that the 'friends and family' group could include numbers in Slovakia.

From 1 November Telefónica CR offers benefits for the prepaid O2 card to both new and existing customers, on the condition that they top up a minimum of CZK 200 per month. This got them calls to all networks for CZK 3.50 per minute and SMS for CZK 1.50. Customers could buy a new card with the pre-set conditions or reconfigure their existing card until 31 December 2011. Contract customers received double the amount of free monthly units (minutes, SMS) from Telefónica CR, in exchange for extending their commitment or switching to a higher tariff. New customers had the benefits set up for them automatically.

In November 2011, Telefónica CR premiered an innovation to the topping up of the prepaid O2 cards. Customers with prepaid cards could use a payment card for a single top-up online, set up an automatic top-up or top up via SMS. The holder of the payment card could also manage several O2 cards, which made it ideal for families. Customers also received extra 10% every time they topped up via the new channel before the end of 2011. The first top-up after the registration in the system attracted a bonus of 20% from the amount of the top-up.

The other noteworthy campaigns included the Christmas mobile voice promotion. Customers of prepaid voice services could get calls to all networks for CZK 3.50 per minute and SMS for CZK 1.50. Contract customers received double the amount of their free units (minutes, SMS) to all networks.

Business and SME

A new service model based on a differentiated approach to customer care was implemented in the segment of small and medium enterprises in 2011.

A new sales channel focused on customer care and retention was also implemented, and considerably helped with stopping the customers from leaving for the competition. A customer is now put directly through to a live operator, and trained specialists and dedicated desks for business customers were instituted in the brand stores.

According to surveys regularly commissioned by the Company, the changes were very well received and reflected positively on the overall customer experience.

Internet

VDSL (Very High Speed DSL) technology which offers faster data transmission was launched in 2011. The campaign featuring a 'runner' was communicated only at a local level (in the so-called GEO locations), which allowed for more focused targeting of potential customers with the proposition. GEO locations for the SME segment are different for the field force channels, whether the brands stores and franchises are the same as in the consumer segment.

Fixed access

The same activities as in the consumer segment were pursued in the fixed access area. The traditional fixed voice and ISDN lines did not get a priority for communication; only internet telephony (VoIP) was offered together with VDSL as part of the Unlimited Line bundle with xDSL and supported with a price promotion. In December 2011, a test pilot campaign for the self-installation kit for the no-VPN variant of the O2 Unlimited Line service.

Mobile access

A campaign to promote the family of tariffs O2 Business was ran during the course of 2011. It featured two main characters, Telefónica CR's rep Lucie and entrepreneur Martin who is a customer. The campaign was a success and the number of subscribers of these tariffs doubled during the year to more than 20,000.

The majority of offers in the consumer segment was open also to SME customers – subsidised smartphones with internet access or the Christmas campaign doubling the number of free minutes. Both the above-mentioned bonuses were eligible for O2 Neon and O2 Business tariffs.

Corporate and government

Telecommunications services

To be able to continue to drive its business and that of its customers forward, Telefónica CR radically reassessed its telecommunications services delivery model: a major customer now gets a comprehensive solution of his telecommunications needs, as well as the many benefits that can only be offered by a single provider capable of meeting all and any needs.

Telefónica CR does not take the customers' trust for granted; the Company decided to cultivate it through its new programme O2 Exclusive, which offers the best level of care, a regular audit of delivered services at dedicated meetings, as well as many other benefits that make the customers' everyday lives easier. This approach helped us secure a number of prestigious corporate accounts in 2011:

In the past, Accenture was courted by Telefónica CR several times, with offers of fixed voice services, which the client always deemed uncompetitive. In 2011 we succeeded with overcoming the initial pessimism that the client brought to the negotiating table, and secured the presence of the decision-makers. The client responded well to the comprehensive proposition in all product lines under the umbrella of O2 Exclusive, and we walked away with a new contract for all types of telecommunications services.

After a commitment to our mobile service, Český Rozhlas became an exclusive client, receiving almost all types of telecommunications services from Telefónica CR. The contract for mobile services is for four years. It was to Telefónica CR's great advantage that the client had a longstanding experience of the quality we deliver through the data and fixed voice services.

In June 2011, ČSA invited tenders for the delivery of a call centre operation from the rather populated sector of ICT providers. Together with its partner Atlantis Software, Telefónica CR beat all the competition and secured the contract. The iCC call centre will go online in April 2012.

Two years ago, Telefónica CR took over WAN connection for the brick-and-mortar branches of Fortuna, from GTS, the previous provider. We repeated the coup in 2011. For Telefónica CR, the contract brings up to 3,000 new lines to Fortuna's POS network in the next two years, separate MPLS central lines, internet connectivity and two independent database and application server centres.

Telefónica CR became a primary provider of data connectivity to the newly built data centre of Synot IC; the contract is presently for five years. This relationship carries a substantial up-sell potential for other O2 services in the region. Moreover, we managed to expand the portfolio of services by 3,000 data and voice SIM cards. Synot Holding became another exclusive customer of Telefónica CR, relying 100% on our service.

In 2011, a contract for WAN service was signed with Moravia Steel. After taking over from GTS, Telefónica CR will provide data and internet services for a contractual period of 24 months.

In addition to its large corporate clients, in 2011 Telefónica CR also acquired several major customers from the government sector; Lesy ČR, is one such client, with a contract for telecommunications services including IP telephony and LAN redesign.

SZIF (State Agricultural Intervention Fund) is another, with a contract for operating and technical support. Telefónica CR bid the lowest price, secured the contract and helped the fund save up to CZK 100 million.

The Czech Army is now also a client of Telefónica CR, with a contract for mobile and fixed voice services which was signed for 48 months. The same extent of service, plus IT infrastructure monitoring, Telefónica CR will provide to the state-owned company DIAMO. The state-owned companies Povodí Ohře and Palivový kombinát Ústí are now the clients of O2 Car Control.

Our new business acquisition activities were also successful with public organisations at the regional level. Telefónica CR is proud to have been chosen to implement the communication infrastructure of the Karlovy Vary and Pilsen regions.

ICT

The Corporate Division was reorganised in the first half of 2011, to make its structure more focused on the marketing of ICT solutions over telecommunications services.

In June 2011, the Board of Directors approved an ICT strategy for the next three years, which focuses on 'machine2machine' verticals, cloud computing and security/networking developed globally at the level of the whole Telefónica Group.

O2 Cloud was the first product to be put on the market in September 2011. The technology behind O2 Cloud offers corporate customers the service of virtual data centres – server capacity, disk arrays, data back-up and restoration. The service has an interactive user and administrator interface, flexible scaling and monthly capacity allotments, all with full functionality guarantees. Customers appreciate the lower cost of this solution compared to operating a proprietary infrastructure.

National and international wholesale services

Interconnection

The consolidation within the electronic communications marketplace continued also in 2011; companies merged, specific services or customer segments were sold off both in the mobile and fixed access segment.

In the area of interconnection of our fixed network with those of other operators, changes occurred in connection with the mergers and acquisitions in the electronic communications marketplace. At the end of 2011, our fixed network was interconnected with 15 other operators of fixed public electronic communications networks and 3 operators of mobile electronic communications networks.

As regards Local Loop Unbundling, the order volume is strong but some services, for which promotions of our clients have ended, are getting cancelled. As a result, the number of active unbundled loops is growing at only a moderate pace.

In 2011, the number of customers who used the services of other operators based on our Wholesale Line Rental (WRL) proposition, continued to grow. On the other hand, the number of customers for CS/CPS continued to decline, albeit at a slower rate. The total volume of CS/CPS traffic is falling only slightly as these services are still used by mostly corporate customers of operators who are interconnected with us.

We achieved our sales targets for 2011, despite the pronounced effect of the interconnection rates cuts (especially mobile termination rates) and the escalating financial crisis in Europe that pas produced an overall economic stagnation and recession

International wholesale services

International data and internet
The growing demand for international transmission capacity of our partners means also an increased demand for transmission capacity from us. The services of international IP connectivity and Ethernet-based services also saw a growth.

International voice
In the area of international wholesale voice, we implemented a new NGN international interconnection platform in our network. The reason for this investment was also the growing demand for capacity propelled by higher volumes of mutually provided services and the continued expansion of our commercial activities, especially in Eastern Europe, Russia and the Near and Middle East. The new technology will help us in following the modern trend in VoIP interconnection.

We achieved our sales targets for 2011. We increased the number of our direct interconnections to new mobile and fixed network operators.

Compared to 2010, the transit voice traffic grew 16% to a record of almost 2.025 billion minutes. The high quality of voice service was maintained. In the area of international services, we continue to build on our cooperation across the Telefónica Group with the international operator TIWS (Telefónica International Wholesale Services)

National wholesale services

The year 2011 was the year of stabilisation of the telecommunications market. As in the previous year, telecommunications operators contained their costs and implemented austerity measures. The measures affected mainly the network operations area, which resulted in a pressure to drive down the wholesale data prices. At the same time, the intensive construction of the mobile 3G networks continued. The Wholesale Division was actively involved in this exercise, which spurred the demand for backbone data services and the related revenues. The project of 3G network sharing with T-Mobile also continued.

All mobile operators in the Czech Republic also forged ahead with their strategies to transform their operation for a purely mobile business to an integrated telecommunications business offering a wider portfolio of services, including fixed access. Consequently, the strong demand for the wholesale ADSL service continued, with a 25% year-on-year increase in the number of accesses to 89,000 at the end of 2011. The upside was facilitated by adding the technology variant of VDSL to the portfolio, which allows for higher transmission speeds.

The demand for our Ethernet-based data services also increased. The Company responded by expanding the coverage and introducing changes to the product portfolio in favour of 1Gbit/s and faster speeds.

Payment services

Telefónica CR has been providing payment services to its customers in keeping with the Act No. 284/2009 Coll., on the payment system, already from 1 November 2009. The services allow customers raise a payment order and use their mobile device or fixed line to pay for goods or services provided by third parties. The customer has a choice of several methods of payments; the most widely used method is via Premium SMS, which, in 2011, was opted for by 435 thousand customers per month on average. The so-called Audiotex (Premium-rate Telephone Number) service was the second most popular payment method, with an average monthly payment per customer of CZK 913, up 21.1% year on year. The total of funds used to pay for goods and services, via the two aforementioned methods of payment, reached CZK 806 million in our network alone in 2011.

Also in 2011, Telefónica CR, in collaboration with other mobile operators, members of the Association of Mobile Network Operators, continued its campaign 'Plať mobilem' (www.platmobilem.cz, 'Pay with Your Mobile'). Its role is to promote mobile transactions in the amount between CZK 20 and CZK 1,500 that can be made using a mobile data capable mobile telephone. Telefónica CR offers the service, m-platba, in its portfolio.

In October 2010, Telefónica O2, together with several Czech banks (Česká spořitelna, a.s., GE Money Bank, a.s., Raiffeisenbank, a.s., UniCredit Bank Czech Republic, a.s.), mobile operator Vodafone Czech Republic, a.s., and A-communications (Malta) Limited, started MOPET CZ, a.s., a company incorporated in the Commercial Register on 3 November 2010. The company's business is to launch a new mobile payment method in the Czech market, to provide an alternative to cash payments for goods and services.

Delays in the launch of a new mobile payment service under the brand Mobito (a project by Mopet), which were caused by a change in the supplier of the transaction platform (August 2011), were shortened to the maximum by an intensive effort put in by all participating partners. The launch of the pilot service is planned in the first half of 2012.

As in the previous years, also in 2011 Telefónica CR continued its pilot of NFC (Near Field Communication) for mobile devices. In cooperation with Komerční banka, Citibank, Globus, Visa Europe and the suppliers of NFC technology (G&D and Oberthur), Telefónica CR launched a contactless Visa card in the mobile application O2 Wallet in July 2011. In November, the project was expanded to include the already ongoing project of the Pilsen travel card in a mobile. In 2012, both pilot projects will be seamlessly carried over to a live operation of contactless mobile NFC services.

Comments on the financial results

In this section we present and comment on the consolidated financial results of the Telefónica CR Group prepared in accordance with International Financial Reporting Standards (IFRS).

Consolidated financial results

Revenues, Operating Costs and OIBDA

The total consolidated revenues reached CZK 52.4 billion in 2011, down 5.7% year on year. In the second half of the year, revenues performance improved due to a stabilisation of spend in the mobile residential segment and the solid revenues from ICT and business solutions. At the same time, revenues in 2011 continued to be impacted by the prevailing competitive pressures largely in the corporate and SMB mobile segments and by the regulatory measures (mobile termination rates, MTR, cuts and lower roaming prices). Other income reached CZK 487 million in 2011 compared to CZK 242 million in 2010. The higher gains from the disposal of fixed assets were the key driver of this growth. The total consolidated operating costs declined 5.1% year on year, reaching CZK 31.1 billion in 2011, as a result of a strict financial discipline in this area.

Operating income before depreciation and amortization (OIBDA) amounted to CZK 21.8 million, down 20.4% year on year. The year-on-year OIBDA comparison in 2011 has been significantly impacted by impairment reversal (CZK 4,344 million) booked in the third quarter of 2010. Excluding this item, OIBDA declined 5.4% year on year in 2011. On a fully comparable basis[1], OIBDA declined 5.1% year on year, reaching CZK 22.9 billion in 2011, while the comparable OIBDA margin[2] improved 0.3 percentage point year on year to reach 43.7% in 2011 on the back of a focus on cost efficiency and the positive and growing OIBDA in Slovakia. OIBDA adjusted for guidance[3] declined 5.0% year on year, within the guidance range of -1% to -5%, to reach CZK 22.9 billion.

[1] OIBDA excluding royalty fees and management fees (2010: CZK 1,057 million, 2011: CZK 1,080 million) and impairment reversal of CZK 4,344 million in 2010.

[2] Comparable OIBDA over revenues.

[3] In terms of 2011 guidance calculation, OIBDA excludes royalty fees and management fees (2010: CZK 1,057 million, 2011: CZK 1,080 million). In addition, 2010 OIBDA base excludes impairment reversal of CZK 4,344 million. 2011 guidance excludes changes in consolidation, includes potential capital gains from non-core asset sales, assuming constant FX rates of 2010.

Operating Income, Income before Tax and Net Income

The consolidated operating income and consolidated income before tax went down 34.7% year on year and reached CZK 10.1 billion and CZK 10.0 billion, respectively, in 2011, largely due to the above-mentioned impairment reversal. The consolidated net income amounted to CZK 8.7 billion in 2011, down 29.3% year on year, due to a combination of the above-mentioned impairment reversal booked in 2010 and the deferred tax in Slovakia booked in 2011 (CZK 709 million). Excluding the impact of impairment reversal on the OIBDA, depreciation and amortisation, and the corporate income tax both in 2010 and 2011, and the impact of the deferred tax income in Slovakia booked in 2011, the net income declined 5.7% year on year to CZK 8.5 billion, largely due to the decline in OIBDA, which was not fully compensated by lower depreciation and amortization, financial expenses and income tax expense.

Cash and Debt levels

On 31 December 2011, the Group's consolidated financial debts (long-term and short-term) amounted to CZK 3.1 billion, broadly in line with the 2010 year-end situation. The amount of cash and cash equivalents reached CZK 7.0 billion as at the end of 2011, compared to CZK 4.8 billion the year before. The combination of cash and debt balances resulted in a net leverage[4] of -5.6% and a gross leverage[5] of 4.4% as at the end of 2011, compared to -2.4% and 4.1%, respectively, as at 31 December 2010.

Capital expenditure

The total consolidated capital expenditure (excluding additions from WiFi acquisition) amounted to CZK 5.6 billion in 2011, down 0.7% year on year, in line with the Group's full year guidance (CAPEX around CZK 5.7 billion). The Group continued to direct investments into the capacity expansion and quality improvement of the 3G network. In addition, the CAPEX budget was spent on a further expansion of the 3G network coverage, including coverage of areas currently without service, on the basis of a network sharing contract with T-Mobile. At the end of December 2011, the Company covered already 1,699 towns and cities in the Czech Republic with its 3G network, representing around 73% coverage of the population. Additionally, the Group focused its investments into the upgrade of its fixed broadband service with the VDSL technology, aiming at strengthening its position on highly competitive fixed broadband market in the Czech Republic and improving customer experience. Also, the relevant part of the CAPEX budget was spent on improving the Company's systems (CRM), to further enhance the customer relationship, simplify and streamline processes and to consequently increase the operating efficiency. In Slovakia, CAPEX went largely into additional network investments related to the launch and expansion of the 3G network. At 2011 year-end, the 3G coverage reached close to 35% of the Slovak population.

Cash Flow

The total consolidated free cash flows[6] declined 8.6% year on year and reached CZK 15.0 billion in 2011; a combination of a 5.6% decline in cash from operating activities, which was broadly in line with the OIBDA decline, and an 3.8% increase in cash used in investing activities, which was driven by higher cash payments on investment in property, plant and equipment and intangible assets, and partially offset by higher proceeds from the disposal of non-core assets.

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[4] Long and short term financial debts less cash and cash equivalents over equity.

[5] Long and short term financial debts over equity.

[6] Net cash from operating activities and net cash used in investing activities.

Over view of consolidated revenues

The total consolidated revenues in 2011 reached CZK 52.4 billion, down 5.7% year on year, mainly due to further cuts in the mobile termination rates, lower roaming prices and the continued strong competitive pressures largely in the corporate and small and medium business segments.

Revenues from voice services (voice – outgoing, interconnection and other wholesale services) reached CZK 18.2 billion in 2011, down 12.6% year on year. Voice revenues declined 12.0% to reach CZK 10.5 billion due to a lower volume of voice traffic generated in the fixed network, more minutes bundled in the monthly charges and the competitive pressure on per-minute charges. Revenues from interconnection and other wholesale services amounted to CZK 7.7 billion in 2011, down 13.3% year on year, on the back of the mobile termination rates cuts, lower incoming mobile voice traffic and the lower transit revenues.

The total volume of mobile traffic[7] generated by customers in the Czech Republic reached 8,956 million minutes in 2011, up 1.9% year on year; it was supported by the higher number of contract customers and the Christmas campaign to promote contract services that offered to double the free airtime included in the monthly subscription charge. Voice traffic generated in the fixed network declined 13.4% year on year in 2011 to 1,507 million minutes due to the continued trend of voice access losses and the effect of fixed-to-mobile substitution.

Revenues from monthly charges declined 4.9% year on year to CZK 12.9 billion in 2011, largely due to the lower number of fixed voice lines. This has not been fully compensated by a growth in the contract customer base in the Czech Republic and Slovakia.

The total mobile customer base in the Czech Republic reached 4,942 thousand at the end of December 2011, a 2.1% increase year on year. In 2011, the company recorded 103.1 thousand net additions in its mobile customer base, compared to only 5.0 thousand in 2010 (excluding the disconnection of inactive contract customers in the second quarter of 2010). The number of contract customers went up 6.5% year on year, reaching 3,049 thousand at the end of 2011, with 185.7 thousand net additions in the year (+15.9% year on year, excluding the disconnection of 111 thousand inactive contract customers in 2Q 2010). This performance continued to be supported by customers migrating from the prepaid to the contract segment, the positive effect of the growth in the number of mobile broadband customers, a higher smartphone penetration and a lower churn. At the end of December 2011, contract customers represented already 61.7% of the base, a 2.5 percentage point growth year on year, which was the highest figure ever. The number of prepaid customers reached 1,892 thousand at the end of 2011, down 4.2% year on year, with 82.6 thousand net losses in 2011 – compared to 155.2 thousand in 2010. Moreover, their number increased by 5.5 thousand in the fourth quarter of 2011, which was the first positive quarterly performance since 3Q 2009; it was credited to the successful Christmas campaign and the lower rate of churn.

The mobile blended monthly average churn rate in the Czech Republic reached 1.85% in 2011, posting a year-on-year decrease of 0.5 percentage point. This is a result of the continuous improvements in the churn rate of contract customers, which was contained to 1.09% in 2011 and was only 0.99% in the fourth quarter alone. It is historically the lowest figure, which represents a year-on-year decrease of 0.3 percentage point. The churn rate in the prepaid segment also

[7] Inbound and outbound, including roaming abroad, excluding inbound roaming.

improved to 3.03% in 2011, down 0.4 percentage point year on year; it was largely helped by our increased focus on the acquisition of higher-worth customers and the success of the Company's loyalty scheme innovation which offered rewards for regular top-ups.

In 2011, the mobile blended ARPU[8] reached CZK 423.7, down 9.6% year on year, as a result of the continued effect of the MTR cuts and increased competition. Excluding the impact of MTR cuts, total ARPU in 2011 declined 5.7% year on year. The voice ARPU dilution driven by persistent competition was the key contributor to the decline. The contract ARPU reached CZK 577.9 in 2011, down 12.4% year on year (-8.9% year on year, not accounting for the effect of the MTR cuts). The prepaid ARPU decreased 9.6% year on year in 2011 down to CZK 186.2. The data ARPU declined 2.4% year on year in 2011 down to CZK 117.2. The Decrease in data roaming prices and continuous SMS/MMS bundling were the key drivers behind data ARPU dilution. Nevertheless, excluding these two items (SMS/MMS and roaming), data ARPU would improve 2.4% year on year in 2011 with mobile internet customer base uptake remaining the key driver of the improvement.

The total number of fixed accesses declined 5.2% year on year to 1,582 thousand at the end of 2011, while net losses were 87.3 thousand in 2011, well below 101.4 thousand in 2010 (-13.9% year on year). This is largely a result of the lower losses in the traditional fixed voice access (-22.4% year on year) and the continuous solid growth of naked access (+45% year on year).

In 2011, the total number of customers in Slovakia went up to 283.7 thousand as a result of the solid contract uptake. Consequently, the total subscriber base reached 1,164 thousand at the end of December 2011, posting a 32.2% year-on-year growth. The number of contract customers grew 48.9% year on year, reaching 498 thousand at the end of 2011, while the number of prepaid customers increased 22.0% year on year and closing at 666 thousand. Thus, the customer mix in Slovakia further improved and contract customers represented already a significant 42.8% of the total customer base, up 4.8 percentage point year on year.

Total data revenues were flat year on year and reached CZK 11.5 billion in 2011. Of that, revenues from leased lines and fixed data services recorded a 9.5% year-on-year decline to CZK 2.8 billion, mainly due to lower revenues from leased lines, which were not fully compensated by a growth in IP based data services. Internet revenues improved 2.8% year on year to CZK 5.5 billion, positively impacted by a growth in the number of xDSL customers and the migration of higher-value customers to VDSL. Revenues from mobile data grew 9.7% to CZK 2.6 billion. This is a result of our successful marketing campaign focused on the promotion of smartphone sales, which accelerated the smartphone penetration to a level close to 20% at the end of 2011. In addition, the growth in mobile broadband customer base and our higher revenues in Slovakia related to the launch of 3G services contributed positively to the increase of mobile data revenues.

The number of xDSL accesses reached 872 thousand at the end of December 2011, up 8.1% year on year. In 2011, the number increased 65.6 thousand. As for the VDSL service which was launched in May, already 103.2 thousand customers subscribed to this service at the end of 2011; the VDSL segment now represents 12% of the total xDSL base and some ¼ of the total addressable existing base. The total number of O2 TV customers reached 136 thousand at the end of 2011, up 5.0% year on year, with 5.0 thousand net additions in the fourth quarter alone – a result of our successful Christmas bundling proposition with broadband Internet.

[8] Including inter-segment revenues.

Other consolidated revenues increased 1.1% in total year on year and reached CZK 9.8 billion in 2011. Of that, revenues from SMS, MMS, PRMS and contents grew 0.9% to CZK 4.8 billion, mainly due to the revenue growth in Slovakia, while in the Czech Republic, the revenues went down as a result of more integrated SMS/MMS bundling. Revenues from equipment and activation charges reached CZK 1.7 billion in 2011, which translates into a 13.2% year-on-year growth thanks to the higher revenues from handsets and broadband equipment sales. Revenues from ICT and business solutions reached CZK 2.4 billion – a respectable amount, considering the austerity measures in the public sector, which has been the principal client in this area.

Overview of consolidated operating expenses

Despite the higher expenses related to our intensified commercial activities, the total consolidated operating expenses of Telefónica CR Group declined 5.1% year on year to CZK 31.1 billion in 2011. Our continued campaign of strict financial discipline, which is aimed at offsetting the declining revenues to the maximum achievable degree, was the key driver for the savings of operating expenses.

Consolidated interconnection and roaming expenses went down 9.6% year on year to CZK 9.2 billion in 2011, in line with the lower interconnection revenues; this trend was largely due to the cuts in the mobile termination rates and the roaming prices. The cost of goods sold reached CZK 2.2 billion in 2011, representing a 13.0% year-on-year growth, which was expected with regard to the higher revenues from the sale of devices. Other direct costs of sales grew 7.9% year on year in total to CZK 3.4 billion. Of that, the cost of telecommunications services, content and other cost of sales went down 33.3% year on year to CZK 665 million, while sub-deliveries increased 20.5% to CZK 1 billion due to a higher volume of sub-deliveries in connection with ICT projects. Commissions went up 30.7% to CZK 1.7 billion due to more intensive commercial activity.

Staff costs including redundancy payments reached CZK 6.2 billion in 2011, down 12.6% compared to 2010. Excluding redundancy payments (CZK 174 million in 2011 and CZK 458 million in 2010) staff costs declined 9.2% year on year, as a result of a restructuring program executed in 2010 and 2011. The total Group headcount declined 8.4% in 2011 and as at 31 December 2011 it stood at 6,890 employees. In the fourth quarter of 2011 alone, the headcount reduction has been facilitated by the outsourcing of IT support services to Telefónica Global Technology, which is to provide IT support for Telefónica's businesses in the Czech Republic, Slovakia and Germany.

Other operating expenses including capitalized own expenses on fixed assets reached CZK 10.1 billion in 2011, down 3.1% year on year. Lower expenses associated with marketing and call centre operation (-9.0% year on year, down to CZK 1.6 billion as a result of improved operating efficiency) were the key contributors to the decline. Significant savings have been recorded also in billing and collection and in the provisions for bad and doubtful debts, which decreased 13.3% year on year in total, down to CZK 831 million. In other categories, it is worth noting the decline in the cost of leases, buildings and vehicles (-4.4% down to CZK 2.1 billion) brought on by our campaign for more efficient utilization of buildings and the car pool optimization. Savings have been reported also in consultancy and professional fees and other external services, which declined 12.2% year on year to CZK 735 million. On the other hand, network & IT repairs and maintenance went up 6.0% year on year to CZK 2.7 billion due to the outsourcing of network-related activities. The growth, however, has been more than compensated by the savings in the related personnel costs. In addition, the Group recorded a higher cost of the utilities, which amounted to CZK 1.1 billion in 2011, up 5.0% year on year, which was mainly caused by the higher energy prices.

The outlook for 2012

In 2012, the Group will continue focusing on improving customer experience through a proposition of the new services that have value for the customer and on products that meet the customer’s needs. Additional investments in process optimization will aim to further improve the relationship with our customers and reduce the number of complaints – ultimately giving a greater customer experience. In line with the strategy to strengthen our market leadership, the Group will focus on customer value management in all segments. The Group believes that these activities will help it to better manage ARPU and churn, thus lowering the pressure in the highly competitive market environment.

Additionally, the Group will continue to enhance its fixed broadband proposition through additional expansion of the VDSL network coverage and to upgrade the speeds for the current accessible base. The Group will also pursue a gradual FTTx deployment with a view to strengthen its market share. In the mobile broadband area, the Group intends to further expand its 3G network coverage while enhancing the capacity and quality of the network, including a backhaul to exploit the opportunity of smartphone and data uptake. Moreover, it will closely monitor and analyze the conditions of the upcoming auction of new frequencies, in which the Group intends to tender for an LTE licence, which would allow it to build a 4G network and remain competitive in the mobile broadband market. In the segment of ICT, the Group will market a standard portfolio of services and solutions, so that the dependency on one-off projects is reduced. This should lead to an improvement in the revenue sustainability in this area.

Telefónica Slovakia will continue in its value- and simplicity-based commercial proposition, targeting higher value customers to maintain a solid subscriber growth while keeping a focus on further improvement of its financial performance through a lean approach to its operations.

The Group expects that, compared to 2011, the fixed and mobile broadband revenues, together with increasing revenues in Slovakia, will be the key drivers for the improvement of the top line performance in 2012. At the same time, the anticipated additional MTR cuts and pressure on ARPU from fierce competition will continue to affect mobile revenues in 2012. The Group will keep its focus on OPEX efficiency improvement, especially in operational areas (implementation of a leaner and more efficient organizational structure and processes, consolidation and optimization of call centre operations), through which it aims to maintain our best-in-class profitability. The investments will continue to go primarily in the direction of upgrades to the fixed and mobile broadband network and improvements of the mobile broadband capability, which are seen as vehicles of growth in the future.

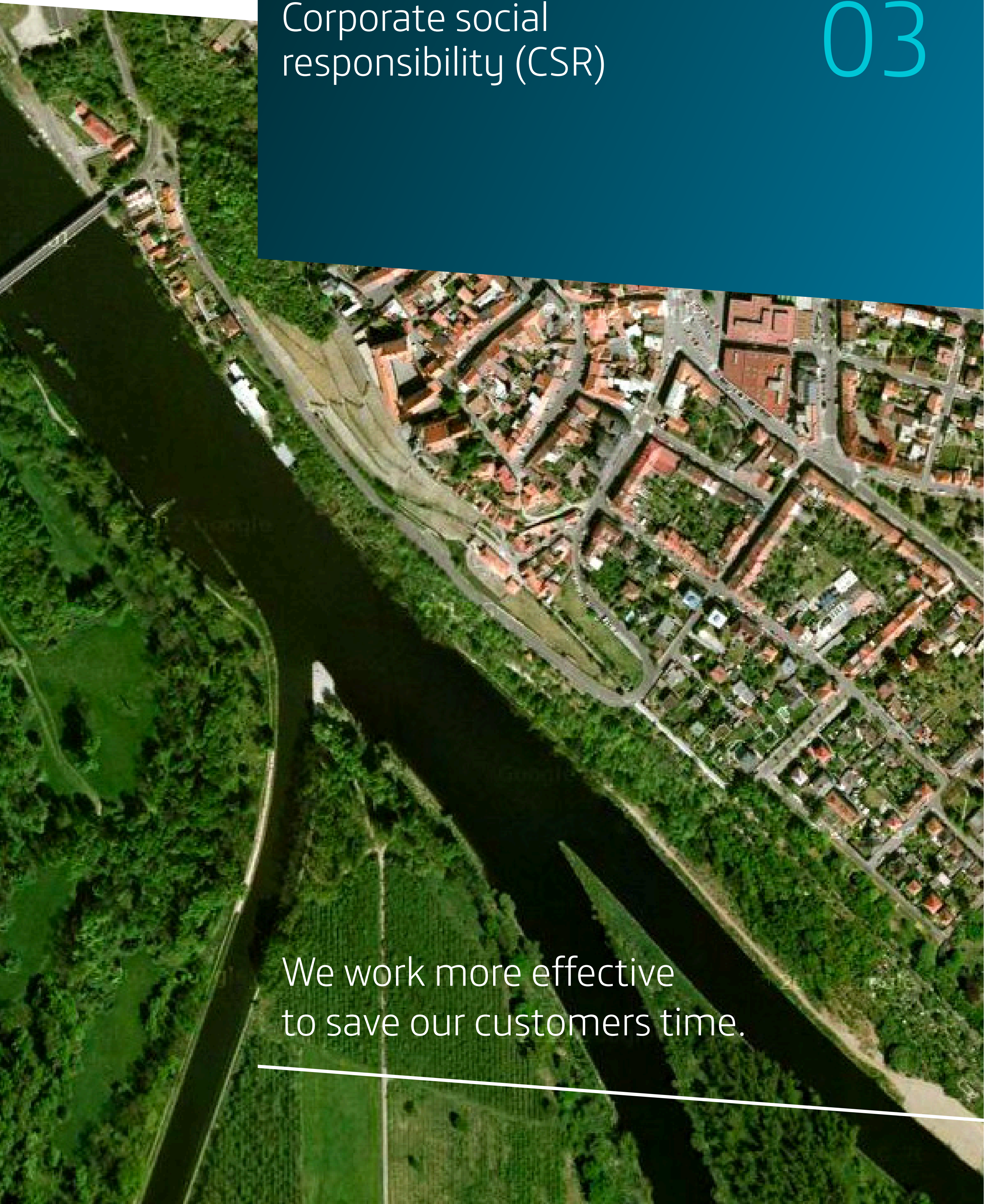
With regard to the above, the Group gives the following guidance for 2012:

	2011 base	**2012 guidance**
Business revenues	-5.7% year-on-year	improving trends vs. 2011
OIBDA margin[9]	43.7%	limited margin erosion y-o-y
CAPEX[10]	CZK 5.6 billion	up to CZK 6.2 billion (flexibility to manage CAPEX/Revenue evolution)

[9] OIBDA before brand fees & management fees; 2012 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2011.
[10] Excluding business acquisitions.

Corporate social responsibility (CSR)

03



We work more effective
to save our customers time.

Corporate social responsibility (CSR)

03

Introduction

Telefónica CR understands corporate responsibility as a way of managing its business in relation to its interest groups. To the extent that the company is capable of making a positive impact on economic, technological and social progress through its activities, it will be capable of guaranteeing its own sustainability as a company.

In short, the way in which the economic-financial results are met and the objectives are achieved is just as important as the results themselves. Thus, Telefónica CR sustainability strategy it's implemented across the business through the management of risks in our business, searching for opportunities linked to the impact of our services in society, and the proactive stakeholder engagement.

In 2011, Telefónica CR was placed in the top five most responsible telco companies all over the world according to the Dow Jones Sustainability Index (DJSI) – the most important socially responsible investment index in the telecommunications super-sector, including landline and mobile operations.

Telefónica CR sustainability performance is verified independently by Ernst &Young through the annual audit and monitored internally by the Governance Committee.

In addition to the global recognition, Telefónica CR can boast many socially responsible achievements in 2011. The launch of Thing Big – a social programme which supports young people in their efforts to improve their local communities; the success of the employee engagement strategy; improved energy efficiency; dealing with challenges faced by the society in connection with the new digital opportunities; improved ethical commitment of all employees; and the improved sustainability across the supply chain, are presented in detail in the following sections:

Business principles

Corporate culture and reputation are among the priorities of the Telefónica Group. In July 2011, Telefónica CR published updated Business Principles that reflect the current priorities of the Telefónica Group. The Business Principles are a set of 42 principles that Telefónica CR sees as a vehicle for gaining and keeping the trust of customers, shareholders, employees, contractual partners and the public at large. Key principles include: 'no' to corruption regardless of its form; conformity with the law; and protecting information and privacy.

In 2011, Telefónica CR continued to promote the Business Principles among the employees by means of an online course. The course is now fully integrated in the standard training portal, with the benefit of improved user comfort. Employees train in the Business Principles every three years; as at 31 December 2011, 85% of all employees had a valid certificate of completion of the Business Principles course.

Employees have the duty to report unethical conduct which they may come across; the Company guarantees anonymity for the whistleblower. In 2011, Telefónica CR continued to raise awareness of the available whistle-blowing tools. Employees can report unethical conduct in several ways: they can choose between an online application, e-mail, letter addressed to the responsible officer (Compliance Officer) or visiting in person. Employees have also the option to approach trained consultants from Human Resources, Security and Legal Affairs. The reports are investigated by Security or Internal Audit in collaboration with the Compliance Officer. There are also instruments of higher instance available: escalation of the report to the Business Principles Office of the parent Telefónica, or the instruments available at the European division of the group, Telefónica Europe. Reporting suspected irregularities in accounting, internal control systems and accounting audit of the Company or the Group is made through a dedicated whistle-blowing channel leading directly to the parent Telefónica. Activities in the area of ethical conduct and business principles enjoy a full support from the governing bodies and the executive management; they are supervised by the Ethics and Corporate Social Responsibility Committee and, through this body, by the Supervisory Board. The effectiveness of the whistle-blowing instruments (and of the subsequent investigations) is regularly monitored by the Ethics and Corporate Social Responsibility Committee. The Internal Audit unit of Telefónica CR regularly audits the compliance with the Business Principles.

The Business Principles are a fundamental policy of the Company, which is a part of the Work Regulation and employees are required to comply. The brochure Business Principles is given to every new employee upon their commencement of employment as part of their orientation training, in which a special section is dedicated to the Business Principles and to the values of the O2 brand; the publication can also be downloaded from the Company's intranet and website.

The Business Principles assert that Telefónica CR is a company that is equally open, trustworthy and transparent towards its people and the customers.

Market conduct and customer orientation

Customer experience

Also in 2011, customer experience continued to be a priority for Telefónica CR and a pillar of the Bravo! Strategy.

The Company also continued to emphasise the delivery on four promises to customers:

1. People make the difference – we want our customers to know that we try our best to address their needs.
2. The best online experience – we give our customers a comprehensive, affordable and serious offer of internet at home, on the road, at work and in the mobile phone.
3. Being an O2 customer always pays off – all our offers deliver real value.
4. We build on trust – we offer a reliable service and the experience that O2 delivers on its promises and gives the customer the care he truly deserves.

These commitments are the guiding criteria for our new and redesigned products and services. Telefónica CR monitors the delivery on the promises and the overall customer experience.

VDSL, a new technology for the customers of our fixed-line services, was launched, offering faster home internet. The communication campaign generated a lot of interest from existing ADSL customers. A large part of the Company's activities focused on demonstrating the benefits of mobile internet, safety in using telecommunications technologies and direct and easy communication.

O2 Guru, Telefónica CR's project to offer assistance and customer service on social networks, was launched in 2011. A series of videos was produced, in which O2 Guru advises, for instance, how to operate a service or configure a smartphone.

The SME division was subjected to customer re-segmentation, with a view of offering a better service to business customers. The IVR system in call centres was abandoned in favour of a direct call with a live operator, which subsequently reflected in improved rating of the customer experience.

POTR, one of the BRAVO projects in Telefónica CR, netted several notable accomplishments in 2011.

The Business Division completed the configuration of a process for keeping customers informed of the status of their requests, including mobile, and any delays which may occur. This helped to reduce the number of customer status-related enquiries. A new process, which implemented a one-day framework contract including tariff optimisation vis-à-vis the customer; this helped to reduce the rate of erroneous data input in the system in the process of entering individual terms and conditions for the customer. A function with automatically enters new numbers into a customer's VPN group was also implemented. The customer is informed of the amount charged for the data service, unless, of course, the customer has a data price plan activated.

Some POTR activities were restarted in the SME division in 2011, which will be given a priority also in 2012. One of them is a system for correcting orders that had been erroneously input due to a failure of the human factor, which is designed to reduce the number of complaints.

In the Consumer Division, Telefónica CR focused on improving the quality of sales through the call centre. Mandatory standards for a sales call were implemented, together with the so-called sales summary before sending the order to the customer via email. The objective is to achieve a 35% reduction in the number of complaints in this category.

In 2011, changes were introduced to the system of service cancellation; the calculation of the notice period is now greatly simplified, and the customer is informed of the cancellation date upon the first contact.

A new system called 'smart promo management', which informs the customer of the end of a promotion by SMS and on an invoice, was applied to 80% of all promotions. The number of complaints in this category was down 75%.

The system for handling complaints in the same division was changed – the process of awarding or refusing a claim by call centre or store employees is now faster, with clear rules for the handling of complaints relating to reminders of late payment.

In our brand stores, individual customers could use the so-called 'order summary', which gives an easy overview of all products for the benefit of the customer and the sales assistant. This improvement helped to reduce the number of complaints and repeat calls to the call centre. An information flyer was produced for the brand stores, with the purpose to set the customer's expectation. Telefónica CR also scrupulously adhered to the Code of Conduct for Retailers.

Products and services for people with specific needs

As in the previous years, also in 2011 the Company focused on helping and supporting people with special needs, especially senior citizens and people with disabilities, by making their communication easier.

Telefónica CR carried several models of telephones designed for senior citizens or people who find it difficult to operate regular control keys. Offering devices for people with disabilities, such as loss of hearing, was a matter of course. There was a choice of devices capable of converting text to speech for people with loss of sight.

In 2011, Telefónica CR offered Aligator A400 and a SIM pre-charged to the value of CZK 100. With each set, the customer was given a present: the brochure 'The Internet School for Senior Citizens'. For contract customers, the tariff O2 Neon Senior offered a purchase of a mobile telephone for the symbolic price of CZK 1.

Deaf Call

Also in 2011, Telefónica CR continued to operate Deaf Call. During the course of the year, the operators handled 15,000 requests.

In the first half of 2011, a campaign was run through the media, with the aim to promote the service to the target group.

In October 2011, Telefónica CR partnered with the Deaf Union Brno and organised a 'Double-decker Tour'. A double-decker bus, originally from London, toured 14 Czech towns and Dear Call operators campaigned at 20 schools and institutions for the fully or partially deaf.

The customer base of the Deaf Call line increased 40% in the last quarter of the year alone.

Discounts

Also in 2011, Telefónica CR offered a discount equalling the amount of the state contribution to people with a dependency of the 1st degree, and a discount on the O2 fixed-line service. The discount was claimed by a total of 48,836 customers.

Conference INSPO 2011 and the competition 'Mobile Phone and My Handicap'

The Company was again in 2011 the General Partner INSPO: a conference on the 'Internet and Information Systems for Persons with Special Needs', the only event of its kind in the Czech Republic. The Company's representatives presented Deaf Call and Emergency Care services for people with disabilities and senior citizens, which they followed up with a demonstration. In addition to financial support to the conference, the Company also donated gifts for the speakers and the winners of the writing competition 'Mobile Phone and My Handicap, whose results were announced at the INSPO conference. The winners walked away with smartphones and two year's worth of free internet.

Online safety

We help to guide children safely through the world of communication technology

As a provider of communications services, Telefónica CR is committed to using all available means to help eliminate potential risks that come with modern technology. Protecting children and creating a safe environment for them in the world of information and communication technology has always been a key priority with regard to the Company's customers. Several specific actions were taken in the area of child protection.

Also in 2011, Telefónica CR continued to observe its policy on the marketing to children, which summarises the principles respected in all the Company's marketing activities and which had been adopted previously. The Company also continued with blocking websites with child pornographic content. All websites that were made illegal in all EU countries were blocked in the O2 network.

Supporting projects in the area of protection of children

As is already a tradition, in February 2011, the Company joined the celebrations of the International Safer Internet Day, together with the National Centre for Safer Internet, gave its support to the pan-European campaign, which focused on our virtual lives. As part of the campaign, which was led by the motto 'It's not a game, it's your life', Telefónica CR organised a series of workshops dedicated to the topic of safer internet.

Also in 2011, Telefónica CR gave its support to a conference of experts, which was held in the Senate of the Czech Parliament and was organised by the National Centre for Safer Internet; the conference was dedicated to the issues of cybercrime prevention, especially among children. The conference was titled 'Cybercrime prevention and children, technology, education and legislation'.

After the conference, the Company organised a working lunch, which brought to one table the representatives from business, policy and media, to discuss together their commitments in the area of digital technology. Luis Antonio Malvido, Chief Executive Officer Telefónica CR, was the host. The conclusions of the expert roundtable were incorporated in the Company's strategy for the area of 'Digital Confidence' for the upcoming years.

The end of 2011 saw already the 9th Cyberspace International Conference, which explored the effects of the internet on the society and which was organised by the Faculty of Law, Masaryk University, in collaboration with the Faculty of Social Studies of the same institution. Telefónica CR was the general partner of the event.

The Company received the prestigious Via Bona Award for its 17 years of partnership with the Safety Line.

Caring for employees and the workplace environment

It is the Company's long-term strategy in the area of human resources to be 'a place which is a pleasure to work at'. A new 'charter' between the Company and its employees was agreed last year, which describes in detail what the Company plans to achieve in various areas and what should be the contribution of employees towards the goal. Some areas are already well underway, whereas others are scheduled for the next few years, as per the work plans.

	number of employees as at 31 December 2011
Employees – total	6,494
of which women	36.98%
of which men	63.02%
Employees with reduced work capacity or disability	0.86%

Organisation unit	Employees (actual) as at 31 December 2011
Wholesale Division	179
Corporate Division	988
Consumer Division	1,849
Operations Division	2,270
Corporate Affairs	20
Human Resources	76
Support Services	295
Finance Division	324
Legal Affairs and Regulation	40
Internal Audit and Risk Management	14
Marketing Division	197
Office of the Chief Executive Officer	33
DHL	55
Telefónica Business Solutions	154
Total	**6,494**

Employee engagement

Reflect

The interest in and the motivation of employees to participate in the internal satisfaction survey remained at the very high level of 83%. The overall Reflect Index was up 3 percentage points – the first upwards trend since 2008. The outcome was regarded by the management as a success, especially as the year ushered in many changes. Also individual areas of the survey saw improvements in the rating. The 'top management' index jumped up 6 percentage points year on year. Indices for areas 'my manager', 'my job and my development' and 'atmosphere' were rated as the Company's greatest strengths. Effectiveness of the executive team, credibility and availability are areas where there is still a room for improvement.

Getting closer to our customers

Also in 2011, the Company continued with its programme called 'One Day with the Customer', to give managers a direct experience of the customer, which should lead to a higher awareness of the needs of our customers. A total of 318 managers took part in the programme; each manager spent one day in a brand store, at a call centre or went on call together with a sales representative or engineer.

Improving internal cooperation

It is important to Telefónica CR for individual internal teams to engage in effective cooperation. Telefónica Team is a new tool for bolstering cooperation – a short structured questionnaire gives an opportunity to team leaders to improve their service to internal customers. After a successful pilot project completed in several divisions last year, the programme was rolled out within the Company in 2011.

Global Bravo Awards

As part of its global Bravo strategy, Telefónica introduced Bravo Awards, in which all employees can nominate themselves or their colleagues for activities that are helping Telefónica CR stay abreast of the telecommunications field.

Work-life balance programmes

Telefónica CR realises that giving the employees an option to work from home is a win-win situation for all involved – the employees, the Company and its customers. Any employee, whose job character allowed for this option, could talk to their manager about working from home. Employees working from home have a company mobile and internet connection to facilitate this style of working. The Company also allowed employees, conditional on the relevant manager's consent, to work part-time. Parents of children of pre-school age could also use employee bonuses from the so-called cafeteria, which were redeemable against pre-school care.

A new online portal called Momma and Poppa went live early in 2011. It is intended for employees who are also parents, especially those who would be returning to the workplace in 6–8 months. The project also organised two two-day workshops designed to bring the participants up-to-date with the recent developments in the Company and to their work; work-life balance was also covered. The new portal and workshops were received with much enthusiasm by parent-employees.

In the second half of the year, Telefónica CR made a grant application to EU funds, for a new day care facility. The grant was approved, so in 2012 we will focus also on the planning and opening of the day care centre.

Education and personal development

Orientation training for new employees

As in the previous years, also in 2011 all new employees attended Welcome Day, a one-day seminar at which they learned a lot of useful information for getting to know and finding their way within the Company.

Basic management skills

The course Management of People helped newly appointed managers to orientate in their role of supervisor or line manager. It gave an insight into the work of a manager and an opportunity to improve existing management skills. The five-day course, spread over two months, was attended by 72 participants in 2011.

Leadership

Also in 2011, the long-term programme Leading to Excellence continued to build leadership skills of middle and higher managers. In 2011, a total of 84 managers attended the course, and 34 of them opted to continue with an additional module, Feedback – the Pathway to Success. Top executives had a choice of courses at Universitas Telefónica.

Motivation and remuneration

Employee shares plan

Also in 2011, employees could invest in the shares of Telefónica S.A. This option was chosen by more than 2,000 employees who could invest up to EUR 1,200 over a period of 12 consecutive months.

If the shares are held for a minimum of 12 more months starting from the end of the twelve-month acquisition period, the Company will match every share purchased with one share, subject to the rules of the scheme.

Employee benefits and incentive programmes

Telefónica CR offers a wide range of employee benefits. Employees can choose from financial products, products and services of the Company or various other benefits in the area of health, education and work-life balance. Employees with reduced work capacity also received a voucher for restorative physiotherapy holiday in the value of CZK 10,000 per year. In addition, various competitions were held throughout the year, for the employees to enter – e.g. to mark the launch of campaigns, with the aim to engage employees in the happenings within the Company.

Health Promoting Enterprise

The year 2011 saw already the 7th edition of Health Promoting Enterprise, a competition organised by the State Health Institute in Prague, under the auspices of the Ministry of Health of the Czech Republic. The 'badge' is given for a period of three years – Telefónica CR has been awarded three times already, now reaching Class III, which means 1st place among other entrants. All shortlisted companies have a documented track record of caring for their employees' health, focussing on prevention and activities associated with healthy living.

Caring for the environment

Environmental protection policy

The commitment of Telefónica CR to keep the footprint of its operations on the environment minimal in 2011 was anchored in the Company's long-term strategy and Environmental Policy. The Environmental Policy focuses on the elimination, or at least the mitigation, of damage to or degradation of the environment – in its whole or in part and with regard to the Company's sphere of activity; in doing so, the company uses the latest research. Telefónica CR's fundamental principles of environmental protection were coordinated across the Telefónica Group and helped to deliver on both the group and local objectives and to meet the statutory and other conditions.

Green Company

Telefónica CR continually worked with its suppliers, gradually raising the bar they have to meet, in order to promote the ideas of environmental protection in its external environment. The Company continued to lead by example in 2011 – its Green Company programme involved employees in protecting the environment; this time employees helped to collect 269 tons of waste electrical and electronic equipment and came first among all teams participating in the project.

Reducing environmental footprint

The Company continued in its successful campaign to reduce its negative footprint on the environment. Compared to 2010, a saving of 18.1% of fuel was achieved by more economical business travel; the consumption of natural gas and electricity also went down 23.84% and 2%, respectively, in year-on-year comparison. The volume of communal-type waste produced by Telefónica in 2011 was 3.5% lower than in 2010. We also succeeded with increasing the volume of waste that was recycled, especially industrial packaging in warehouses. In 2011, we also saw a major progress in the removal of the regulated coolant R22 from the air-conditioning units; 56 units over 10 kW and 228 units under 10 kW were treated.

The way the Company cares for the environment showed also in other areas – for instance, recycled materials and environmentally friendly materials continued being used for packaging.

Certification

The Company's activities in the environmental area were regularly audited, both internally and with respect to suppliers. The standard of environmental protection is certified according to ISO 14001 international standards. Telefónica CR was the first telecommunications operator in the Czech Republic to have this certificate.

Supporting sustainability

Green Open Air Festival

Already for the second year running, Telefónica CR, General Partner to Open Air Festival in Panenský Týnec, was in charge of its sustainable format. The Eko Think Big festival zone provided for the recycling and coordination of clean-up teams, but there was also educational programme. Festival goers were invited to visit recycling boxes and learn more about recycling and about protecting the environment in general. One Think Big tent offered the opportunity to try how hard it is to make enough electricity to charge up a mobile phone by pedalling on a bicycle.

As in 2010, caterers used biologically degradable plastic cups. 'Green patrols' were monitoring the compound for any waste, helping to keep the grounds neat and clean for the duration of the festival. The care and diligence helped in Telefónica CR and the organiser reclaiming the 'Commended' mark in the Greener Festival Awards also in 2011.

Supporting communities

Community-oriented and philanthropic projects were deeply rooted in the Company's CSR. Telefónica CR strived to put its technology to use in helping to improve the quality of life. Already for the tenth year running, O2 Foundation was the key instrument in transparent and systemic corporate donorship.

In 2011, the Company took part in the 8th edition of TOP Corporate Philanthropist, awards given by the Donors' Forum to businesses excelling in the field of CSR. Telefónica CR ranked in the TOP 10 companies in the Czech Republic; in the quantitative category TOP 10 Corporate Philanthropist measured by the volume of philanthropic investment it stood in the fourth position. 'Responsible Leader 2011', an award sponsored by Telefónica Czech Republic, was presented on the same occasion.

The total value of donations, gifts and telecommunications services provided by Telefónica CR to or for the benefit of charitable projects in 2011 exceeded the mark of CZK 52 million.

Think Big

In 2011, the O2 Foundation started Think Big, a new social programme which succeeded the scheme of Regional Grants.

The goal of the long-term programme is to support informal groups of young people in making their ideas and projects, through which they want to change, improve or create something of value in their own community, into reality.

The first call for Think Big projects garnered 276 project proposals, of which 100 were chosen for some of the total pie of more than CZK 5.3 million. Teams of young people qualified for grants ranging from CZK 10,000 to CZK 90,000, weekend courses, telecommunications packages from the Company and mentoring from employees of Telefónica CR.

Grant applications were reviewed by nine regional committees, each comprising two employees of the Company, one expert in non-profit and youth leisure activities, one media representative and one young person already with some experience with implementation of such projects.

Projects that received financial support were announced at the programme website www.o2thinkbig.cz

Safety Line 116 111

Already for seventeen years running, the O2 Foundation was the General Partner to the only free and anonymous helpline for children who are faced with a difficult life situation. In 2011, the O2 Foundation co-hosted the Safety Line benefit concert for the third time. Television viewers sent donor SMS, raising more than CZK 450,656. The benefit yielded over CZK 7.5 million with Telefónica CR becoming the largest donor with CZK 3.5 million donated through the O2 Foundation.

Senior Line

The O2 Foundation continued in its support to Senior Line operated by Elpida Plus. Senior citizens could dial the number 800 200 007 and share their concerns and joys, consult on various issues – health, legislation, psychology and welfare. In 2011, the helpline answered more than 28,000 calls, of which more than 4,300 were of serious nature. The funding from the O2 Foundation helped to keep the service free of charge.

Stop bullying!

Also in 2011, the O2 Foundation partnered with the programme to stop bullying in schools. A national competition 'Children Say NO to Bullying' was held in collaboration with Aisis, the programme's main organiser. Fourteen schools entered the competition with their ideas, which were evaluated as to their inventiveness and communication potential. The winners in 2011 were the children from the 28th Elementary Pilsen.

Volunteer programmes for employees

Creating opportunities for employees to actively engage in activities for public good, including helping out with O2 Foundation's projects, is an integral part of the Company's own CSR, through which it aims to develop corporate volunteering.

In 2011, a record 2 374 employees volunteered in various community-oriented activities. As for employee volunteering, Telefónica CR achieved the highest level of engagement among Telefónica Europe companies.

In 2010, employees also participated in successful fundraising campaign; a total of CZK 1,367,288 was raised from 1,530 employees. The most successful fundraiser was the one to benefit of the victims natural disasters: a total of CZK 394,265 was raised for the victims of tsunami in Japan, and CZK 352,898 went to help the victims of Somalian famine. Telefónica CR matched both of these amounts by 100% and donated the funds to the humanitarian relief organisations Adra and People in Need.

In 2011, employee donations also helped to turn around the lives of sixteen people who were able to buy necessary health aids with the fundraiser proceeds of CZK 494,000. Employees also gave support to the Safety Line, Senior Line and helped children in Latin America.

Employees regularly participated in volunteer events and helped with their time, knowledge and skills.

Corporate teambuilding events turned into volunteer events – managers and their teams worked in non-profit organisations. In 2010, 933 employees (16 teams) donated almost 7,500 hours of work to non-profit organisations; 132 employees donated their free time. The largest part of the total 4,755 hours was spent by employees mentoring young people in the Think Big programme.

The O2 Foundation also recognised those employees of the Company who were active volunteers in their personal free time. Their service to the community earned CZK 400,000 to 18 employees in 2011, which was in turn donated to the non-profit organisations they worked with on a long-term basis.

On Easter and Christmas markets, which were organised by the O2 Foundation in twelve of the Company's buildings in the Czech Republic, products hand-made by people with disabilities in sheltered workshops were sold to employees. In 2011, employees spent close to CZK 450,000 on products from sixty sheltered workshops.

Proniño International Volunteer Programme

Volunteer activities of employees in 2010 again transcended the limits of the Czech Republic as six employees of the Company participated in the international volunteer programme Proniño implemented by Telefónica CR in Latin America.

Altogether thirty volunteers hailing from all countries where Telefónica operates were sent to Ecuador, Brazil, Guatemala, Argentina and Colombia. After arriving to their destination their role was to add meaningful content to the free time of children who, once their school finishes, either roam the streets or have to work. Employees volunteered their personal vacation time, each donating more than 252 hours of their free time.

Give blood with O2 Foundation

Also the project Give Blood with O2 Foundation continued in 2011, seeking to promote voluntary blood donorship in the Czech Republic. During the year, 156 employees participated and collectively donated more than 70 litres of blood. Blood collection took place in Company premises.

Corporate governance

04

The way of doing business is equally important for us as its results.

Corporate governance 04

Corporate governance of the Telefónica Czech Republic Group

In terms of organisation, Telefónica CR is a part of Telefónica's European division (Telefónica Europe), which holds all companies that use the O2 commercial brand regardless of ownership relations. No significant changes occurred in the ownership structure of the Company; Telefónica S.A., holding a 69.41% stake, remains the majority shareholder.

Telefónica CR's ownership rights in its subsidiary companies are exercised by the Board of Directors. Personnel changes in the statutory and supervisory bodies of subsidiary companies and in companies in which Telefónica CR holds an ownership interest (in positions occupied by the Company's representatives) are approved by the Board of Directors of the Company and, in accordance with the Articles of Association, they are also subject to a prior approval by the Supervisory Board of the Company, whose decisions are made in consideration of the opinion given by the Nomination and Remuneration Committee.

Subsidiaries, associates and other ownership interests (as at 31 January 2012)

The structure and number of companies in the Telefónica Czech Republic Group changed in 2011 from the situation described in the 2010 Annual Report and the 2011 Half-year Report. Below are the changes that occurred in the reported period:

— The subsidiary company Telefónica O2 Slovakia, s.r.o., changed its name in connection with the change of the name of the parent company, and with effect from 10 May 2011 became registered under the company name of Telefónica Slovakia, s.r.o.;
– In June 2011, the Board of Directors approved the plan to transform the subsidiary company Telefónica O2 Business Solutions, spol. s r.o., by demerger which resulted in a spin-off of some assets of the demerged company into a newly incorporated subsidiary Internethome, s.r.o.;
— The newly incorporated subsidiary company Internethome, s.r.o., was registered in the Commercial Register on 1 October 2011, with the registered business of provision of electronic communication services;
— On 16 December 2011, the Board of Directors decided to incorporate a new subsidiary company Informační linky, a.s., which was founded by way of a contribution of a part of the assets of the organisation unit Information and Assistance Services, which operates directory and assistance services on the numbers 1180, 1181 and 1188; the company was incorporated as of 1 January 2012 by registration in the Commercial Register by the Commercial Court.

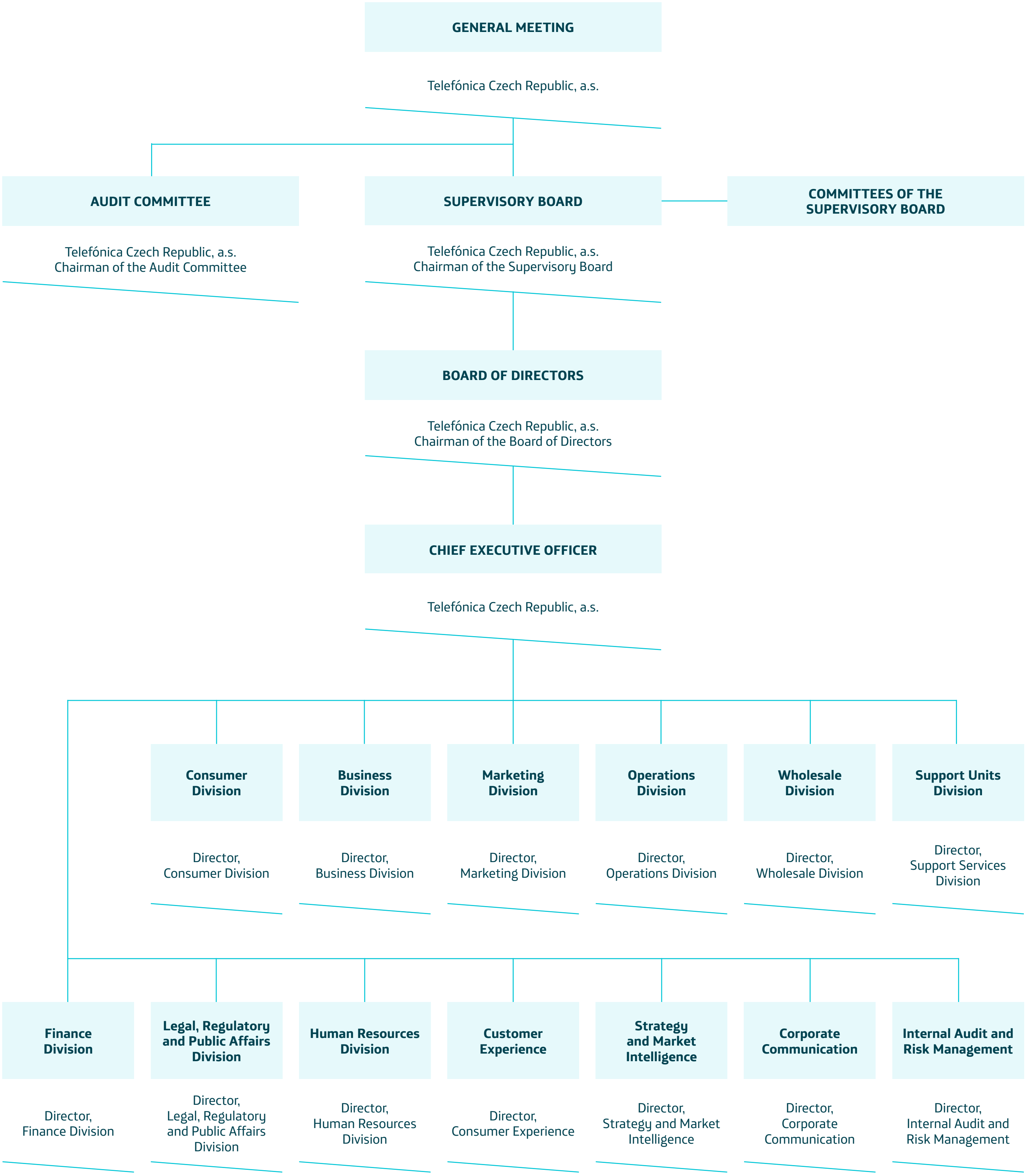
Company name	**Registered/share capital**		**Telefónica CR's share**
Telefónica Slovakia, s.r.o.	EUR	240,000,000	100 %
Telefónica O2 Business Solutions, spol. s r.o.	CZK	10,000,000	100 %
CZECH TELECOM Austria GmbH	EUR	35,000	100 %
CZECH TELECOM Germany GmbH	EUR	25,000	100 %
První certifikační autorita, a.s.	CZK	20,000,000	23,25 %
AUGUSTUS, spol. s r.o.[1]	CZK	166,000	39,76 %
MOPET CZ a.s.	CZK	104,000,000	14 %
Internethome, s.r.o.	CZK	200,000	100 %
Informační linky, a.s	CZK	150,000,000	100 %
Tesco Mobile Slovakia, s.r.o.[2]	EUR	5,000	50 %

1 Telefónica CR does not control this company.
2 Owned through the subsidiary Telefónica Slovakia, s.r.o.

The organisation of Telefónica CR

No principal changes occurred in the organisation structure of the Company in 2011 from the situation described in the 2010 Annual Report and the 2011 Half-year Report.

Executive macrostructure of Telefónica Czech Republic (as at 31 January 2012)



Governing bodies (as at 31 January 2012)

General Meeting

The General Meeting is the supreme governing body of the Company in matters related to its business, organisation and operations. The General Meeting is called by the Board of Directors at least once a year, to take place within six months from the last day of the accounting period. It is convened by way of a written invitation sent to all shareholders no later than 30 days prior to the date of the General Meeting. The General Meeting constitutes a quorum if shareholders holding shares or equivalent securities with the nominal value exceeding a half of the share capital of the Company are present. Voting is by ballot signed by the voter. The General Meeting decides by a simple majority of votes present; any changes to the Articles of Association are decided by a two-thirds majority of all votes present.

The General Meeting has the exclusive authority to:

- approve the Rules of Procedure of the General Meeting;
- decide on amendments to these Articles of Association, unless any change which occurred under any other legal circumstances is involved;
- decide on an increase of the share capital or on the authorisation of the Board of Directors pursuant to Art. 210 of the Commercial Code (i.e. on the authorisation of the Board of Directors to decide on an increase of the share capital) or on the option to offset monetary receivable due from the Company against receivable of payment of the subscription price of shares;
- decide on the reduction of the share capital;
- decide on issue of bonds, where the decision by the General Meeting is required by the Commercial Code;
- decide to wind up the Company with liquidation, appoint and dismiss the liquidator, including determination of the amount of his/her remuneration, approve proposed distribution of the liquidation balance;
- decide on transformation of the Company, unless the law stipulates that the Board of Directors is authorized to make such decision;
- decide on a change in class of shares and any change in the rights attached to individual classes of shares;
- decide on changes in type and form of shares;
- elect and dismiss the members of the Supervisory Board, except for the members of the Supervisory Board elected by employees pursuant to the provisions of Art. 200 of the Commercial Code;
- approve regular and extraordinary financial statements and consolidated financial statements and, in cases set forth by law, also interim financial statements, decide upon the distribution of profits or other own resources or cover of losses, determine the amount and payment date of royalties, and the amount and payment date of dividends, and approve rules for usage of undistributed profits;
- decide to increase the Reserve Fund;
- discuss a Board of Directors' annual report on the Company's business activity, and on the situation of the Company's assets as part of the annual report according to Act No. 563/1991 Coll. on Accounting as amended (hereinafter referred to as the „Act No. 563/1991 Coll.");
- approve agreements set forth in Art. 67a of the Commercial Code;
- decide on the establishment and the use of other funds created from profits;
- decide on approval of the rules of remuneration to members of the Board of Directors, the Supervisory Board and the Audit Committee and stipulation of remuneration to members of the Board of Directors, the Supervisory Board and the Audit Committee and maturity thereof;

- decide on approval of control agreements, profit transfer agreements and silent partnership agreements and changes thereto, if the Company concludes such agreements;
- decide on approval of agreements on the performance of the office of members of the Supervisory Board and the rules for provision of non-claim perquisites to members of the Supervisory Board of the Company;
- decide on determination of an auditor to carry out mandatory audits or to audit other documents where the determination is required by law;
- elect and dismiss of the members of Audit Committee;
- decide on approval of agreements on the performance of the office of members of the Audit Committee and the rules for provision of non-claim perquisites to members of the Audit Committee; and
- decide on approval of financial assistance if such approval is required by law.

Audit Committee

The Audit Committee has five members and it is an autonomous body of the Company. Members of the Audit Committee are elected and recalled by the Company's General Meeting. They may be elected from the members of the Supervisory Board or from persons external to the Company. The Audit Committee members are elected for a period of five years and may be re-elected. The General Meeting may also elect up to 5 substitute members of the Audit Committee, designating the order of their succession. The Audit Committee meets as necessary, once in a quarter as a rule, but at least four times in the course of a calendar year. The Audit Committee has a quorum if a simple majority of its members is present at the meeting.

The Audit Committee has the particular authority to:

- monitor the process of compilation of the financial statements and the consolidated financial statements;
- evaluate the effectiveness of the Company's internal controls, internal audit and risk management system;
- monitor the process of the statutory audit of the financial statements and the consolidated financial statements;
- review the independence of the statutory auditor and the audit firm, and the provision of non-audit services to the Company by the audit firm;
- recommend an auditor;
- receive from and discuss with the auditor all and any information, declarations and communications as per the applicable laws.

Supervisory Board

The Supervisory Board is a supervisory body of the Company. It has fifteen members. It supervises the discharge of the powers by the Board of Directors in managing the business of the Company. The Supervisory Board meets as necessary, once in a quarter as a rule, but at least four times in the course of a calendar year. Two thirds of the Supervisory Board members are elected and recalled by the General Meeting; one third of the Supervisory Board members are elected and recalled by employees of the Company. Members of the Supervisory Board are elected for tenure of five years. The Supervisory Board has a quorum if a simple majority of its members is present at the meeting.

The Supervisory Board has the particular authority to:

- review the regular, extraordinary and consolidated or, as the case may be, interim financial statements and proposals for distribution of profits or the other Company's resources or for coverage of losses, and to submit its standpoint to the General Meeting;
- elect and recall members of the Board of Directors;
- approve agreements on the performance of the office of members of the Board of Directors in compliance with the provisions of Art. 194 (1) of the Commercial Code;
- decide on approval of the rules for provision of non-claim perquisites to members of the Board of Directors of the Company in compliance with the provisions of Art. 194 (1) of the Commercial Code;
- convene the extraordinary General Meeting, if the interests of the Company so require, and propose any necessary measures to the General Meeting;
- submit to the General Meeting and to the Board of Directors its standpoints, recommendations, proposals and results of its inspection activities;
- review the exercise of the powers of the Board of Directors, based on the request of the shareholders who have shares which nominal value amounts to at least 3% of the registered capital, in respect of the matters determined in the application;
- based on the request of the shareholders who have shares which nominal value amounts to at least 3% of the registered capital, claim the right for compensation of damage incurred by the Company vis-à-vis a member of the Board of Directors;
- decide on issues concerning remuneration and other benefits for Board of Directors members insofar as stipulated by law, Articles of Association, individual agreements on the performance of the office of the Board of Directors members or rules approved by the General Meeting;
- decide on issues concerning remuneration and other benefits for Supervisory Board or Audit Committee members insofar as stipulated by law, Articles of Association, individual agreements on the performance of office or rules approved by the General Meeting;
- review Board of Directors report under Art. 66a (9) of the Commercial Code; to inform the General Meeting of the review of this report and to submit its standpoint to the General Meeting.

The Supervisory Board gives to the Board of Directors its prior consent in matters related to the issuing of shares or other debt instruments; intra-group cooperation agreements; investments in or disposal of ownership interests in other companies that involve more than one quarter of the equity capital; more than ten percent of the Company's employees; transformation of the Company; personnel changes in the bodies of subsidiary companies; conclusion of agreements on the transfer of assets; disposal of property exceeding one quarter of equity; and the appointment of the Company Secretary.

Under its powers, the Supervisory Board sets up committees as its advisory and initiative bodies. Committees of the Supervisory Board are an inherent part of corporate governance. The Supervisory Board always institutes a Nomination and Remuneration Committee.

Members of Supervisory Board committees are elected and recalled by the Supervisory Board. The tenure of a member of a Supervisory Board committee is 2.5 years. Committees established by the Supervisory Board can comprise only the members of the Supervisory Board.

Board of Directors

The seven-member Board of Directors is a statutory body that manages the business of the Company and acts on its behalf. The Board of Directors decides on all corporate affairs which, by law or the

Articles of Association, are not reserved for the General Meeting or the Supervisory Board. As a rule, the Board of Directors meets once every calendar month, but at least 12 times in the course of a calendar year. Members of the Board of Directors are elected and recalled by the Supervisory Board. The tenure of a member of the Board of Directors is 5 years. The Board of Directors has a quorum if a simple majority of its members is present at the meeting.

The Board of Directors has the particular authority to:

— secure the business activities and ensure the operational management of the Company;
— approve the Rules of Procedure of the Board of Directors;
— execute the rights of employer;
— convene the General Meeting;
— ensure the preparation and submit to the General Meeting for discussion the matters coming under the authority of the General Meeting;
— implement the General Meeting resolutions in accordance with law and the Articles of Association;
— ensure due and proper keeping of accounts and Company documents, in line with legal regulations applicable;
— submit to the Supervisory Board for review the Company's regular, extraordinary or, as the case may be, interim financial statement, always in its consolidated as well as unconsolidated form, and the proposal for distribution of profit or the other Company's resources or for coverage of losses and the report by the Board of Directors pursuant to the provisions of Art. 66a (9) of the Commercial Code;
— decide on the conclusion of agreements establishing business companies and cooperatives, agreements establishing associations or interest groups, and on capital investment in business companies or cooperatives; on acquisition, cessation, and alienation of participations in other business companies or cooperatives, without limitation to having their registered office in the Czech Republic;
— use the undistributed profits in accordance with the principles set forth by the General Meeting;
— decide on use of the Funds of the Company in accordance with the principles set forth by the General Meeting;
— prepare the report of the Board of Directors on the business activity of the Company and on its property in accordance with the provisions of Art. 192 (2) of the Commercial Code, annual report according to the provisions of Art. 21 of the Act No. 563/1991 Coll., the provisions of Art. 118 of the Act No. 256/2004 Coll., including the report by the Board of Directors pursuant to the provisions of Art. 66a (9) of the Commercial Code, semi-annual report pursuant to the provisions of Art. 119 of the Act No. 256/2004 Coll., interim report or equivalent quarterly information in accordance with the provisions of Art. 119a of Act No. 256/2004 Coll. and a summary explanatory report pursuant to the provisions of Art. 118 (8) of Act No. 256/2004 Coll.;
— determine the course of business policy;
— stipulate principles for the collective agreement;
— decide on use of the Reserve Fund;
— grant and withdraw the power of proxy;
— organize, in compliance with the Commercial Code, election or dismissal of members of the Supervisory Board by the employees and to approve the election rules for such election or dismissal;
— stipulate the rules for the creation and use of the Social Fund on the basis of collective bargaining;
— enter into an agreement on mandatory audit or, if applicable, on other services to be rendered with the auditor;
— discuss the audit report with the auditor.

Board of Directors (as at 31 January 2012)

Luis Antonio Malvido (*1964) Chairman

Graduated in Industrial Engineering at the Instituto Technológico de Buenos Aires. Joined Telefónica in the late 1980s during the privatisation process as a member of a team for the valuation of the target company. Afterwards he worked in various positions in customer service, sales, business development and strategic planning in Telefónica. In June 1998 he was appointed Vice President and Chief Executive Director at Telefónica Móviles Argentina, Unifón, where he was responsible for the start-up of the company, its merger with another regional operator and for the establishment of a nation-wide mobile operator. From January 2005 he was President and Chief Executive Director of Telefónica Venezuela, Movistar and later he became a President of the Quality Committee in Latin America. From January 2008 he was Chief Executive Director at TeleSP, the Telefónica fixed subsidiary in Brazil. In February 2010 he was appointed Chief Executive Officer and Chairman of the Board of Directors of Telefónica Czech Republic.

Jesús Pérez de Uriguen (*1970) 1st Vice-chairman

Graduated in Business Administration at University of Maryland at College Park in 1992, with specialisation in Finance and Accounting, where he got his degree of Bachelor of Science in Business and Management. In 1993, he earned his MBA degree at Instituto de Empresa in Madrid. Before joining Telefónica Czech Republic he worked in Bank of America, Arthur Andersen, Jazz Telecom, S.A., and Telefónica Móviles, S.A. At these companies he gained extensive experience in the telecommunications and finance area – he was responsible for planning, management control, etc. Lastly, he worked in the position of CFO in Telefónica Centroamérica for nearly four years.
He was member of the Board of Directors of Telefónica Moviles in Panamá, El Salvador, Nicaragua and Guatemala. Now he holds the position of Director, Finance Division and 1st Vice-chairman of the Board of Directors in Telefónica Czech Republic.

Petr Slováček (*1959) 2nd Vice-chairman

Graduated from the Technical University, Prague, with a degree in telecommunications from the Faculty of Electro-technical Engineering. Also holds a postgraduate Master of Business Telecommunications (MBT) degree from the Technical University of Delft in the Netherlands. After graduation he joined the Telecommunications Research Institute, Prague, he joined SPT TELECOM (the legal predecessor of Telefónica Czech Republic) in 1989, working in switching, technical development, network management projects and OSS. In 2005–2007 he was Statutory Representative of the subsidiary Telefónica O2 Business Solutions. In June 2008 he was re-elected 2nd Vice-chairman of the Board of Directors of Telefónica Czech Republic. He currently holds the position of Director, Operations Division.

Martin Bek (*1969)
Member

Studied foreign trade at the University of Economics, Prague, and completed his studies at the European Business School, Paris, where he majored in Finance. He worked various French companies: ABC International, DRT International and later Guérard Viala Prague as senior consultant and tax advisor. From 1996, he worked at ČESKÝ TELECOM (the legal predecessor of Telefónica Czech Republic) as Director for Tax and Accounting, later as Executive Director for Planning and Controlling. In April 2004 he was appointed Statutory Representative of Eurotel Praha, spol. s r.o. (the legal predecessor of Telefónica Czech Republic) and since September 2004 he has been Eurotel's Chief Operating Officer. Now he holds the position Director, Division Support Services in Telefónica Czech Republic. He acts as Statutory Representative in Telefónica O2 Business Solutions, NOVELLO and is a member of the Board of Trustees of the O2 Foundation.

Jakub Chytil (*1961)
Member

Graduated from the Faculty of Law, Charles University, Prague, where he got his JUDr. degree. In 1991–1995, he was a junior associate and, later on, an attorney specialising in commercial and civil law, working with international law firms. In 1995–2000, he was a Legal Counsel for the Czech and Slovak Republic at Philip Morris ČR and Kraft Foods. In 2000–2003, he was the Senior Counsel of Philip Morris International, Lausanne, Switzerland, where he was responsible for the legal affairs of Philip Morris International's subsidiaries in various countries. Since his arrival to ČESKÝ TELECOM (the legal predecessor of Telefónica Czech Republic) in December 2003 he has been in the position of Director, Legal Affairs, and from 2010 he is Director, Legal and Regulatory and Public Affairs. From May 2006 he has been the Company Secretary and he is also a member of the Board of Trustees of the O2 Foundation..

John Gerald McGuigan (*1960)
Member

Before joining O2, John was the Chief Executive and executive board member of NHS24, a telephone triage service for Scotland and held this position for 2 years. He joined Telefónica O2 UK in 2007 and was General Manager for the consumer segment in three sites: Glasgow, Preston Brook and Bury. From 2009 to 2011 he was Chief Executive Officer of Telefónica Slovakia. In November 2011 he moved to Telefónica Germany as Managing Director for Sales and Customer Service. From 2010 he is a statutory representative of Tesco Mobile Slovakia.

František Schneider (*1967)
Member

He graduated in Artificial Intelligence at the University of West Bohemia, Pilsen, and went on to start his professional career in Vikomt CZ. From 1997 he worked in Dell Computer, where started as Director for Sales to Small and Medium Enterprises, Czech and Slovak markets. In 2001 he became Business Development Manager for Eastern Europe, Middle East and Africa, where he managed development projects aimed at effective capture of the corporate market. This job took him also to Israel, Turkey, Saudi Arabia, United Arab Emirates and Russia. In 2003 he went to Greece to manage the start-up of a new branch for which he also designed a medium-term business development plan. From May 2004 he was managing director for the Czech and Slovak markets and Statutory Representative of Dell Computer. He joined Telefónica Czech Republic in April 2008 as Executive Director, Corporate Sales, and presently holds the position of Director, Business Division. In 2007–2011 he was a member of the board of trustees of the endowment fund Srdce na dlani.

Overview of membership in the Board of Directors of Telefónica CR as at 31 January 2012

Name	Position	Member since
Luis Antonio Malvido	Chairman of the Board of Directors	1 February 2010
Jesús Pérez de Uriguen	1st Vice-chairman of the Board of Directors	1 May 2008
Petr Slováček	2nd Vice-chairman of the Board of Directors	14 June 2008
Martin Bek	Member of the Board of Directors	27 April 2006 re-elected by the Supervisory Board on 18 February 2011 (with effect from 28 April 2011)
John Gerald McGuigan	Member of the Board of Directors	27 October 2009
Jakub Chytil	Member of the Board of Directors	26 April 2006 re-elected by the Supervisory Board on 18 February 2011 (with effect from 28 April 2011)
František Schneider	Member of the Board of Directors	4 November 2010

Executive management (as at 15 March 2011)

Listed below are the executive managers of the Company:

Luis Antonio Malvido (*1964)
Chief Executive Officer
(résumé in section Board of Directors)

Jesús Pérez de Uriguen (*1970)
Director, Finance Division
(résumé in section Board of Directors)

Petr Slováček (*1959)
Director, Operations Division
(résumé in section Board of Directors)

Martin Bek (*1969)
Director, Support Units
(résumé in section Board of Directors)

Jakub Chytil (*1961)
Director, Legal, Regulatory and Public Affairs, Company Secretary
(résumé in section Board of Directors)

František Schneider (*1967)
Director, Business Division
(résumé in section Board of Directors)

Jiří Dvorjančanský (*1969)
Director, Marketing Division

Jiří Dvorjančanský graduated from the Czech Technical University in Prague and also holds a D.E.A. degree from National Polytechnique Institut in Grenoble, France. He subsequently earned his MBA in the executive MBA programme at Thunderbird School of Global Management in Prague. He joined Telefónica Czech Republic from Deutsche Telekom Group where he worked for 11 years in various executive positions in the field of sales and marketing. He was also Executive Director, Marketing Division at T-Mobile Czech Republic; he was later promoted to the same top executive position in T-Mobile Germany. His international experience also includes membership in the Supervisory Board of T-Mobile UK and a standing membership in the International Marketing Board of T-Mobile Group. Jiří Dvorjančanský joined Deutsche Telecom from the position of Sales Director at COTY.

Dana Dvořáková (*1965)
Director, Corporate Communication

Graduate from the University of Economics, Prague; completed her postgraduate education in Corporate Communication at the Erasmus University, Rotterdam and earned her MBA from the University of Pittsburgh in the United States. She started her professional career as a journalist writing about the economy for Hospodářské noviny and MF Dnes, later she managed public relations and marketing in large corporations (Český Telecom, Všeobecná úvěrová banka, ČSA and Unipetrol). In 2009 she was recognised as PR Manager of the Year by the Association of Czech PR Agencies. In May 2011 Dana Dvořáková was appointed Director, Corporate Communication in Telefónica Czech Republic. She is responsible for corporate communication, CSR and the O2 Foundation.

Ctirad Lolek (*1973)
Director, Human Resources

Ctirad Lolek is a graduate of the Palacký University in Olomouc where he studied sociology and andragogy with a specialisation in HR management. After graduation he worked in several positions in human resources for multinational companies such as Kapa Karton Morava and EPCOS. In 2001 he was appointed HR director for The Timken Company, where he oversaw the start-up of a new plant in the Czech Republic; later he managed HR activities in Central and Eastern Europe. In 2008 he joined ArcelorMittal Ostrava as HR Director – he was responsible for HR strategy and management, served on the Board of Directors and, after two and half years started as HR Director of the Luxembourg-based division ArcelorMittal Long Carbon Europe. He joined Telefónica Czech Republic in 2011 as Director, Human Resources Division. In this position he is responsible for the management of human resources in the Czech Republic and in Slovakia. He is a member of the board of the health insurance fund Metal-Aliance.

Luis Aldo Martin (*1962)
Director, Consumer Division

Luis Aldo Martin graduated in Construction Engineering from Universidad Católica Argentina in 1987. Later he continued with his postgraduante studies at Universidad de Ciencias Empresariales y Sociales which he completed in 1997 with a Masters degree in Marketing and Strategic Management. Before joining Telefónica, he worked for 12 years for ESSO S.A. Petrolera Argentina. In this multinational oil and gas company he progressed through various positions and areas, including retail, project management, sales coordinator supervisor, retail director, retail business development director, etc. Later he worked for two years in Tambos San Isidro Labrador S.A., which produced ice cream and operated zoological gardens, where he, as retail project director, succeeded in expanding substantially the retail network, improving the quality of products and enhancing customer experience. He also successfully managed a project of development of the Temaiken zoo.
Luis Aldo Martin joined Telefónica in 2000 in the department of channel partners in Telefónica Móviles Argentina S.A. and its Movistar brand. In this position he built and managed a network of 1,400 points of sale across Argentina. In 2006–2008 he worked as Operations Director for Norte region in Argentina. Before coming to the Czech Republic he managed sales and distribution, including direct and partner channels in the region and the country. In the last five years he was not a member of any other governing, executive or supervisory bodies outsider Telefónica Czech Republic.

Report by the Supervisory Board of Telefónica Czech Republic

In keeping with the Company's Articles of Association, the Supervisory Board of Telefónica Czech Republic in 2011 supervised the discharge of the Board of Directors' powers and the running of the Company's business. Supervisory Board members have the power to inspect all documents and records concerning the Company's activities; check whether the accounting records are kept to reflect the reality; determine whether the business of Telefónica Czech Republic is done in compliance with the law, Articles of Association and instructions of the General Meeting.

The Supervisory Board continuously monitored the activities of Telefónica Czech Republic and key decisions made by the Board of Directors and the management. Further, the Supervisory Board addressed the suggestions raised by its committees and its members individually. Board of Directors and the management provided the Supervisory Board with the documentation and information necessary for the discharge of its functions in accordance with the legislation and the Articles of Association. The Supervisory Board worked in close contact with the Audit Committee of Telefónica Czech Republic regarding all principal matters falling to the authority of both the governing bodies.

At the meeting held on 17 February 2012, the Supervisory Board reviewed the audited annual financial statements for the year 2011 (unconsolidated and consolidated) prepared in accordance with the International Financial Reporting Standards. The Supervisory Board also reviewed the Board of Director's proposal for the distribution of profit for the year 2011 and of the retained earnings of the Company, and, as the case may be, any disposable funds of the Company, and the determination of royalties for the year 2011. In both instances, the Supervisory Board issued a recommendation to the General Meeting of the Company to approve the proposals.

In Prague, 17 February 2012

José María Álvarez-Pallete López
Chairman of the Supervisory Board

Supervisory Board (as at 31 January 2012)

José María Álvarez-Pallete López (*1963) Chairman

Mr. Álvarez-Pallete has a degree in Economics from the Complutense University of Madrid. He also studied Economics at the Free University of Brussels, in Belgium, holds an international Management Programme from IPADE and an Advance Research Degree from the Complutense University of Madrid. In February 1999 he joined the Telefónica Group as a General Manager of Finance for Telefónica Internacional, S.A. In September of the same year it was given the post of General Manager of Corporate Finance in Telefónica, S.A. In July 2002 he was appointed Chairman and CEO of Telefónica Internacional, S.A. In July 2006, Managing Director of Telefónica Latin America and Chairman, and in March 2009, CEO of Telefónica Latin America. From 5 September 2011 he serves as Chairman and CEO of Telefónica Europe and Member of the Board of Telefónica, S.A., position that holds from July 2006. He is also one of Members of the Telefónica Executive Committee. He began his professional career with Auditors Arthur Young in 1987, before joining Benito & Monjardín / Kidder, Peabody & Co. in 1988. After this, in 1995, he joined the Company of Cementos Portland (Cemex) as head of the Investor Relations and Studies Department. In 1996, he was promoted to Financial Manager for Spain and in 1998, to General Manager for Administration and Finance responsible for the Cemex Group's interests in Indonesia and member of the Board of Cemex Asia, Ltd. In 2001, he won the CFO Europe Best Practice Award in the category of Mergers and Acquisitions 2000 by the CFO Europe Magazine (The Economist Group). He is also Honorific Member of Carlos III Foundation Latin-American Forum since April 2003 and in July 2007, he won the 'Forum de Alta Dirección' Golden Master. The 4th of October 2011, he was awarded as the Best Business Leader 2011 by El Economista.

María Eva Castillo Sanz (*1962) 1st Vice-chairman

Eva Castillo led the Global Wealth Management business of Bank of America Merrill Lynch in Europe, Middle East and Africa (EMEA) from 2006 to 2009, having held a number of other senior positions in Merrill Lynch from 1997, including head of Global Markets and Investment Banking in Iberia and President of Merrill Lynch Spain and, before that, as Chief Operating Officer for Merrill Lynch EMEA Equity Markets. Previously she had worked for the International Equities division of Goldman Sachs in London between 1992 and 1997. Her career in the financial services industry began at the Spanish broker Beta Capital in Madrid, where she worked from 1988 until 1992. She has been a non-executive director of Telefónica, S.A., since the beginning of 2008 and She serves as non-executive director of Old Mutual plc since February 2011. She has a Bachelor of Arts in Business and Law from the Universidad Pontificia de Comillas – ICADE E3 in Madrid.

Lubomír Vinduška (*1956)
2nd Vice-chairman

Graduated in radio communications from the Secondary School of Electrical Engineering. In 1974–1979 he worked as a TV repairman and later as an electrical technician at Okresní kovopodnik Praha-východ (Prague-East Regional Metal Works), then at TESLA Strašnice and Czechoslovak Radio. He has been with Telefónica Czech Republic and its legal predecessors since 1979. He worked as an energy operations foreman, head of energy operations and head of territorial transport and mechanisation, Prague. At present he holds the position of Transport and Mechanisation Specialist. He is Deputy Chairman for Telecommunications of the Post, Telecommunications and Newspaper Services Employees Trade Union, Deputy Chairman of the Trade Union Steering Committee at Telefónica Czech Republic and Chairman of the Prague Trade Union Steering Committee. In 2005 and 2009 he completed courses in International Financial Reporting Standards and financial relations within a group of companies. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Antonio Botas Bañuelos (*1963)
Member

Antonio Botas earned his Bachelor degree at Universidad Complutense in law and a Masters degree in Economics and Business Administration (MBA) at IESE in Barcelona. He has twenty years of experience in management, operative and strategic marketing and co-ordination of large multinational teams, and he has worked in international markets, namely those in the Americas and Europe. He worked as Marketing Manager in Royal Insurance, which he joined after leaving Johnson & Johnson. He joined the Telefónica Group in 1995 and he worked for Telefónica Publicidad e Informacion, Doubleclick Iberoamérica, Terra and Terra Lycos in positions ranging from Chief Sales and Marketing Officer to Executive Vice President for New Business. From 2005 until August 2007 he worked as Chief Transformation and Convergence Officer in Telefónica Czech Republic. From September 2007 he serves as Managing Director Product Development & Brand Management at Telefónica Germany GmbH & Co. OHG. He has been a member of the Supervisory Board of Telefónica Czech Republic since April 2008. From 2010 he has served as Director of International Coordination Global Marketing in Telefónica, S.A.

Patricia Cobian Gonzalez (*1975)
Member

Patricia Cobian is Business Development Director for Telefónica Europe, in charge of strategic initiatives, new business opportunities and the coordination with Telefónica Digital and Telefónica Global Resources. Prior to that she was Business Manager for Telefónica Europe's Chairman and CEO. She joined the Telefónica Group in 2006 as Vice President for Strategy and Development for O2 Group. Prior to joining the Telefónica Group, Patricia spent seven years with McKinsey & Company, where she was a member of the Telecommunications and Corporate Finance practices in the Madrid, New York and London offices. She started her career at Hewlett-Packard in the Financial Services Division. Patricia holds a MSc. in Industrial Engineering from Universidad Pontificia Comillas – ICAI, Madrid.

Vladimír Dlouhý (*1953)
Member

Graduated from the University of Economics in Prague; in 1977–1978 he also studied at the Catholic University in Leuven, Belgium. In 1980–1982 he got his postgraduate degree in Probability and Mathematical Statistics from the Charles University in Prague, where he worked as research assistant at the Department of Econometrics after he completed his undergraduate studies at the University of Economics. In 1984 he was one of the founding members of the Forecasting Institute of the Czechoslovak Academy of Sciences, where he worked first as a researcher and finally as deputy director. In 1989–1992 he was Minister for Economy of the Czech and Slovak Federal Republic; from 1992 until June 1997 he was Minister of Industry and Trade of the Czech Republic. He was a member, and later deputy chairman of the Civic Democratic Alliance and member of the Czech parliament. From 1997 until the present he works as an international consultant for the investment bank Goldman Sachs; in 1998–2010 he consulted for ABB. He presently serves also as Chairman at Chayton Capital (London), Meridiam Infrastructure (Paris) and holds membership in the board of directors at KSK Power Ventur in Hyderabad (India). In 2000 he started teaching at the Faculty of Social Sciences, Charles University in Prague, and in 2004–2010 he taught at the University of Economics in Prague, also serves as a member of the scientific council of the Faculty of the National Economy. He is also a member of the supervisory Board at the Illinois Institute of Technology in Chicago, deputy chairman of the Trilateral European Group and a member of the European group of advisors to the International Monetary Fund. He authored many research and popular papers and he speaks English, Spanish, Russian, German and French.

Tomáš Firbach (*1976)
Member

Graduated in Management and Economics in Transportation from the Czech Technical University, Faculty of Transportation. After his graduation in 1999 he worked in JSJ as information systems manager. In 2001 he joined Eurotel Praha (the legal predecessor of Telefónica Czech Republic) as network planning specialist. In 2004–2005 we worked in ČD Telekomunikace (presently ČD Telematika, a.s.) as business consultant. He has been with Telefónica Czech Republic since 2005, presently in the position of Senior Key Account Manager. In the last five years he was not a member of any other governing, executive or supervisory bodies outsider Telefónica Czech Republic.

Petr Gazda (*1965)
Member

Graduated in Economics and Management from the Business College Ostrava. He has been with Telefónica Czech Republic (and its legal predecessors) since 1991; he presently works as Network Operations Director. Previously: 1991–2006 Eurotel Praha; 1988–1991 ČESKÝ TELECOM; 1986–1988 AŽD Praha, specialist; 1983–1984 AŽD Praha, electrical engineer. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Pavel Herštík (*1951)
Member

Graduated in communication technology from the Secondary Technology School of Electrotechnical Engineering. In 1972, he started working as a telephone test centre technician in Ředitelství telekomunikací Praha (Telecommunications Headquarters, Prague). For the next 20 years (1975–1995), he worked in the field of work procedure planning, evaluation and work efficiency measurement. From 1995 to 2005, he was Head of Information Management and went on to become Head of the Management, Organisation and Administration Department. At present, he is Senior Specialist in the area of management and administration of management documents. In 2005 and 2009 he completed courses in international accounting standards and intra-holding relationships. In 2007 he was certified under the National Certification Programme for Corporate Ethics and Culture. He is Chairman of the Trade Union Steering Committee of Telefónica Czech Republic. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Maria Pilar López Álvarez (*1970)
Member

A graduate of Business Studies, she joined Telefónica after working for several years at JP Morgan in London and New York where she worked her way up to Vice President. She joined the Telefónica Group 1999 in Telefónica de España's Strategic Planning Department. In May 2000 she was appointed Director of Management Control at Telefónica, S.A. Two years later she joined Telefónica Móviles S.A. to head up its Management Control function. In October 2006 she was promoted to Director of Strategy and Business Development at Telefónica de España. On 1 March 2007 she was appointed Chief Financial Officer of Telefónica Europe plc (now Telefónica Europe plc). She serves on the board of Telefónica Europe.

Enrique Medina Malo (*1972)
Member

Holds a law degree from Carlos III University of Madrid and was admitted to the Spanish Government Legal Services in 1997. From 2002 to 2004 he was appointed General Director for Legislation of the Ministry of Science & Technology. He has been Chief Legal Officer of the Spanish Broadcasting Corporation. Until 2006, he served as State Lawyer for the Public Administration, Ministry of Science and Technology, Ministry of Industry and Energy and the High Court of Cataluña. He joined Telefónica on 2006, as Public Law Manager and afterwards Telecommunications and Information Society Legal Affairs Manager being the responsible of regulation and competition legal issues. On 2008 he was appointed Chief Legal Officer of Telefónica, S.A., reporting to the Group's General Counsel. From September 2011 until the present he has held the position of General Counsel of Telefónica Europe. He serves on the board of Telefónica Europe.

Dušan Stareček (*1956)
Member

Qualified in Electronic and Electrical Technology at the Technical and Engineering Secondary School in Rožnov p. Radhoštěm. In 1975, he started work as a technician at Long-distance Cables Administration, Prague (the legal predecessor of ČESKÝ TELECOM). In 1992, he was promoted to the position of Head of External Maintenance in the Transmission Technology Unit (the legal predecessor of Telefónica Czech Republic). At present, he works as Specialist for Operation and Maintenance of Digital Telecommunications Technology in Ostrava. He is Chairman of KOV MORAVA and member of EWC (European Works Council) at Telefónica Europe plc. He serves as Vice-chairman of the Ethics and Corporate Social Responsibility Committee of Telefónica Czech Republic. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Ángel Vilá Boix (*1964)
Member

He is General Manager for Finance and Corporate Development and member of the Executive Committee at Telefónica, S.A. Mr Vilá joined Telefónica in 1997 as Group Controller, moving on to become CFO of Telefónica Internacional, where he led the Telebras privatisation team. In 2000, he was appointed Group Head of Corporate Development. In this position, he executed landmark corporate acquisitions such as O2 plc and Brasilcel/Vivo and took part in the initial investment of Telefónica in China Netcom. Other significant transactions would include Telco SpA and Český Telecom, as well as the disposals of Airwave and TPI. From 2010, Mr. Vilá also oversaw the Affiliates group, comprising Atento, T- Gestiona and Telefónica Contenidos. Prior to joining Telefónica, he held positions at Citigroup, McKinsey&Co, Ferrovial and Planeta. Ángel Vilá is member of the Board of Directors of Telco SpA (Italy), Telefónica Digital, Telefónica Contenidos, Telefónica Czech Republic and Digital Plus. He previously served on the Boards of BBVA, Endemol, Atento, CTC Chile and Terra Lycos, and the Advisory panel of Macquarie MEIF funds. Mr. Vilá graduated in Industrial Engineering from Universitat Politècnica de Catalunya and holds a MBA from Columbia University (New York).

Overview of membership in the Supervisory Board of Telefónica CR as at 31 January 2012

Name	Position	Member since
José María Álvarez-Pallete Lopez	Chairman of the Supervisory Board	8 November 2011
María Eva Castillo Sanz	1st Vice-chairman of the Supervisory Board	7 May 2010
Lubomír Vinduška	2nd Vice-chairman of the Supervisory Board	29 June 2008
Antonio Botas Bañuelos	Member of the Supervisory Board	21 April 2008
Patricia Cobian Gonzalez	Member of the Supervisory Board	8 November 2011
Vladimír Dlouhý	Member of the Supervisory Board	Co-opted on 18 February 2011 Elected by the General Meeting on 28 April 2011
Tomáš Firbach	Member of the Supervisory Board	29 June 2008
Petr Gazda	Member of the Supervisory Board	29 June 2008
Pavel Herštík	Member of the Supervisory Board	29 June 2008
Maria Pilar López Álvarez	Member of the Supervisory Board	26 July 2007
Enrique Medina Malo	Member of the Supervisory Board	8 November 2011
Dušan Stareček	Member of the Supervisory Board	29 June 2008
Ángel Vilá Boix	Member of the Supervisory Board	23 June 2005 Re-elected by the General Meeting on 7 May 2010 (with effect from 24 June 2010)

All changes in the personnel composition in the Supervisory Board in 2011 were described in the 2010 Annual Report and in the 2011 Half-year Report.

In the second half of 2011 and in the period starting 1 January and ending 31 January 2012, the following changes occurred in the personnel composition of the Supervisory Board:

Alfonso Alonso Durán	resigned from membership and chairmanship in the Supervisory Board with effect from 8 November 2011
Eduardo Andres Julio Zaplana Hernández-Soro	resigned from membership in the Supervisory Board with effect from 8 November 2011
Anselmo Enriquez Linares	resigned from membership in the Supervisory Board with effect from 8 November 2011
Guillermo José Fernández Vidal	resigned from membership in the Supervisory Board with effect from 8 November 2011
Luis Lada Díaz	resigned from membership in the Supervisory Board with effect from 8 November 2011
José María Álvarez-Pallete Lopez	co-opted in the Supervisory Board and elected Chairman on 8 November 2011 pending confirmation at the next General Meeting
Patricia Cobian Gonzalez	co-opted in the Supervisory Board on 8 November 2011 pending confirmation at the next General Meeting
Enrique Medina Malo	co-opted in the Supervisory Board on 8 November 2011 pending confirmation at the next General Meeting

Audit Committee (as at 31 January 2012)

María Eva Castillo Sanz (*1962) Chairman

(résumé in section Supervisory Board)

Maria Pilar López Álvarez (*1970) Vice-chairman

(résumé in section Supervisory Board)

Vladimír Dlouhý (*1953) Member

(résumé in section Supervisory Board)

Pavel Herštík (*1951) Member

(résumé in section Supervisory Board)

Jaime Smith Basterra (*1965) Member

Graduated in Economics and Business Administration (BA, Universidad Comercial Deusto, Spain) and holds an MA in Finance and Investments (Exeter University, UK). Before joining Telefónica, he worked in the financial sector for a Spanish brokerage firm, and for Banesto (BSCH Group) as Director for Global Equities in its fund management division. He joined the Telefónica Group in 1999 as Director for Financial Planning at Telefónica Internacional, and was promoted to Chief Financial Officer in December of the same year. In October 2000, he was appointed Controller of the Telefónica Group. From December 2002 he held the position of Chief Financial Officer of Telefónica de España. In June 2005 he was made Chief Executive Office and Chairman of the Board of Directors of ČESKÝ TELECOM (now Telefónica Czech Republic). In June 2007 he was promoted to Chief Executive Officer of Telefónica O2 Germany GmbH. Since June 2009 he was made Director of Subsidiaries and Industrial Alliances of Telefónica, S.A. From October 2010 he is Director of Telefónica Mobile Operations in Mexico, Central America and Venezuela. From 2006 to 2009 he was also a member of the Board of Directors of Telefónica Europe plc. In 2006–2009 he served as Chairman of the Supervisory Board of Telefónica Czech Republic.

Overview of membership in the Audit Committee of Telefónica CR as at 31 January 2012

Name	Position	Member since
María Eva Castillo Sanz	Chairman of the Audit Committee	7 May 2010
Maria Pilar López Álvarez	Vice-chairman of the Audit Committee	3 April 2009
Vladimír Dlouhý	Member of the Audit Committee	8 November 2011 (elected substitute member on 28 April 2011)
Pavel Herštík	Member of the Audit Committee	3 April 2009
Jaime Smith Basterra	Member of the Audit Committee	3 April 2009

All changes in the personnel composition in the Audit Committee in 2011 were described in the 2010 Annual Report and in the 2011 Half-year Report.

In the second half of 2011 and in the period starting 1 January and ending 31 January 2012, the following changes occurred in the personnel composition of the Audit Committee:

Alfonso Alonso Durán	resigned from membership in the Audit Committee and from his vice-chairmanship of the Audit Committee with effect from 8 November 2011
Vladimír Dlouhý	became member of the Audit Committee by succession from his substitute membership

Rules for the remuneration of persons with executive powers in the issuer

The group of persons with executive powers in Telefónica CR includes the following executives: members of the Board of Directors, the Chief Executive Officer and those members of the executive management of the Company (sub-section Executive management) who are not members of the Board of Directors (persons who make decisions in the issuer, which can affect the future development and the corporate strategy of the issuer, and who have access to insider information).

The remuneration of members of the Board of Directors and the Supervisory Board (including the members of Supervisory Board committees), as well as the granting of other benefits to members of the Supervisory Board, is governed by the rules for the remuneration and awarding of non-claim benefits which are approved by the Company's General Meeting. The approval of the rules for awarding non-claim benefits to members of the Board of Directors is, as per the Company's Articles of Association (Article 20(3d)), in the competence of the Company's Supervisory Board. The adequacy of the system of remuneration (and other benefits) and any modifications thereto are reviewed and proposed by the Nomination and Remuneration Committee of the Supervisory Board (see sub-section Committees established by the Governing Bodies of the Company below).

The rules of remuneration provide specific amounts of remuneration for individual categories of members of the Board of Directors and of the Supervisory Board (including the Supervisory Board committees), i.e. the remuneration which a regular member, vice-chairman and chairman of the body are entitled to, as well as other conditions for the granting of the remuneration. Each member of the Board of Directors/Supervisory Board is entitled to the whole amount of remuneration on the condition that he/she makes a claim for it; if the member of the Board of Directors/Supervisory Board does not make a claim for the whole amount of remuneration, he/she will be remunerated only in the extent in which a claim was made.

In 2011, no changes occurred in the principles for remuneration of members of the Company's governing bodies as they were described in the 2010 Annual Report.

Basic information about the rules for the remuneration, including a list of non-claim benefits, for members of the Board of Directors and the Supervisory Board and of the members of the Supervisory Board committees is given below. The full text of the new Rules for the Remuneration of Members of the Governing Bodies of Telefónica CR is published in the Czech and English languages on the Company's website (www.telefonica.cz).

The Board of Directors and Chief Executive Officer

a) Remuneration

The rules for the remuneration of members of the Company's Board of Directors, whose key principles are outlined above, stipulate a two-component flat monthly remuneration, which comprises the following:

— an amount covering mandatory payments (e.g. taxes, health insurance contributions, etc.) which a member of the Board of Directors is liable to pay due to the fact that they are covered by a liability insurance for any damage arising from the performance of a member of the Board of Directors, and mandatory payments arising from the provision of the amount as per this sentence. The amount depends on the amount of insurance premium attributable to the member of the Board of Directors; the overall amount is calculated using methods common in the business of insurance;
— an amount attributable to the individual categories of members of the Board of Directors for the number of meetings attended: (i) member of the Board of Directors: CZK 25,000; (ii) Vice-chair of the Board of Directors: the amount as in (i) plus CZK 10,000; Chair of the Board of Directors: the amount as in (ii) plus CZK 10,000. In 2011, the members of the Board of Directors did not claim their remuneration for meetings.

The Chief Executive Officer is also entitled by virtue of his/her function to additional remuneration which comprises the following components:

— basic gross salary;
— performance-related bonus;
— compensation of the balance between the health insurance benefits and 100% of the average daily wage.

The performance-related bonus is granted to the Chief Executive Officer conditional on delivering on the targets set for the CEO for the calendar year in question. These targets are directly correlated to the annual budget and business plan approved by the Board of Directors. The targets represent the key performance indicators of both financial and non-financial nature (e.g. delivering the projected operating profit, achieving the revenue targets, attaining a higher level of customer satisfaction). The performance against these targets is evaluated by the Board of Directors and discussed by the Nomination and Remuneration Committee of the Supervisory Board; the audited financial results and, in the case of customer experience, independent (external) surveys form the basis for consideration. The performance-related bonus may, in aggregate for the calendar year, reach 80% of the total annual income if the targets are achieved to a standard level. Other non-pecuniary benefits are connected with the relocation of the executive from his/her home country to the Czech Republic (accommodation in Prague, flights for visiting the family, contributions towards school fees at the international school in Prague, international health insurance). In the event of temporary work incapacity, the Company will compensate to the Chief Executive Officer, for each day of the work capacity, the balance between the health insurance benefits and the 100% of the average daily salary.

The remuneration due to persons who are members of the Board of Directors by virtue of performing an executive (management) function in Telefónica CR comprises two components: a gross basic salary and a performance-related bonus awarded in relation to delivery on specific annual targets. The methods of target setting, performance evaluation and control are governed by the same rules and procedures as in the case of the Chief Executive Officer. The performance-related bonus may, in aggregate for the calendar year, reach 50% or 40% of the total annual income if the targets are achieved to a standard level. The overall performance of the persons in their management positions is assessed by the Chief Executive Officer.

b) Compensation for the commitment to a non-competition covenant

A member of the Board of Directors may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the same), unless such business is done in another member of the Group. The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the Supervisory Board of the Company.

The compensation for the commitment to the non-competition covenant is based on the following principles:

— the non-competition covenant is accepted for a period of six months as of the termination of office;
— the Company is obliged to provide to the member of the Board of Directors in question, for committing to the non-competition covenant, compensation amounting to six times the average flat remuneration as laid down in the Rules for the Remuneration of Members of the Board of Directors, in an amount attributable to one member of the Board of Directors, in the month preceding the month in which the member of the Board of Directors terminated their position in the Board of Directors; the fact that any member of the Board of Directors has or has not made a claim to their remuneration is not considered in the calculation of the average flat remuneration.

Upon terminating his/her employment, the Chief Executive Officer is bound by the non-competition covenant covering the whole Telefónica Group.

c) In-kind benefits

Damage liability insurance
The Company, as the policy holder, contracted an insurance policy covering against damage caused in relation to the performance of designated functions; the insured persons (i.e. persons whose functions are covered by the policy) may include members of the Board of Directors. The total insurance premium paid by the Company is evenly divided amongst the insured persons and the amount calculated per insured person constitutes their income.

Endowment insurance
No endowment insurance has been contracted for members of the Board of Directors in relation to their duties as members.

Car
Members of the Board of Directors are not provided with cars for private use in connection with their duties as members. The Chief Executive Officer is provided with a car both for work and private use. Other executive members of the Company's Board of Directors are, by virtue of their executive, entitled to the same benefit.

The Supervisory Board

a) Remuneration

The rules for the remuneration of members of the Company's Supervisory Board, whose key principles are outlined above, implement a two-component monthly flat remuneration, which comprises the following:

— an amount covering mandatory payments (e.g. taxes, health insurance contributions, etc.) which the member of the Supervisory Board is liable to pay due to the fact that they are covered by a liability insurance for any damage arising from the performance of a member of the Supervisory Board, and mandatory payments arising from the provision of the amount as per this sentence. This amount depends on the amount of insurance premium attributable to the member of the Supervisory Board; the overall amount is calculated using methods common in the business of insurance;
— an amount attributable to the individual categories of Supervisory Board members for the number of meetings attended: (i) member of the Supervisory Board: CZK 40,000; (ii) Vice-chairman of the Supervisory Board: the amount as in (i) plus CZK 20,000; Chairman of the Supervisory Board: the amount as in (ii) plus CZK 20,000.

If a member of the Supervisory Board is at the same time member of any of the committees established by the Supervisory Board, they are entitled to remuneration for working in the committee, which is construed as a bonus per meeting of the committee, as follows: (i) member of the committee: CZK 10,000; (ii) vice-chairman of the committee: the amount as in (i) plus CZK 12,000; (iii) chairman of the committee: the amount as in (ii) plus CZK 15,000.

b) Compensation for the commitment to a non-competition covenant

A member of the Supervisory Board may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the same), unless such business is done in another member of the Group. The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the General Meeting.

The compensation for the commitment to the non-competition covenant is based on the following principles:

— the non-competition covenant is accepted for a period of six months as of the termination of office;
— the Company is obliged to provide to the member of the Supervisory Board in question, for committing to the non-competition covenant, compensation amounting to six times the average flat remuneration as laid down in the Rules for the Remuneration of Members of the Supervisory Board, in an amount attributable to one member of the Supervisory Board, in the month preceding the month in which the member of the Supervisory Board terminated their position in the Supervisory Board; the fact that any member of the Supervisory Board has or has not made a claim to their remuneration is not considered in the calculation of the average flat remuneration.

c) In-kind benefits

Damage liability insurance
The Company, as the policy holder, contracted an insurance policy covering against damage caused in relation to the performance of designated functions; the insured persons (i.e. persons whose functions are covered by the policy) may include members of the Supervisory Board. The total insurance premium paid by the Company is evenly divided amongst the insured persons and the amount calculated per insured person constitutes their income.

Endowment insurance – this discretionary benefit was deleted by decision of the General Meeting of 3 April 2009 from the Rules for the Awarding of Discretionary Benefits to Supervisory Board Members as part of the amendment to this policy.

Car
The Supervisory Board Chairman and Vice-chairman are, according the Rules approved by the General Meeting, entitled to a car (class D or E) for work and private use. This benefit has not been claimed since mid-2005.

Other benefits

The company also granted the following benefits to members of the Board of Directors (including the Chief Executive Officer) and to members of the Supervisory Board:

— voice and data services and products of the Company for business and private use (excluding doing business in one's own name);
— communication and IT equipment (mobile telephone, desktop PC or notebook, PDA, including accessories) for business and private use (excluding doing business in one's own name);
— VISA payment card (in the case of the Supervisory Board, only the Chairman and Vice-chairmen were eligible; the benefit has not been claimed in 2011);
— medical care.

The above benefits were granted to persons in the position of member of the Board of Directors by virtue of having an executive (management) position in the Telefónica Czech Republic Group, for the compliance with the duties arising from their functions. In the case of Supervisory Board members, awarding of in-kind benefits is governed by the rules for the award of non-claim benefits to members of the relevant governing body.

Other information relating to persons with executive powers

Information about pecuniary and in-kind income received in the accounting period by persons with executive powers (with the exception of persons who make decisions in the issuer, which can affect the future development and the corporate strategy of the issuer, and who have access to insider information) from Telefónica CR and entities controlled by it

(in CZK)	Pecuniary income	Of which royalties	In-kind income
Board of Directors – total	69,103,743	0	28,812,631
— of which by virtue of membership in the issuer's Board of Directors	462,000	0	1,431,409
Supervisory Board – total	11,315,385	0	3,381,186
— of which by virtue in the issuer's Supervisory Board	5,596,204	0	3,006,521

The information about pecuniary and in-kind incomes of the Board of Directors collectively includes also incomes from the subsidiary Telefónica Slovakia, s.r.o. In 2011, members of the Supervisory Board received no pecuniary or in-kind income from entities controlled by Telefónica.

(in CZK)	Pecuniary income	Of which royalties	In-kind income
Executive management [1]	19,448,581	0	5,002,694

[1] The category Executive Management of the Company includes income of persons listed in the sub-section Executive Management; the income of these persons who are at the same time members of the Board of Directors is shown in the table above, line Board of Directors – total.

Information on the number of shares issued by Telefónica CR and held by statutory bodies or their members, persons with executive powers, including persons related to these persons, information on option and similar agreements, information on individual transactions concluded by the said persons in the accounting period

	Number of shares
Board of Directors	0
Supervisory Board	100
Audit Committee [1]	0
Other persons with executive powers – Executive management [2]	0

[1] Shares held by members of the Audit Committee who are also members of the Supervisory Board, are accounted for in the Supervisory Board total category.

[2] The Executive management category includes the shares held by executives in the positions that members of the Executive Management of Telefónica CR (see sub-section Executive management). The shares held by those members of the Board of Directors who, at the same time, qualify as Executive Management are accounted for in the Board of Directors total category.

No conflict of interest was found in relation to members of the Board of Directors, Supervisory Board and executive management; no member has been, in the last five years, lawfully sentenced for fraud, nor been – as a statutory or supervisory body – a party to insolvency proceedings, nor been subject to receivership or liquidation, nor charged or sanctioned by statutory or regulatory bodies.

Information on work contracts and similar contracts concluded between members of the Board of Directors, the Supervisory Board and the Audit Committee with the issuer

In 2011, all members of the Board of Directors and of the Supervisory Board, with the exception of the substitute member of the Supervisory Board (José María Álvarez-Pallete Lopez, Patricia Cobian Gonzalez and Enrique Medina Malo) who were co-opted by the Supervisory Board on 8 November 2011, were bound by a valid agreement for discharge of the office of a member, which stipulates the eligibility for compensation for members who had committed to the non-competition covenant after the termination of their office.

Telefónica CR's Declaration of Compliance with the Code of Good Corporate Governance based on OECD Principles (2004)

Telefónica CR made a commitment to the principles of Good Corporate Governance already in its 2001 Annual Report; it has been making regular statements in its annual reports, concerning the progress of implementation of the principles of Good Corporate Governance in its practices. The Company has been meeting all the main criteria and observing the principles and recommendations of the Czech Code of Good Corporate Governance based on OECD Principles, which was published in 2004 (the Code). The Code is available at the website of the Ministry of Finance of the Czech Republic (www.mfcr.cz). An exception to this rule are the principles of Good Corporate Governance that are not in direct control of the Company's governing bodies and are dependent on the decisions of its owners (in particular the criterion concerning the number of independent members of the Supervisory Board). The Board of Directors regularly oversees the good practice of Corporate Governance in subsidiaries controlled by Telefónica CR.

Organisation of Corporate Governance

The Corporate Governance model of Telefónica CR has not incurred any changes in 2011 compared to the previous year. The model, as per the Articles of Association, is based on interaction between the executive Board of Directors, made up exclusively of executive managers of the Telefónica CR Group, and the Supervisory Board. The Supervisory Board has powers to control key decision-making processes (using the mechanism of 'prior standpoints' of the Supervisory Board to selected issues), and monitor other important aspects of the Company's operation. The powers of the Supervisory Board and their discharge make a full and active use of advisory and initiative roles of the Supervisory Board's committees. The controlling, supervisory and review function in the model of Corporate Governance in Telefónica CR has been strengthened by the independent position of the Audit Committee. An integral part of the model is the combination of the Chief Executive Officer's function with the function of Chairman of the Board of Directors, which the Company finds efficient and acceptable given the strong role of the Audit Committee, Supervisory Board and the active involvement of its committees. Members of the Board of Directors are individually bound by the agreement for discharge of the office of a member and additionally they have work contracts for the work they have been hired to do, which is different from serving on the governing body.

An Ordinary **General Meeting** of the Company was held on 28 April 2011. The agenda of the Company's supreme governing body comprised standard items relating to the operations of the joint-stock company, and a proposal for the amendment to the Company's Articles of Association in order to accommodate recent changes in the legislation. A detailed overview of the conclusions of the Ordinary General Meeting is available on the Company's website (www.telefonica.cz), and was also published in the 2011 Half-year Report. Information about the dividends, the record and disbursement dates for the dividend payment is given in section 'Other information for Shareholders and Investors' further in this Annual Report.

The Board of Directors held twenty three meetings in 2011, thus complying with the duty to hold a minimum of twelve meetings each year.

The Supervisory Board held four meetings in 2011, which was in accordance with the Company's Articles of Association that command a minimum of four meetings during the course of a calendar year.

The Audit Committee (AC) of the Company held four meetings in 2011, which was in accordance with the Company's Articles of Association for a minimum number of meetings during the course of a calendar year. The practice to call AC meetings on the same date as the regular meetings of the Supervisory Board has proven convenient as it lays foundations for the development of a close information exchange between these two bodies, especially in those areas in which their authority overlaps. The system allows the members of the Supervisory Board to use outcomes and conclusions from the AC meetings as a resource for the discussion of matters on the agenda of the Supervisory Board.

The rules for the remuneration of AC members, as well as the rules governing the granting of non-claim benefits to members of governing bodies, which were approved by the Ordinary General Meeting of the Company held in 2009, remained unchanged in 2011. In 2011, AC members collected pecuniary income of CZK 3,938,497 and in-kind income equivalent to CZK 909,936 from the Company, of which CZK 92,000 was the pecuniary income and no in-kind income for their membership in the AC. The committee members did not receive any pecuniary or in-kind income from entities controlled by Telefónica CR in 2011. In 2011, all AC members were bound to the Company by an agreement for the discharge of office of a member, which contained a non-competition covenant which applies also for the period after the office is terminated.

As part of performing **internal controls in the area of financial reporting**, the Company has implemented the key requirements of the Sarbanes-Oxley Act (SOX), which it is bound to respect – principally as a result of the fact that the shares of the parent Telefónica, S.A. are listed on the US capital markets. Twice a year the Company performs an evaluation of its internal controls in the area of financial reporting in the scope of the regulatory framework introduced by SOX Section 404, including an evaluation of the controlling mechanism in the area of the Company's information systems that could have a potential impact on the bottom line of the Company. The audits verify the standard of the description, configuration and form of walkthrough tests and compliance tests of transactions, as well as the effectiveness of controlling mechanisms in the area of financial reporting. The audit results are consulted with the external auditor of the Company.

The audits performed in 2011 concluded that the internal controls, as applied, were of a standard which meets the SOX requirements. The quarterly declaration of the management (Chief Executive Officer and Director, Finance Division) attesting to the veracity of the information contained in the financial statements, implementation and application of effective internal controls, and other matters required by SOX Section 302 (including the information about any changes in the Company's accounting policy, one-off/extraordinary or material items having an impact on the Company's results for the quarter, and the overview of material reserves created by the Company in order to cover for its contingent risks and liabilities – e.g. from litigation) form an integral part of the SOX compliance procedures in the general area of Corporate Governance. The above documents are presented internally to the Board of Directors and to the Audit Committee for review and discussion.

In 2011, **the internal audit and risk management function** in the Company continued to be developed; the organisation of these functions (which are consolidated into one organisation unit), the line management of the Chief Executive Officer and the functional subordination of Internal Audit (in accordance with the International Standards for the Professional Practice of Internal Auditing) to the Audit Committee and the Board of Directors remained as before.

Internal Audit represents an important instrument of Corporate Governance and it provides the Company's governing and executive bodies with independent and professional assessment of the Company's internal control system and the situation and trends in the given area compared to current best practice, the rules and regulations in force, and work orders and instructions issued. In 2011, Internal Audit and Risk Management carried out 49 audits and controls (including the regular audit of internal controls required by SOX 404) as per the annual plan of Internal Audit or as mandated by the governing bodies and the Chief Executive Officer. In addition to performing audits and controls in Telefónica CR, the Internal Audit unit also acts as internal auditor of Telefónica Slovakia and other subsidiary companies in the Telefónica Czech Republic Group. The audit conclusions were used by the management to formulate actions to redress the issues identified. Internal Audit monitors the implementation of such actions and reports to the governing bodies and the executive management. The activities of Internal Audit and its main processes are laid down in the Internal Audit Charter of Telefónica Czech Republic, which also stipulates the principle of independence of the Internal Audit function and the principle of objectiveness of internal auditors. The work of Internal Audit is monitored on a regular basis by the Audit Committee which discusses audit reports and other reporting presented by Internal Audit. The Internal Audit Charter stipulates the Audit Committee's participation in the preparation and approval of the annual plan of internal audits; the Audit Committee also approves the annual budget of Internal Audit and its annual performance evaluation. The Director of Internal Audit & Risk Management has full access to the Audit Committee and is present for the discussion of audit reports and other outputs of Internal Audit & Risk Management at meetings of the governing bodies of the Company.

Since the year 2007, the Internal Audit and Risk Management unit of Telefónica Czech Republic, is certified in quality by the Institute of Internal Auditors (IIA). This certification assesses Internal Audit activity's conformity to The IIA's International Standards for the Professional Practice of Internal Auditing (Standards).

In 2011, the Company continued in the development of its **risk management** function and in its harmonisation with the methodology and practice within the global Telefónica Group, which creates more space for the sharing of experience and knowledge in the area of mitigation of specific risks with the parent company and other members of the Group. The risk management system covers all areas of operations of Telefónica CR, including its subsidiary Telefónica Slovakia, and provides for the identification, assessment and mitigation of risks, which it continues to monitor throughout. The Board of Directors and the Supervisory Board receive regular monthly and quarterly reports, respectively, containing information about key risks and their development over time. The Audit Committee is concerned with the risk management primarily from the point of assessing its effectiveness and adequacy (whether the key risks of the Company are adequately identified and managed); to this end, the committee receives regular reports from the Risk Management Unit of Telefónica Czech Republic Group, and information about the methods used, the processes of risk management, etc. Members of the bodies have an equal and full access to risk management reports and the risk register of Telefónica CR and the subsidiary Telefónica Slovakia. More information about risk management is given in sub-section Risk management of the Annual Report.

An electronic platform, the so-called CG Portal, is operated in Telefónica Czech Republic Group. It supports the exercise of powers of all governing bodies and provides for efficient administration of Corporate Governance in Telefónica Czech Republic. The portal is available on the Company's intranet and also remotely to users with the access privileges. This tool performs several functions; the key ones include the function for convening meetings (including the distribution of resource documents), dissemination of the latest information and regular reporting to members of governing bodies and committees between meetings. Last but not least, the CG Portal serves as a digital archive for all documents in the area of corporate governance. The portal is bi-lingual (in Czech and English); accordingly, the majority of corporate governance documents is systematically made in both languages. The instrument confers equal access to archived and current documents and information to all members (executive and non-executive) of the relevant governing bodies, irrespective of any local or time limitations. This includes, in addition to the minutes of meetings, also internal audit reports and risk reports, information about the Telefónica Czech Republic Group and its subsidiaries, etc. The portal is currently used also as a platform for supporting and administrating other activities in the general sphere of corporate governance. It is mainly the agenda of the Business Principles (including the operation of a confidential whistle-blowing channel for reporting of suspected ethical malpractices). The results achieved in this area in 2011 are recapitulated in sub-section Business principles.

For the sake of expedient and effective acquaintance with the Company, new members of the Board of Directors, Audit Committee, the Supervisory Board and its committees have, already upon assuming their function, a special set of comprehensive and structured Corporate Governance information and documents available to them, as well as having access to all other current and archived documents which they may require for the due discharge of their function. The information is disseminated via the CG Portal.

Telefónica CR has a position of Company Secretary is at the executive level in the new Corporate Governance Model of Telefónica CR formally combined with that of General Counsel (Director, Legal, Regulatory and Public Affairs).

Shareholder relations

A strict compliance with all the statutory rights of shareholders, commitment to the principle of equal treatment of all shareholders of a similar standing, while respecting the specific statutory rights of minority shareholders belong among the key guiding principles of Corporate Governance of Telefónica CR. The majority shareholder of Telefónica CR, which is Telefónica, S.A. (see sub-section Company policy towards stakeholders), exercises its rights in Telefónica CR through its voting rights at the Company's General Meetings.

The Company is scrupulous about the timely and full information to all shareholders about the developments in the Company, its financial results and business plans. The Company uses its website as the main platform for communication (www.telefonica.cz, section About). The Company publishes regular press releases with the quarterly financial results and announces all significant events and developments.

When organising General Meetings, the Company proceeds in a way that guarantees the compliance with all the statutory conditions and with the Articles of Association, whilst observing to the maximum extent possible the requirements of the Code which concern the rights of shareholders and their fair treatment. The Company publishes the date of the General Meeting sufficiently in advance on its website; the date, time and location of the General Meeting are chosen on the merit of ready access and availability. The Rules of Procedure of the General Meeting are approved at each meeting of the governing body. The text of the Rules of Procedure has not changed in several years; during this time, the shareholders have not made any motions to amend the Rules of Procedure. The Rules of Procedure allow shareholders to participate effectively in decision-making on fundamental changes in the Company and to ask questions and seek information on matters included on the agenda of the General Meeting. The Rules of Procedure of the General Meeting contains the following substantial provisions:

- Shareholders can exercise their rights at the General Meeting either in person or by proxy; they can vote on the proposed items on the agenda, receive, in accordance with the Commercial Code, explanations in matters relating to the Company, or any undertakings controlled by it, as the case may be, provided the explanation is necessary for understanding the matter addressed by the General Meeting, and they also have the right in accordance with the Commercial Code to raise proposals an counterproposals. Shareholders may lodge a protest against a decision of the General Meeting and demand that it be recorded in the Minutes of the General Meeting.
- As a rule, any requests for explanation, proposals, counterproposals and protests must be made by shareholders in writing, and filed with the information desk. Upon making the motion it must be specified whether it is a request for explanation, proposal, counterproposal or a protest. Any requests for explanation, proposals, counterproposals and protests submitted in writing must be legibly undersigned by the shareholder in question or their proxy.
- In keeping with the Commercial Code and the Company's Articles of Association, the Board of Directors is obliged to provide an explanation upon request, in matters concerning the agenda of the General Meeting.
- At the General Meeting, a proposal by convener of the General Meeting is subjected to a vote first; if it is not passed, other proposals and counterproposals relating to the point in question are voted on, in the order in which they were submitted. As soon as a motion is passed, other counterproposals are not subjected to a vote. The Chairman of the General Meeting is obliged to ensure that, prior to voting at the General Meeting, the shareholders are informed of all proposals and counterproposals made by shareholders in relation to the item of the agenda of the General Meeting which is put to a vote.

Also in 2011, all the necessary documents were available in print form, in two languages (Czech and English). All the documents for the General Meeting and other relevant documents (e.g. the Articles of Association) were available to the shareholders also at the information desk which the Company operates for its shareholders at every General Meeting. Each point on the agenda was voted on separately, after the discussion on that point had been concluded. In addition to members of the Board of Directors and of the Supervisory Board (its committees), the representatives of the Statutory Auditor were also available to take questions from shareholders throughout the General Meeting. A public notary was present for the whole duration of the General Meeting.

All motions (questions, requests for explanation, counterproposals and proposals) made by shareholders during the Ordinary General Meeting of 28 April 2011 were adequately addressed by the members of the Board of Directors and subsequently they were, together with the answers, recorded in the Minutes of the General Meeting.

Transparency and open information policy

Telefónica CR scrupulously and diligently complies with all national and community laws and the principles of the Code. In line with its mandatory duties and voluntary commitments, Telefónica CR continually and pro-actively provides shareholders and investors with all vital information on its business, financial standing, ownership structure and governance issues. Furthermore, the Company is very scrupulous in seeing that all price-sensitive information and facts are disclosed in a full and timely manner. The Company strives to provide the shareholders and investors with everything they may need for making qualified decisions regarding the ownership of the Company stock, and in voting at General Meetings. To this end, the Company uses various information channels and instruments, namely of electronic and online nature, via its website, and via the websites www.akcie.cz and www.londonstockexchange.com. The website of Telefónica CR (particularly the section About) provides investors and shareholders with all corporate documents and various information about the Company in the Czech and English languages. The Company regards the electronic platform for disseminating information as key, especially since many of its shareholders are foreign legal and natural persons; the website facilitates access to information about the Company, especially for the international institutional investors and for small shareholders. This in turn improves their opportunities for their active, effective and valid participation in the decisions relating to the matters of the Company.

The policy of transparency dictates that the Company makes sufficient disclosure about the remuneration of members of the Board of Directors and the Supervisory Board of the Company (and of the Supervisory Board committees). This matter is addressed in detail in sub-section Rules for the remuneration of persons with executive powers in the issuer, which describes and explains the principles of the system for the remuneration of members of the Board of Directors, the Supervisory Board and other persons, and iterates other emoluments provided by the Company to these persons (a similar information concerning the members of the Audit Committee is disclosed in sub-section Organisation of Corporate Governance). The subsequent section (Other information relating to persons with executive powers) gives an account of benefits claimed in the past period (the information concerning the members of the Audit Committee is disclosed in sub-section Organisation of Corporate Governance). The Company's website contains the current and previous versions of documents in this area (Rules for the Remuneration of Members of the Board of Directors, Rules for the Remuneration of Members of the Supervisory Board, Rules for the Granting of Discretionary Benefits to Members of the Supervisory Board, Rules for the Granting of Discretionary Benefits to Members of the Audit Committee).

In keeping with its Business Principles, Telefónica CR practices zero tolerance of conflicts of interest. The procedures for the consideration and decisions in the governing bodies are aligned in a way that prevents members of the governing bodies from voting on matters which could compromise their impartiality (affiliated transactions). Potential conflicts of interests stemming from membership in the governing bodies of other companies, involvement in commercial transactions and other defined situations are subject to a regular review by the Ethics and Corporate Social Responsibility Committee (see sub-section Committees established by the Governing Bodies of the Company below).

The Company is scrupulous about the prevention of insider trading for unlawful personal enrichment in trading in the Company's shares; in this respect, it is compliant with the applicable community and Czech laws, as well as with the rules adopted by the UK market regulator (Financial Services Authority). The Company has adopted a strict internal policy, which sets the limits for the disposal of shares issued by the Company or by undertakings that it controls. Telefónica CR keeps a regularly updated list of persons (members of governing bodies, employees, external persons) who would qualify as insiders in possession of such information.

Committees established by the Governing Bodies of the Company

The Supervisory Board committees have been an integral part of the Company's system of Corporate Governance since 1996 and continue to play a major role in discharging the powers of the Supervisory Board. In the definition of the remit and role of the committees, the Company observes the Code and the Commission Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, which was amended by Recommendation 2009/38/EC from April 2009. Basic information about the committees established by the Supervisory Board is given in sub-section Governing bodies.

The Nomination and Remuneration Committee (NRC) has five members and makes recommendations in respect of particularly all matters relating to personnel changes in the Board of Directors, Audit Committee, Supervisory Board and the Supervisory Board committees. The committee also gives a standpoint on any nomination proposals for vacancies in the governing bodies of members of the Telefónica Czech Republic Group. The NRC's remit extends to reviewing the remuneration and other benefits granted to members of the Board of Directors, Supervisory Board and the Audit Committee. The committee continually monitors and assesses the performance of members of the Board of Directors, Audit Committee, Supervisory Board and its committees; in this respect, the NRC also it also assesses the need for and promotes further education of members of the governing bodies, in particular in professional disciplines and languages. The committee held two meetings in 2011.

The Ethics and Corporate Social Responsibility Committee (ECSRC) is a voluntary committee of the Supervisory Board with six members, whilst observing the rule that a half of the ECSRC's members are always Supervisory Board members elected by the employees, and the other half Supervisory Board members elected by the General Meeting. Every year, the committee addresses the issue of a potential conflict of interest; members of the Board of Directors, Audit Committee, Supervisory Board, executive management and members of the governing bodies in subsidiary companies are examined in this respect. The ECSRC regularly monitors compliance with the Company's Business Principles, and the functioning of the confidential whistle-blowing channel, and it is regularly informed about the activities undertaken as part of the Compliance Programme for the prevention of unethical conduct. Another primary area of interest for the ECSRC is the promotion of Corporate Social Responsibility. The committee held two meetings in 2011.

Company policy towards stakeholders

Telefónica CR values Corporate Social Responsibility (CSR) as an integral part of its operations and business. Given the scope and volume of the Company's CSR initiatives, the Annual Report now contains a separate section (Corporate social responsibility) dedicated to Corporate Social Responsibility.

Information relating to matters according to Section 118(5) of the Act No. 256/2004 Coll., the Capital Market Undertakings Act (CMUA), and information which is a part of a summary report compiled according to the requirement of Section 118(8) of the CMUA

The figures and information relating to matters under Sections 118(5a)–118(5l) of the Act No. 256/2004 Coll., the Capital Market Undertakings Act (CMUA):

a) Information about the issuer's equity capital structure, including shares not admitted for trading on the regulated market in a European Union Member State, including any potential qualification of different types of shares or similar securities representing a share in the issuer, and the share in the share capital of each type of share or similar security representing a share in the issuer

The equity structure of Telefónica CR as at 31 December 2011 was as follows:

	(in CZK millions)
Share capital	32,209
Share premium	24,374
Fund for share-related payments	53
Funds	6,450
Retained earnings	9,306
Total	**72,392**

The Company's share capital as at 31 December 2011 was CZK 32,208,990,000 and was fully paid up. The share capital is made up of the following shares:

A.	Type:	ordinary
	Form:	registered
	Kind:	booked
	Number of shares:	322,089,890 shares
	Nominal value:	CZK 100
	Total volume of issue:	CZK 32,208,989,000
	ISIN:	CZ0009093209

B.	Type:	ordinary
	Form:	registered
	Kind:	booked
	Number of shares:	1 share
	Nominal value:	CZK 1,000
	Total volume of issue:	CZK 1,000
	ISIN	CZ0008467115

The rights and obligations related to the registered share which represents a share in Telefónica CR are set out in Article 5 of the Articles of Association of the Company.

The registered shares in the nominal value of CZK 100 were listed for trading on the following markets:

Market	Note
Prague Stock Exchange (Burza cenných papírů Praha, a.s.)	On the main market
RM-SYSTÉM, česká burza cenných papírů, a.s.	–
London Stock Exchange	In the form of Global Depository Receipts (GDR). The depository for the GDR is The Bank of New York Mellon, ADR Division, 101 Barclay Street, West New York, NY 10286, USA; the custodian is Komerční banka, a.s., Na Příkopě 33, čp. 906, 114 07 Prague 1.

A full wording of the Terms and Conditions of the Share Issue – the document which is the source of this summary – is available at the registered address of the security issuer.

The registered share in the nominal value of CZK 1,000 was not listed for trading on any regulated market in a European Union Member State.

b) Information about transferability of securities

Only the statutory requirements need to be met for a transfer of shares and Global Depository Receipts. The Company's Articles of Association impose no further restrictions on the transferability of the shares and there are no other restrictions for reasons that would be on the part of the Company.

c) Information about significant direct and indirect shares in the voting rights of the issuer

Key shareholders of Telefónica CR as at 31 December 2011:

	Shareholder	Address	% of share capital
1	Telefónica, S.A.	Gran Vía 28, 28013 Madrid, Kingdom of Spain	69.41%
2	Investment funds and individual shareholders	–	30.59%

As at 31 December 2011, the share of Telefónica, S.A., in the voting rights of Telefónica Czech Republic, a.s., according to the provision of Section 122 of the Capital Market Undertakings Act was 69.41%.

d) Information about the holding of shares with special rights, including the description of these rights

The Company has not issued any securities with special rights, only ordinary shares as per point (a) above.

e) Information about restrictions of voting rights

Voting rights are attached to all shares issued by the Company and may be restricted or excluded only in instances set out in the law. The Company is not aware of any such statutory restriction or exclusion of voting rights. The Company's Articles of Association do not stipulate any restriction of voting rights; there are no other restrictions for reasons that would be on the part of the Company.

f) Information about agreements between shareholders or owners of securities representing a share in the issuer, which could restrict the transferability of shares or similar securities representing a share in the issuer, or of voting rights, if such information is known to the issuer

The Company has no knowledge of any agreements between shareholders which could restrict the transferability of shares or voting rights.

g) Information about special rules for the election and recall of the statutory body, amendment to the articles of association or similar document of the issuer

Members of the Board of Directors are elected and recalled by the Supervisory Board of the Company. The eligibility conditions for election to the Board of Directors are laid down in the law; the Articles of Association do not contain any restriction beyond the statutory scope; there are no other restrictions for reasons that would be on the part of the Company.

Two thirds of members of the Supervisory Board are elected and recalled by the General Meeting of the Company; one third is elected and recalled by the Company's employees. The eligibility conditions for election to the Supervisory Board are laid down in the law; the Articles of Association contain only a single condition beyond the statutory scope – that the Chief Executive Officer may not be elected as member of the Supervisory Board. There are no other restrictions for reasons that would be on the part of the Company.

h) Information about special powers of members of the statutory body, in particular about their authorisation as per Sections 161a and 210 of the Commercial Code

Members of the Board of Directors hold no special powers; some acts by the Board o Directors require, as per Article 14(4) of the Company's Articles of Association, a previous consent by the Supervisory Board.

i) Information about important contracts, which the issuer is a party to and which will come into effect, change or expire upon a change in the issuer's control as a result of a take-over bid, and about the effects thereof, with the exception such contracts whose disclosure would bear a serious harm for the issuer, which, however, does not reduce other duties of disclosure of such information under this law or under other laws

The Company has not entered into any contracts that will come into effect, change or expire upon a change in the issuer's control as a result of a take-over bid.

j) Information about contracts between the issuer and the members of the statutory body or employees, by which the issuer is bound in the event of the termination of their office or employment in connection with a take-over bid

No contracts were concluded between the Company and the members of its Board of Directors or its employees, by which the Company would be bound in the event of the termination of their office or employment in connection with a take-over bid.

k) Information about any programmes based on which the employees and members of the statutory body of the company can acquire shares, share options or other rights at preferential terms, and about how the rights associated with these securities are exercised

No programmes exist for members of the Board of Directors or employees of the Company based on which they could acquire shares, share options or other rights of the Company at preferential terms.

l) Information about payments remitted to the state for mining licences, provided the core business of the issuer is in the mining sector

With regard to the fact that the Company has no business in the mining sector, this declaration is not applicable.

Consolidated financial statement

05

for the year ending 31 December 2011
prepared in accordance with international
financial reporting standards

Business revenues reached
CZK 52.39 billion.

Consolidated financial statement

for the year ending 31 December 2011 prepared in accordance with international financial reporting standards

05

Content

General information

Telefónica Czech Republic, a.s. Group (the „Group“) consists of Telefónica Czech Republic, a.s. (the „Company“) and its subsidiaries: Telefónica Slovakia, s.r.o., Telefónica O2 Business Solutions, spol. s r.o., Internethome, s.r.o., CZECH TELECOM Germany GmbH and CZECH TELECOM Austria GmbH.

The Company has a form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

The Group is a member of the Telefónica Group of companies (the „Telefónica Group“) with a parent company, Telefónica, S.A. (the „Telefónica“).

The Company is the principal supplier of fixed line telecommunication services and is one of the four suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Group amounted in average to 7,297 in 2011 (2010: 8,145).

The Company's shares are traded on the Prague Stock Exchange.

These consolidated financial statements were approved for issue by the Company's Board of Directors on 17 February 2012.

Corporate name change

Effective from 16 May 2011 the Company changed its name Telefónica O2 Czech Republic, a.s. to Telefónica Czech Republic, a.s. and the new corporate name is entered in the Commercial Register. The Company will continue to operate under its O2 brand for its clients and all customers.

The 3G network sharing

The Company and T-Mobile Czech Republic a.s. signed an agreement on sharing the 3G network. The agreement concerns currently unserved areas and will accelerate construction of the network and significantly expand the 3G coverage of both operators. The pilot commercial operation has been launched in the second quarter of the 2011. The Company's high speed data service presently covers 73% of the Czech population.

Joint network monitoring

The Company and Telefónica Germany signed contracts regulating a joint project implementing Fixed and Mobile Networks Management for Telefónica networks in both countries. The project includes the integration of monitoring of several Telefónica Group networks in the Czech Republic, Slovakia and Germany – contributing to a more efficient use of resources and considerable operating costs savings. The entire project fits within the global Telefónica Group strategy.

Demerger of Telefónica O2 Business Solutions, spol. s r.o. by spin-off

On 27 July 2011, the Company approved a spin-off project of Telefónica O2 Business Solutions, spol. s r.o. Based on the project a part of enterprise was spun-off into a newly founded subsidiary Internethome, s.r.o. The effective date of the transaction is 1 January 2011. The main activity of the new subsidiary is to provide Internet access using WiFi technology. Since the effective date i.e. 1 January 2011 adoption of International Financial Reporting Standards for accounting and preparation of notes of the company Internethome, s.r.o. was decided.

WiFi acquisitions

During 2011, the Group has started a campaign of acquisition of WiFi network infrastructures, customer bases and related assets from local providers of internet access by WiFi technology. These purchases were made through purchase of assets or part of enterprise. Since the decisive date of the demerger by spin-off (i.e. 1 January 2011) these activities have been considered as transactions carried out on behalf of the new company Internethome, s.r.o.

Restructuring

During 2010, the Group restructured its activities mainly in Field Line Management areas of its business. Restructuring projects resulted in transfer of some activities to outsourcing partners.

During 2011, the Group went on achieving efficiency and cost optimization by introducing new projects in various areas of its business. Restructuring projects focused among others on call center consolidation and optimization. During the restructuring process more than 500 employees were made redundant and the Group incurred restructuring costs of CZK 174 million (see Note 2).

Branch of Telefónica Global Technology

On 1 December 2011, a Czech branch of Telefónica Global Technology started to operate. The branch employs more than 200 people, mostly assigned from the Company. Telefónica Global Technology S.A.U. (a parent company of Telefónica Global Technology, S.A., branch) is a 100% owned subsidiary of Telefónica S.A. and was founded with the aim to provide IT services to individual operating departments of Telefónica Group. One of the two new European data centers is going to be built in the Czech Republic, where IT infrastructure for the Czech Republic, Slovakia and Germany will be located and operated.

Independent auditor's report to the shareholders of Telefónica Czech Republic, a.s.

Independent auditor's report

To the Shareholders of Telefónica O2 Czech Republic, a.s.:

We have audited the accompanying consolidated financial statements of Telefónica Czech Republic, a.s. and its subsidiaries ("the Group") which comprise the consolidated balance sheet as at 31 December 2011, and the consolidated statement cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

Management of Telefónica Czech Republic, a.s.is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with international Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with international Financial Reporting Standards as adopted by the European Union.

Ernst & Young Audit, s.r.o.
License No. 401
Represented by

Brian Welsh
Partner

Petr Vácha
Auditor, License No. 1984

17 February 2012
Prague, Czech Republic

Consolidated statement of total comprehensive income for the year ended 31 December 2011

In CZK million	Notes	Year ended 31 December 2011	Year ended 31 December 2010
Revenues from voice services	2	18,197	20,811
Monthly charges		12,900	13,569
Data services	2	11,477	11,474
Other revenues	2	9,814	9,708
Revenues		**52,388**	**55,562**
Other income	2	487	242
Interconnection and roaming expenses		(9,230)	(10,205)
Cost of goods sold		(2,170)	(1,920)
Other direct cost of sales	2	(3,429)	(3,178)
Other expenses	2	(10,056)	(10,375)
Staff costs	2	(6,179)	(7,071)
Impairment reversal/(loss)		(21)	4,325
Operating income before depreciation and amortization (“OIBDA”)		**21,790**	**27,380**
Depreciation and amortisation	7,8	(11,651)	(11,856)
Operating profit		10,139	15,524
Finance income	3	627	367
Finance costs	3	(758)	(573)
Profit before tax		10,008	15,318
Corporate income tax	4	(1,324)	(3,038)
Profit for the year		**8,684**	**12,280**
Other comprehensive income			
Translation differences		110	(107)
Other comprehensive income, net of tax		110	(107)
Total comprehensive income, net of tax		**8,794**	**12,173**
Profit attributable to:			
Equity holders of the Company	5	8,684	12,280
Total comprehensive income attributable to:			
Equity holders of the Company		8,794	12,173
Earnings per share (CZK) – basic [1]	5	27	38

[1] There is no dilution of earnings as no convertible instruments have been issued by the Company.

Consolidated balance sheet as at 31 December 2011

In CZK million	Notes	31 December 2011	31 December 2010
ASSETS			
Property, plant and equipment	7	51,525	56,651
Intangible assets	8	20,658	21,437
Investment in associate	22	22	22
Other financial assets	11	149	170
Deferred tax assets	15	746	5
Non-current assets		**73,100**	**78,285**
Inventories	10	488	606
Receivables and prepayment	11	8,273	8,638
Income tax receivable	4	165	453
Cash and cash equivalents	12	6,955	4,798
Current assets		**15,881**	**14,495**
Non-current assets classified as held for sale	**7**	**1**	**12**
Total assets		**88,982**	**92,792**
EQUITY AND LIABILITIES			
Ordinary shares	20	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		12,514	16,593
Total equity		**69,097**	**73,176**
Long-term financial debts	14	–	2,883
Deferred tax liability	15	3,736	3,936
Non-current provisions for liabilities and charges	16	26	52
Non-current other liabilities	13	108	25
Non-current liabilities		**3,870**	**6,896**
Short-term financial debts	14	3,061	141
Trade and other payables	13	12,882	12,408
Income tax liabilities	4	5	–
Provisions for liabilities and charges	16	67	171
Current liabilities		**16,015**	**12,720**
Total liabilities		**19,885**	**19,616**
Total equity and liabilities		**88,982**	**92,792**

These consolidated financial statements were approved by the Board of Directors on 17 February 2012 and were signed on its behalf by:

Luis Antonio Malvido
Chairman of the Board of Directors
Chief Executive Officer

Jésus Pérez de Uriguen
1st Vice Chairman of the Board of Directors
Vice-President, Finance Division

Consolidated statement of changes in equity for the year ended 31 December 2011

In CZK million	Notes	Share capital	Share premium	Foreign exchange translation reserve	Equity settled share based payments reserve	Funds[1]	Retained earnings	Total
At 1 January 2010		**32,209**	**24,374**	**(55)**	**38**	**6,452**	**10,861**	**73,879**
Net income and expense recognised directly in other comprehensive income		–	–	(107)	–	–	–	(107)
Profit for the year		–	–	–	–	–	12,280	12,280
Total comprehensive income		**–**	**–**	**(107)**	**–**	**–**	**12,280**	**12,173**
Capital contribution and other transfers		–	–	–	–	–	8	8
Dividends declared in 2010	6	–	–	–	–	–	(12,884)	(12,884)
At 31 December 2010		**32,209**	**24,374**	**(162)**	**38**	**6,452**	**10,265**	**73,176**
At 1 January 2011		**32,209**	**24,374**	**(162)**	**38**	**6,452**	**10,265**	**73,176**
Net income and expense recognised directly in other comprehensive income		–	–	110	–	–		110
Profit for the year		–	–	–	–	–	8,684	8,684
Total comprehensive income		**–**	**–**	**110**	**–**	**–**	**8,684**	**8,794**
Capital contribution and other transfers		–	–	–	18	–	(7)	11
Dividends declared in 2011	6	–	–	–	–	–	(12,884)	(12,884)
At 31 December 2011		**32,209**	**24,374**	**(52)**	**56**	**6,452**	**6,058**	**69,097**

[1] Refer to Note 20 regarding amounts not available for distribution.

Consolidated statement of cash flows for the year ended 31 December 2011

In CZK million	Notes	Year ended 31 December 2011	Year ended 31 December 2010
CASH FROM OPERATING ACTIVITIES			
Cash received from operations		56,452	59,060
Cash paid to suppliers and employees		(33,886)	(34,913)
Dividends received		5	3
Net interest and other financial expenses paid		(101)	(218)
Taxes paid		(1,938)	(2,193)
Net cash from operating activities		**20,532**	**21,739**
Cash flow from investing activities			
Proceeds on disposals of property, plant and equipment and intangible assets		601	224
Payments on investments in property, plant and equipment and intangible assets		(5,953)	(5,53)
Payments on investments in WiFi acquisition		(141)	–
Payments made on financial investments		(22)	(13)
Net cash used in investing activities		**(5,515)**	**(5,315)**
CASH FLOW FROM FINANCING ACTIVITIES			
Dividends paid		(12,878)	(12,876)
Repayments of loans, borrowings and promissory notes		(2)	–
Net cash used in financing activities		**(12,880)**	**(12,876)**
Effect of foreign exchange rate changes on collections and payments		**20**	**(19)**
Net increase / (decrease) in cash and cash equivalents during the period		**2,157**	**3,529**
Cash and cash equivalents at the beginning of the period		**4,798**	**1,269**
Cash and cash equivalents at the end of the period		**6,955**	**4,798**
Balance at the beginning of the period	**12**	**4,798**	**1,269**
Cash on hand and at banks		4,774	1,251
Other cash equivalents		24	18
Balance at the end of the period		**6,955**	**4,798**
Cash on hand and at banks	12	6,932	4,774
Other cash equivalents		23	24

Accounting policies

Content

A Basis of preparation

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

The consolidated financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS") and all applicable IFRSs adopted by the EU. IFRS comprise standards and interpretations approved by the International Accounting Standards Board ("IASB") and the IFRS Interpretations Committee (formerly called the International Financial Reporting Interpretations Committee, IFRIC).

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll. requires the Group to prepare its consolidated financial statements in accordance with IFRS adopted by the EU (Regulation (EC) No 1606/2002). At the year-end, there is no difference in the IFRS policies applied by the Group and IFRS adopted by the EU.

The consolidated financial statements were prepared under the historical cost convention except for non-current assets held for sale, inventory held at net realizable value, financial derivatives, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS required the Group to use certain critical accounting estimates. It also required management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note U.

The amounts shown in these consolidated financial statements are presented in millions Czech Crowns ("CZK"), if not stated otherwise.

Adoption of new or revised IFRS standards and interpretations (includes standards and interpretations applicable for the Group)

In 2011, the Group applied the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Group.

IAS 24 Related Party Transactions – Amendment (effective 1 January 2011)

The IASB issued an amendment to IAS 24 that clarifies the definitions of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarifies the circumstances in which persons and key management personnel affect related party relationships of an entity. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The adoption of the amendment did not have any impact on the financial position or performance of the Group.

IAS 32 Financial instruments: Presentation – Amendment (effective 1 February 2010)

The amendments address the classification of certain rights issues denominated in a foreign currency as either equity instruments or as financial liabilities. Under the amendments, rights, options or warrants issued by an entity for the holders to acquire a fixed number of the entity's equity instruments for a fixed amount of any currency are classified as equity instruments in the financial statements of the entity provided that the offer is made pro rata to all of its existing owners of the same class of its non-derivative equity instruments. Before the amendments to IAS 32, rights, options or warrants to acquire a fixed number of an entity's equity instruments for a fixed amount in foreign currency were classified as derivatives. The amendments require retrospective application.

The application of the amendments has had no effect on the amounts reported in the current and prior years because the Group did not issued instruments of this nature.

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective 1 July 2010)

The Interpretation provides guidance on the accounting for the extinguishment of a financial liability by the issue of equity instruments. Specifically, under IFRIC 19, equity instruments issued under such arrangement will be measured at their fair value, and any difference between the carrying amount of the financial liability extinguished and the consideration paid will be recognised in profit or loss.

The application of IFRIC 19 has had no effect on the amounts reported in the current and prior years because the Group has not entered into any transactions of this nature.

Amendments to IFRIC 14 Prepayments of a Minimum Funding Requirements (effective 1 January 2011)

The amendments correct an unintended consequence of IFRIC 14 – IAS 19 the Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. Without the amendments, in some circumstances entities are not permitted to recognise as an asset some voluntary prepayments for minimum funding contributions. This was not intended when IFRIC 14 was issued, and the amendments correct the problem. The amendments must be applied retrospectively to the earliest comparative period presented.

There were not any material changes to the disclosure in the notes to the consolidated financial statements.

Improvements to IFRSs

IFRS 3 Business Combinations (applicable to annual periods beginning on or after 1 July 2010)

a) Measurement of non-controlling interests

   Specifies that the option to measure non-controlling interests either at fair value or at the proportionate share of the acquiree's net identifiable assets at the acquisition date under IFRS 3 (2008) applies only to non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the acquiree's net assets in the event of liquidation. All other components of non-controlling interests should be measured at their acquisition date fair value, unless another measurement basis is required by IFRSs.

b) Un-replaced and voluntary replaced share-based payment awards

Specifies that the current requirement to measure awards of the acquirer that replace acquiree share-based payment transactions in accordance with IFRS 2 at the acquisition date applies also to share-based payment transactions of the acquiree that are not replaced.

Specifies that the current requirement to allocate the market-based measure of replacement awards between the considerations transferred for the business combination and post-combination remuneration applies to all replacement awards regardless of whether the acquirer is obliged to replace the awards or does so voluntarily.

c) Transitional requirements for contingent consideration from a business combination that occurred before the effective date of IFRS 3 (2008)

Clarifies that IAS 32 Financial Instruments: Presentation, IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures do not apply to contingent consideration that arose from business combinations whose acquisition dates preceded the application of IFRS 3 (2008).

There was not any material effect relating to the adoption of this amendment on the Group consolidated financial statements.

IFRS 7 – Financial instruments: Disclosures (effective 1 January 2011)

Encourages qualitative disclosures in the context of the quantitative disclosure required to help users to form an overall picture of the nature and extent of risks arising from financial instruments.

Clarifies the required level of disclosure around credit risk and collateral held and provides relief from disclosure of renegotiated loans.

There were not any material changes to the disclosure in the notes to the consolidated financial statements.

IAS 1 – Presentation of Financial Statements (effective 1 January 2011)

Clarifies that an entity may present the analysis of other comprehensive income by item either in the statement of changes in equity or in the notes to the financial statements.

There was not any material effect relating to the adoption of this amendment on the Group consolidated financial statements.

IAS 27 Consolidated and Separate Financial Statements (effective for annual periods beginning on or after 1 July 2010)

Clarifies that the amendments made to IAS 21 The Effects of Changes in Foreign Rates, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures as a result of IAS 27 (2008) should be applied prospectively (with the exception of paragraph 35 of IAS 28 and paragraph 46 of IAS 31, which should be applied retrospectively).

There was not any material effects relating to the adoption of this amendment on the Group consolidated financial statements.

IAS 34 Interim Financial Reporting (effective 1 January 2011)

Emphasises the principle in IAS 34 that the disclosure about significant events and transactions in interim periods should update the relevant information presented in the most recent annual financial report.

Clarifies how to apply this principle in respect of financial instruments and their fair values.

There were no material changes to the disclosure in the notes to the consolidated financial statements.

New IFRS as at 31 December 2011 (includes standards applicable for the Group)

At the date of preparation of the accompanying consolidated financial statements, the following IFRS had been published, but their application was not mandatory. The Group intends to adopt those standards when they become effective.

Standards and amendments		**Mandatory application: annual periods beginning on or after**
IFRS 7	Disclosures – Transfers of Financial Assets (Amendment)	1 July 2011
IAS 1	Presentation of Items of Other Comprehensive Income (Amendment)	1 July 2012
IAS 12	Deferred Tax – Recovery of Underlying Assets (Amendment)	1 January 2012
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2013
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 19	Employee benefits (Amendment)	1 January 2013
IAS 27	Separate Financial Statements (as revised in 2011)	1 January 2013
IAS 28	Investments in Associates and Joint Ventures (as revised in 2011)	1 January 2013

The Group is currently assessing the impact of the application of these standards and amendments. Based on the analyses made to date, the Group estimates that their adoption will not have a significant impact on the consolidated financial statements in the initial period of application.

The Group is currently monitoring the development in the area of IFRSs being prepared regarding to leases and revenue recognition which are planned to be submitted in 2012.

B Group accounting

Consolidation

Subsidiary undertakings, which are those companies in which the Company, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations, have been consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group (date of acquisition) and are no longer consolidated from the date when the Group ceases to have control.

A business combination is accounted for using the acquisition method. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed when incurred. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. The excess of the fair value of the Group's share of the identifiable net assets acquired over the considerations transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree is recorded as gain in profit or loss on the acquisition date. For detail refer to Note E Intangible assets and also to Note 8.

Intercompany transactions and balances among the Group companies are eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies for subsidiaries are changed, where necessary, to ensure consistency with the policies adopted by the Group and another companies within the Group.

Intercompany transactions and balances between the Group and Telefónica companies for the period after the transfer of majority ownership to Telefónica, S.A. are not eliminated. They are identified, disclosed and measured for the disclosure purposes and elimination procedures of the majority shareholder – Telefónica, S.A.

C Foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Czech Crowns ("CZK"), which is the Group's presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss, except when deferred in other comprehensive income as qualifying cash flow hedges. Such balances of monetary items are translated at period-end exchange rates. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(iii) Group companies

Profit or loss of foreign entities are translated into the Group's reporting currency at the average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities and of borrowings and other currency instruments designated as hedges of such investments are taken to other comprehensive income. When a foreign entity is sold, such exchange differences are recognised in profit or loss as part of the gain or loss on sale.

D Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less impairment charges.

Property, plant and equipment acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less depreciation and impairment charges.

Property, plant and equipment include all costs directly attributable to bringing the asset to working condition for its intended use. With respect to the construction of the network, this comprises every expenditure up to the customers' premises, including the cost of contractors, materials, direct labour costs and interest cost incurred during the course of construction.

Subsequent costs are recognised as property, plant and equipment only if it is probable that future economic benefits associated with the item will flow to the Group and the cost can be measured reliably.

Repairs and maintenance costs are expensed as incurred.

Items of property, plant and equipment that are retired are not intended for sale and are not expected to create any future economic benefits or are otherwise disposed of, are eliminated from the balance sheet, along with the corresponding accumulated depreciation. Any gain or loss arising from retirement or disposal is included in net operating income, i.e. net gain or loss is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is either de-recognised or at the date the asset is classified as held for sale.

Depreciation does not cease, when the asset becomes temporarily idle or retired from active use, unless the asset is fully depreciated.

Estimated useful lives adopted in these consolidated financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	10 to 25
Exchanges and related equipment	up to 25
Other fixed assets	up to 20

Freehold land is not depreciated as it is deemed to have an indefinite life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (refer to Note G Impairment of assets).

E Intangible assets

Intangible assets include computer software, purchased goodwill, licenses and customer base. Computer software mainly represents the external acquisition costs of the Group's information systems that are intended for use within the Group. Generally, costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Group and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally from one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less amortisation and impairment charges and are amortised on a straight-line basis over their estimated useful lives. Customer bases are amortised over a period of the remaining average terms of the binding contracts.

Acquired licenses are recorded at cost and amortised on a straight-line basis over the remaining life of the license (i.e. over 15 to 20 years), from the start of commercial service, which best reflects the pattern by which the economic benefits of the intangible assets will be utilised by the Group.

Intangible assets with an indefinite useful life are not amortised. They are subject to the regular impairment reviews (see Note 8 and Note 9).

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired. Goodwill is not amortised but is tested for impairment at least annually or anytime there are indications of a decrease in its value.

The Group reviews at least at the balance sheet date the useful lives of intangible assets that are not amortised to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate.

On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

Intangible assets that are no longer in use and no future economic benefits are expected or that are disposed of for any other reason are de-recognised from the balance sheet together with the corresponding accumulated amortisation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with an indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is de-recognised, the date the asset is classified as having the indefinite useful life or the date the asset is classified as held for sale.

F Non-current assets classified as held for sale

The Group classifies separately in the balance sheet a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups), its sale is highly probable and sale is expected within one year.

The Group measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Group recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as an impairment loss with impact on profit or loss of the relevant period.

From the moment the asset is classified as held for sale and eventually revalued, it ceases to be depreciated/amortised and is reviewed only from impairment point of view.

Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in profit or loss.

G Impairment of assets

Property, plant and equipment and other assets, including goodwill and intangible assets, are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or at least on an annual basis for goodwill and for intangibles with an indefinite useful life and for intangibles not yet in use. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level, for which there are separately identifiable cash flows (cash-generating units).

Impairment losses are recognised in expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss in the period in which the reversal occurs.

The Group makes an assessment at least at each balance sheet date whether there is any indication that an impairment loss may no longer exist, may have decreased or may have increased. If any such indication exists, the Group estimates a recoverable amount of the assets and compares to the carrying value (net of the impairment allowance). In assessing whether there is any indication that the impairment loss recognised in the past may no longer exist, the Group considers both external and internal sources of information (asset's market value, changes expected in the market, including technological, economic or legal changes, market interest rates, significant changes with effect on the Group in the extent to which, or manner in which, the assets are used or are expected to be used, evidence available from internal reporting indicating economic performance of assets etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions used.

H Investments and other financial assets

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets.

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2011 and 2010, the Group did not hold any financial assets in this category.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are measured at amortised cost using an effective interest rate method and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis, as required under IAS 39.

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets at fair value through profit or loss and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective interest rate method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in profit or loss in the period in which they arise. On the contrary, unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in other comprehensive income in the period in which they arise, except for impairment losses, until the financial asset is de-recognised, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in profit or loss.

Impairment of financial assets

The Group assesses at each balance sheet date whether financial assets or groups of financial assets are impaired.

(1) Assets carried at amortized costs

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for individually assessed financial assets, whether significant or not, it is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in profit or loss and only to the extent that the carrying amount of the financial asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible or sold.

(2) Available-for-sale financial assets

If this asset is impaired, the cumulative loss that had been previously recognised (due to fair value revaluation) in other comprehensive income shall be removed from other comprehensive income and recognised in profit or loss even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from other comprehensive income and recognised in profit or loss shall be the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in profit or loss.

Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

De-recognition of financial assets

A financial asset is de-recognised when:

a) the rights to receive cash flow from the asset have expired,
b) the Group retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement, or
c) the Group has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

I Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of specific asset or assets and the arrangement conveys a right to use the assets.

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment that is required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Group bears substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of interest. The corresponding lease obligations, net of finance charges, are included in other long-term payables (depending on maturity).

The interest element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. If there is a reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

J Inventories

Inventory is stated at the lower of cost or net realisable value. Costs of inventories include the purchase price and related costs of acquisition (transport, customs duties and insurance). The cost of inventory is determined using weighted average cost. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

K Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the initial market rate of interest for similar borrowers. Cash flows relating to short-term receivables are usually not discounted. The amount of the allowance is recognized in profit or loss.

L Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the statement of cash flows, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities section of the balance sheet.

M Financial debt

Borrowings are recognised initially as the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest rate method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in profit or loss over the period of the borrowings.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Interest costs on borrowings used to finance the acquisition and construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

N Current and deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws, used to compute the amount are those that are enacted or substantively enacted by the balance sheet date in the relevant country.

Income tax relating to items recognised directly in other comprehensive income is recognised in other comprehensive income and not in profit or loss.

Deferred income taxation is calculated using the liability method applied to all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates and laws expected to apply when the asset is realised or the liability is settled are used to determine the deferred income tax.

The principal temporary differences arise from differences in the tax and accounting values of property, plant and equipment, impairment of receivables and allowance for obsolete and slow moving inventories, non tax deductible allowances and provisions, unused tax credits and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Group accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised in other comprehensive income, any related tax effects are also recognised in other comprehensive income. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill.

Deferred income tax assets and tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority. The same applies for offsetting of current tax assets and liabilities.

O Employee benefits

(1) Pension obligations

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates applicable during the period and are based on gross salary payments. The arrangements of the Government's health, retirement benefit and unemployment schemes correspond to the arrangements for defined contribution plans. The Group has no further payment obligations once the contributions have been paid. The expense for the contributions is charged to profit or loss in the same period as the related salary expense. The Group also makes contributions to defined contribution schemes operated by external pension companies. These contributions are charged to profit of loss in the period to which the contributions relate.

(2) Redundancy and termination benefits

Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Group recognises provision for redundancy and termination benefits when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after the balance sheet date.

(3) Bonus plans

The Group recognises a liability for bonuses based on a formula that takes into consideration certain performance related measures, such as turnover or free cash flow, after certain adjustments.
The Group recognises a provision where the Group is contractually obliged or where there is a past practice that has created a constructive obligation.

P Share-based compensation

During 2006, the Group introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Certain compensation plans are settled in cash, while the others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price with the following accounting treatment:

Option plans that can be either cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted.

In the cash-settled share option plan, the total cost of the rights to granted shares are expensed over the period during which the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Group revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through profit or loss for the period, if appropriate.

For the equity-settled share option plan, fair value at the grant date is measured using the binominal methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Group revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity. As the plan will be settled by a physical delivery of equity instruments of the parent, Telefónica, S.A., to the employees, the personnel expense accrued is recognised against equity.

Q Provisions

Provisions are recognised when the Group has either a present legal or constructive obligation resulting from past events, and it is probable that an outflow of resources will be required to settle the obligation assuming that a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

R Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Group, comprises goods sold and services provided. Revenues are measured at their fair value of the consideration received or receivable. The amount of revenue is recognised if it can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. If necessary, revenue is split into separately identifiable components.

The Group offers customers free minutes for a selected price based on a chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Group is not obliged to reimburse the customer for unused minutes and the option of rolling over any unused minutes is valid for only one month.

The Group recognises revenue for free minutes in the period when the related services are provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

In assessing whether revenue should be recognised gross, i.e. with separate disclosure of costs to arrive at gross profit, or on a net basis, the Group considers these indicators of gross revenue reporting:

a) the Group is the primary obligor in the arrangement,
b) the Group has general inventory risk,
c) the Group has price latitude,
d) the Group changes the product or performs part of the service,
e) the Group has discretion in supplier selection,
f) the Group is involved in the determination of product or service specifications,
g) the Group has credit risk,
h) the Group has the ability to set the terms of the transaction,
i) the Group has the managerial control over the transaction.

The relative strength of each indicator is considered while deciding the accounting treatment.

If a transaction is considered to meet conditions of an agency arrangement, the revenue is recognised only at the amount of the commission received/realised.

Revenue from fixed price construction contracts (long-term contracts) is recognised using the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. A loss expected from the construction contract is recognised as an expense immediately, when it is probable that total contract costs will exceed total contract revenue.

(1) Fixed line business revenues

Revenue is recognized as follows:

Domestic and international call revenues
Domestic and international call revenues are recognised in profit or loss at the time the call is made.

Universal service
The Group is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. Relevant costs are compensated by the Czech Telecommunication Office (CTO). The Group recognises the compensation using gross principle on standard accrual basis of revenue recognition.

Subscription revenues
Revenue is recognised in profit or loss in the period in which the services are rendered.

Revenues from sales of prepaid cards
Prepaid call card sales are deferred until the customer uses the stored value on the card to pay for the relevant calls. The expiry date for prepaid cards is not longer than 36 months.

Connection fees
Connection fees, arising from the connection of the customers to the Group's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and other sale of goods
Revenue from the sale of telephone equipment, accessories and other goods is recognised at the time of sale i.e. when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods.

Local loop unbundling
Revenue from access to the local loop unbundling is deferred in profit or loss and recognised in the period in which the service is rendered. Regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the location (collocation) for an alternative operator is recognized upfront in profit or loss when it occurs.

Audiotex
Revenues from audiotex, service offering content to which a special tariff applies and enables to transfer money and to pay for goods or services from the third parties, are recognised using netto principle.

Information and communication technologies services
Information and communication technologies services (ICT) include complex customer solutions and managed services, mainly system integration, outsourcing services, project solutions, software development. Revenue recognition of such services reflects substance of the provided services.

(2) Mobile business revenues

The Group earns mobile services revenue from customers usage of the Group's network, interconnection and roaming. The Group also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues

Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is recognised as their airtime and other services are used. Prepaid customers recharge a credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognised as the airtime and other services are used. An estimate of unused airtime is recognised in profit or loss and spread over an average top up life cycle at the moment of every top up. For calculation of the estimate, the Group applies a percentage of expiry rate based on historical experience of expired airtime.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime that are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

Connection fees

Connection fees, arising from the connection of the customers to the Group's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and mobile services

Monthly service revenues and revenues from handset sales are recognized as revenue when the product or service is delivered to the distributor or to the end customer. Resulting losses from sale of handsets at a discount are recognised at the date of sale.

Roaming revenues

Mobile segment derives roaming revenue as a result of airtime and other services used by the mobile segment's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled net on a regular basis.

Premium SMS

Revenues from premium SMS, short text messages that enable customers to use their mobile phones to send money transfer requests and pay for goods and services from third parties, are recognised using netto principle.

Costs

Discounts directly related to the sale of equipment, SIM cards and activations are netted against revenue in the period the product is sold to the dealer, distributor or the end customer. Commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

(3) Interconnect revenues

Interconnect revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but use the Group's network. These revenues are recognised in profit or loss at the time when the call is received in the Group's network. The Group pays a proportion of the call revenue it collects from its customers to other domestic and foreign operators' for calls and other traffic that originate in the Group's network but use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet, IPTV and data services

The Group earns revenue from providing Internet services, IPTV and other data services. Revenue from such services is recognised at the time the service is provided.

(5) Dividend income

Dividend income is recognized when the right to receive payment is established.

(6) Interest

Revenue is recognised as interest accrues (using the effective interest method).

(7) Instalment sales

Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, using the effective interest method.

S Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

T Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives. Detailed figures are described in Note 14.

Financial risk management

The Group's is exposed to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates as a result of ordinary business, debt taken on to finance its business and net investment in foreign operations. The Group's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Group. The Group uses either derivative financial instruments (such as forward and swap contracts) or non-derivative instruments (such as cash instruments) to hedge certain exposures.

The Group does not conduct any speculative trading activities.

Risk management is carried out by the treasury department under approved policies. The Board of Directors provides written principles for overall risk management. In line with these principles, policies exist for specific areas, such as foreign exchange risk, interest rate risk, credit risk, liquidity risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign currency risk

The Group is exposed to foreign currency risk arising from various currency exposures, primarily with respect to the Euro and partially to US Dollar:

a) balance sheet items (such as debt, receivables, payables) denominated in foreign currency
b) probable forecasted transactions or firm commitments (such as purchases or sales) denominated in foreign currency,
c) net investment in Slovak subsidiary (functional currency differs from CZK).

The Group's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes.

The Group primarily hedges the balance sheet foreign currency exposure, mainly long term debt denominated in EUR and net payables in EUR or USD. Just plain-vanilla instruments are currently used for hedging this kind of exposure.

(ii) Interest rate risk

The Group is exposed to interest rate risk arising from:

a) floating interest rate bearing cash investments and debt instruments,
b) fair value of debt on fixed interest rate.

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The cash assets and short term debt are currently maintained on floating rates while long term debt instruments are on fixed rates. The Group may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable interest rates.

(iii) Liquidity risk

The Group's essential objective of liquidity risk management is having access to the cash resources sufficient to meet all its cash payment obligations as they fall due, allowing some flexibility. The cash resources consist of generated cash position (maintained in quickly liquid instruments), and committed credit facilities arranged with banks.

The Group is particularly focusing on the liquidity profile within the time horizon of the next 12 months considering projected cash flow from operations and maturity structure of both debt obligations and financial investments. The balance between funding continuity and flexibility is managed through maintaining the possible use of bank overdrafts or bilateral credit lines.

(iv) Credit risk

Credit risk concentration, with respect to trade accounts receivable, is limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Group does not currently foresee a dramatically higher credit risk associated with these receivables, repayment is significantly impacted by the financial stability of a particular national economy.

The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers wishing to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the resulting into the non significant Group's exposure to bad debts. The maximum exposure is the carrying amount as disclosed in Note 0. There is no significant concentration of credit risk within the Group.

With respect to credit risk arising from the financial assets of the Group, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Group's exposure arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Credit Risk is managed by the Credit Management Unit and is based on three main activities:

a) monitoring of accounts receivables: regular monitoring of payment moral of existing customers and monitoring and analyzing of the receivable aging structure (internal and external indicators of any potential bad debts). Those activities are processed in the integrated system solution for scoring, maintenance and collection of receivables called RMCA.
b) prevention: scoring of new customers – checking procedures (integrated Black List, Debtors Register Solus, other external information databases), set up the limits or/and collection of the deposit according to customer segments, products. Set up the credit limits for indirect sales partners (dealers, distributors, retailers, franchises) for purchase of our products, „securing" of credit limits (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc).
c) collection process: Credit Management cooperate with Customer Care on set up of reasonable, effective and continual collection process. Collection process competence is divided. Collection of active customers is in competence of Customer Care unit, following collection process after contract cancellation is in responsibility of Credit Management.

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are re-measured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Group designates certain derivatives as either:

a) hedge of the fair value of a recognised asset or liability (fair value hedge), or
b) hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

Changes in the fair value of derivatives that are designated and qualified as fair value hedges and that are highly effective are recorded in profit or loss, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualified as cash flow hedges and that are highly effective are recognised in other comprehensive income. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the gains and losses previously deferred in other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in other comprehensive income are transferred to profit or loss and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects profit or loss.

Certain derivative transactions, while providing effective economic hedges under the Group's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Group has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the fair value of such derivative instruments that do not qualify for hedge accounting are recognised immediately in profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting under IAS 39, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in profit or loss when the committed or forecasted transaction ultimately is recognised in profit or loss. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to profit or loss.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The Group also documents its assessment, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Fair value estimation

Except for currency options, the fair values of the derivative financial instruments reflect estimates based on calculations performed using the Group's own discounted cash flow models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Group's bankers.

U Use of estimates, assumptions and judgements

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The estimates and assumptions that might have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next year are discussed below:

(1) Income taxes and deferred taxes

The Group created a provision for current income taxes and in consideration of the temporary differences also for deferred tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business and the measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Group expects to recover or settle the carrying amount of assets and liabilities.

Where the final tax-non-deductible/non-taxable items are different from the amounts that were calculated, such differences will impact the current income and deferred tax provisions in the period in which such determination is made (See Note 4 and Note 15).

(2) Property, plant and equipment, intangible assets and goodwill

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognized in profit or loss. The decision to recognize an impairment loss involves estimates of amount of the impairment, as well as analysis of the reasons for the potential loss. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The Group evaluates its cash-generating units' performance regularly to identify potential impairments. Determining the recoverable amount of the cash-generating units also entails the use of assumptions and estimates and requires a significant element of judgment. The Group assesses at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, The Group estimates the recoverable amount where an impairment loss recognised in prior periods shall be subject to the reversal (See Note 9).

The Group tests goodwill for impairment at each reporting date. However, goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. In accordance with the requirement of IAS 36, goodwill is tested annually for its recoverable amount, as well as when there are indications of impairment (See Note 8).

(3) Provisions and contingent liabilities

As set out in Note 17 the Group is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Group's treatment of obligations with uncertain timing and amount depends on the management's estimation of the amount and timing of the obligation and probability of an outflow of resources embodying economic benefits that will be required to settle the obligation (both legal or constructive). A provision is recognised when the Group has a present obligation as a result of past events, it is probable that an outflow of resources to settle the obligation will be required and a reliable estimate of the amount of the obligation can be made (See Note 16). Contingent liabilities are not recognised, because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. Contingent liabilities are assessed continually to determine whether an outflow of resource embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

V Change in accounting policy

No significant changes in accounting policies were applied in 2011 and 2010.

W Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, interest expense, other financial expense (which includes primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

Notes to the consolidated financial statements

Content

1. Segment information

Business segments recognised by the Group are as follows:

- fixed – network communication services using a fixed network, WiFi infrastructure and IS/ICT services provided by the Company and other consolidated subsidiaries
- mobile – mobile communication services provided by the Company and by Telefónica Slovakia, s.r.o.

Year ended 31 December 2011 **In CZK million**	**Fixed**	**Mobile**[1]	**Group**
Revenues from voice services	6,627	12,235	18,862
Monthly charges	4,298	8,602	12,900
Data services	8,878	2,599	11,477
Other revenues	3,016	6,798	9,814
Revenues incl. inter-segment sales	22,819	30,234	53,053
Inter-segment sales	(318)	(347)	(665)
Total consolidated revenues	22,501	29,887	52,388
Other income	477	10	487
Total consolidated costs	(14,101)	(16,963)	(31,064)
Impairment loss	(9)	(12)	(21)
Depreciation	(7,164)	(2,079)	(9,243)
Amortisation	(922)	(1,486)	(2,408)
Total consolidated depreciation and amortization	(8,086)	(3,565)	(11,651)
Operating income	782	9,357	10,139
Net financial loss			(131)
Profit before tax			10,008
Corporate income tax			(1,324)
Profit for the year			**8,684**
Assets (excluding goodwill)	40,472	35,057	75,529
Goodwill	133	13,320	13,453
Total assets	**40,605**	**48,377**	**88,982**
Trade and other payables	5,793	7,089	12,882
Other liabilities	3,474	3,529	7,003
Total liabilities	**9,267**	**10,618**	**19,885**
Capital expenditure	**3,456**	**2,400**	**5,856**

[1] Standalone figures of Telefónica Slovakia, s.r.o. included.

Year ended 31 December 2010 In CZK million	Fixed	Mobile[1]	Group
Revenues from voice services	7,297	14,310	21,607
Monthly charges	5,131	8,438	13,569
Data services	9,106	2,368	11,474
Other revenues	3,026	6,682	9,708
Revenues incl. inter-segment sales	24,560	31,798	56,358
Inter-segment sales	(345)	(451)	(796)
Total consolidated revenues	24,215	31,347	55,562
Other income	215	27	242
Total consolidated costs	(14,658)	(18,091)	(32,749)
Impairment reversal	4,325	–	4,325
Depreciation	(6,684)	(2,790)	(9,474)
Amortisation	(1,048)	(1,334)	(2,382)
Total consolidated depreciation and Amortization	(7,732)	(4,124)	(11,856)
Operating income	6,365	9,159	15,524
Net financial loss			(206)
Profit before tax			15,318
Corporate income tax			(3,038)
Profit for the year			**12,280**
Assets (excluding goodwill)	52,456	26,888	79,344
Goodwill	128	13,320	13,448
Total assets	**52,584**	**40,208**	**92,792**
Trade and other payables	5,501	6,907	12,408
Other liabilities	3,491	3,717	7,208
Total liabilities	**8,992**	**10,624**	**19,616**
Capital expenditure	**2,872**	**2,792**	**5,664**

[1] Standalone figures of Telefónica Slovakia, s.r.o. included.

Revenue of the Group is predominantly derived from domestic trading activities. With respect to the issue of IFRS 8 Operating segments and the deep integration process from the past convergence of fixed and mobile operations, the Group has analysed criteria for segment identification. As a result of the analysis, concept of fix and mobile segment is still valid and most appropriate for segment recognition.

The inter-segment pricing rates applied in 2011 and 2010 were determined on the same basis as rates applicable for other mobile operators and are consistent with rates applied for pricing with other mobile operators.

Capital expenditures comprise additions to property, plant and equipment and intangible assets.

During 2011, Telefónica Slovakia, s.r.o. further strengthened its position on the Slovak mobile market. In line with its strategy to offer simple and transparent services, it has extended its offer by new tariffs for higher residential segment (O2 Filip) and segment of small and medium businesses (O2 Moje firma). On 18 July 2011, mobile data services based on 3G technology were launched covering one third of Slovak population as at 2011 year-end. This helped to increase total subscribers base in 2011 by 32.2% year-on-year to 1,164 thousand. Of that, contract customers grew by 48.9% year-on-year to reach 498 thousand, while prepaid base increased by 22% reaching 666 thousand at the end of 2011. Consequently, contract customers reached 42.8% of total customer base, representing a 4.8 percentage points increase year-on-year. Subscriber's market share of Telefónica Slovakia, s.r.o. improved during 2011 from 14.7% to over 18%. Subscribers' growth and improving customer mix led to an increase in revenues which reached CZK 3,870 million in 2011 compared to CZK 2,824 million in 2010. As at 31 December 2011, net book value of fixed assets deployed in Slovakia amounted to CZK 2,692 million (2010: CZK 2,642 million).

2. Revenues and costs

Revenues from voice services **In CZK million**	**Year ended** **31 December 2011**	**Year ended** **31 December 2010**
Voice – outgoing	10,453	11,875
Interconnection and other wholesale services	7,744	8,936
Total revenues from voice services	**18,197**	**20,811**

Data services **In CZK million**	**Year ended** **31 December 2011**	**Year ended** **31 December 2010**
Leased lines and fixed data services	2,836	3,132
Internet (including monthly and one-off charges)	5,531	5,383
Mobile data	2,598	2,368
IPTV	512	591
Total revenues from data services	**11,477**	**11,474**

Other revenues **In CZK million**	**Year ended** **31 December 2011**	**Year ended** **31 December 2010**
SMS & MMS & PRMS and Contents	4,806	4,765
Equipment and activation charges	1,667	1,473
ICT and business solutions	2,356	2,555
Other telecommunication revenues	985	915
Total other revenues	**9,814**	**9,708**

Other income **In CZK million**	**Year ended** **31 December 2011**	**Year ended** **31 December 2010**
Rental and non-telco income	83	93
Gains from fixed assets disposal	346	92
Indemnities, penalties and similar income	58	57
Total other income	**487**	**242**

Revenues from related parties are disclosed in Note 21.

Other cost of sales In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Telco services, Contents and other cost of sales	(665)	(997)
Sub-deliveries	(1,023)	(849)
Commissions	(1,741)	(1,332)
Total cost of sales	**(3,429)**	**(3,178)**

Other expenses In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Billing and collection, provision for bad and doubtful debts	(831)	(958)
Network & IT repairs and maintenance	(2,658)	(2,508)
Rentals, buildings and vehicles	(2,131)	(2,228)
Utilities supplies	(1,126)	(1,072)
Marketing and call centers	(1,642)	(1,804)
Consultancy and professional fees and other external services	(735)	(837)
Royalties and management fees	(1,080)	(1,058)
Administrative fees and other operating expenses	(524)	(547)
Capitalized own expense on fixed assets	671	637
Total other expenses	**(10,056)**	**(10,375)**

Staff costs In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Wages and salaries	(4,285)	(4,770)
Redundancy payments	(174)	(458)
Health and Social security contributions	(1,434)	(1,595)
Staff welfare costs	(286)	(248)
Total staff costs	**(6,179)**	**(7,071)**

Group does not participate in any pension plan.

A restructuring plan covering both employees and members of management was approved and subsequently implemented by the Group during 2010 and 2011. As a result of the restructuring process the Group incurred restructuring costs of CZK 174 million during the year ended 31 December 2011 that have been recognised for the redundancy payments (2010: CZK 427 million).

Statutory auditor's fees were as follows:

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Auditor's fees	27	27

Purchases from related parties are disclosed in Note 21.

3. Financial income and costs

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Financial income		
Interest income	117	80
Gain on fair value adjustments of financial instruments	185	–
Other financial income [1]	325	287
Total financial income	**627**	**367**
Financial costs		
Interest expenses	(224)	(240)
Loss on fair value adjustments of financial instruments	–	(175)
Other financial costs [1]	(534)	(158)
Total financial costs	**(758)**	**(573)**
Net financial loss	**(131)**	**(206)**

[1] Vast majority consists of gains/(losses) arising from foreign exchange differences.

4. Income taxes

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Total income tax expense is made up of:		
— Current income tax charge	2,231	2,440
— Deferred income tax charge (Note 15)	(907)	598
Taxes on income	**1,324**	**3,038**

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Group as follows:

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Profit before tax	10,008	15,318
Income tax charge calculated at the statutory rate of 19% (2010: 19%)	1,902	2,910
Not taxable income	–	(21)
Expenses not deductible for tax purposes	129	142
Tax related to prior periods	59	(63)
Tax losses from previous years	(57)	–
Effect of the first time deferred tax recognition by Telefónica Slovakia, s.r.o.	(709)	–
Unrecognised tax losses	–	70
Taxes on income	**1,324**	**3,038**
Effective tax rate	13%	20%

As at 31 December 2011, the total amount of provision for current income taxes is CZK 2,220 million (2010: CZK 2,488 million), advances paid for income taxes amount to CZK 2,380 million (2010: CZK 2,941 million) and the net deferred tax liability is CZK 3,736 million (2010: CZK 3,936 million) and the net deferred tax asset is CZK 746 million (2010: CZK 5 million).

5. Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	31 December 2011	31 December 2010
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	8,684	12,280
Basic earnings per share (CZK)	27	38

There is no dilution of earnings as no convertible instruments have been issued by the Company.

6. Dividends

In CZK million	31 December 2011	31 December 2010
Dividends declared (including withholding tax)	12,884	12,884

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2011. Approval of the 2011 profit and the decision regarding the amount of any dividend payment for the 2011 financial year will take place at the Annual General Shareholders Meeting.

Dividend per share for the years ended 31 December were as follows:

In CZK	Year ended 31 December 2011	Year ended 31 December 2010
Dividend per share (nominal value of CZK 100)	40	40

7. Property, plant and equipment

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Communication technology and related equipment	Other fixed assets	Total
At 31 December 2011					
Opening net book amount	11,808	33,688	9,314	1,841	56,651
Additions	317	823	2,650	446	4,236
Additions from WiFi acquisition	–	–	30	–	30
Disposals and other movements	(1)	(4)	80	(2)	73
Assets classified as held for sale	(199)	(2)	–	–	(201)
Depreciation charge	(949)	(4,858)	(2,626)	(810)	(9,243)
Impairment charge	–	–	(21)	–	(21)
Closing net book amount	**10,98**	**29,647**	**9,427**	**1,475**	**51,525**
At 31 December 2011					
Cost	20,180	102,999	90,460	8,183	221,822
Accumulated depreciation and impairment allowance	(9,204)	(73,352)	(81,033)	(6,708)	(170,297)
Net book amount	**10,976**	**29,647**	**9,427**	**1,475**	**51,525**
At 31 December 2010					
Opening net book amount	11,883	33,542	10,020	2,100	57,545
Additions	337	926	2,398	627	4,288
Disposals and other movements	(48)	74	(35)	(31)	(40)
Assets classified as held for sale	(3)	(1)	–	–	(4)
Depreciation charge	(726)	(4,636)	(3,254)	(858)	(9,474)
Impairment charge	(1)	–	(7)	–	(8)
Impairment reversal	366	3,783	192	3	4,344
Closing net book amount	**11,808**	**33,688**	**9,314**	**1,841**	**56,651**
At 31 December 2010					
Cost	20,596	102,473	90,646	8,689	222,404
Accumulated depreciation and impairment allowance	(8,788)	(68,785)	(81,332)	(6,848)	(165,753)
Net book amount	**11,808**	**33,688**	**9,314**	**1,841**	**56,651**

The net book amount at 31 December 2011 includes 1,805 million CZK of assets in the course of construction (31 December 2010: 2,842 million CZK) and assets in the course of construction are spread in all disclosed categories of property, plant and equipment following their nature.

As at 31 December 2011, the carrying value of non-depreciated assets amounted to CZK 191 million (2010: CZK 215 million).

No property, plant and equipment were pledged as at 31 December 2011.

No borrowing costs were capitalized during the years 2011 and 2010.

Classes of property, plant and equipment can be broken down into main categories as follows:

Land, buildings and construction	Closing balance	
In CZK million	31 December 2011	31 December 2010
Buildings [1]	5,679	6,143

[1] Majority of buildings are buildings for telecommunication technologies.

Ducts, cables and related plant	Closing balance	
In CZK million	31 December 2011	31 December 2010
Twin cables	21,539	24,735
Terrestrial optic fibre	5,167	5,621

Communication technology and related equipment	Closing balance	
In CZK million	31 December 2011	31 December 2010
Exchanges	1,235	1,095
Transmission equipment	1,504	1,401
IP technology, routers, modems	943	992

Other fixed assets	Closing balance	
In CZK million	31 December 2011	31 December 2010
Information process equipment	1,113	1,184

The Group reports and classifies the following assets held for sale at the balance sheet date:

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Other fixed assets	Total
At 31 December 2011				
Cost	6	–	–	6
Accumulated depreciation and impairment allowance	(5)	–	–	(5)
Net book amount	**1**	**–**	**–**	**1**
At 31 December 2010				
Cost	502	86	69	657
Accumulated depreciation and impairment allowance	(490)	(86)	(69)	(645)
Net book amount	**12**	**–**	**–**	**12**

Assets intended for sale in most cases represent buildings with lands that have become idle and ready to be sold. It is expected that the sale will take place within one year. Spaces in sold buildings were partially leased by the Group.

The non-current assets classified as held for sale are presented in the fixed segment.

In 2011, the Group achieved a total gain from the sale of the above fixed assets amounting to CZK 346 million (2010: CZK 92 million) and total losses in amount CZK 49 million (2010: CZK 19 million).

In 2011, the Group conducted a copper project, which consisted of sale of unused copper cables (twin cables) achieving total gain CZK 223 million.

Cost of fully depreciated property, plant and equipment was CZK 70,470 million as at 31 December 2011 (2010: CZK 71,620 million).

8. Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2011				
Opening net book amount	13,448	3,628	4,361	21,437
Additions	–	–	1,386	1,386
Additions from WiFi acquisition	5	–	199	204
Disposals and other movements	–	1	38	39
Amortisation charge	–	(393)	(2,015)	(2,408)
Closing net book amount	**13,453**	**3,236**	**3,969**	**20,658**
At 31 December 2011				
Cost	13,453	6,217	26,781	46,451
Accumulated amortisation and impairment allowance	–	(2,981)	(22,812)	(25,793)
Net book amount	**13,453**	**3,236**	**3,969**	**20,658**
At 31 December 2010				
Opening net book amount	13,448	4,029	5,000	22,477
Additions	–	–	1,376	1,376
Disposals and other movements	–	(8)	(26)	(34)
Amortisation charge	–	(393)	(1,989)	(2,382)
Closing net book amount	**13,448**	**3,628**	**4,361**	**21,437**
At 31 December 2010				
Cost	13,448	6,215	27,426	47,089
Accumulated amortisation and impairment allowance	–	(2,587)	(23,065)	(25,652)
Net book amount	**13,448**	**3,628**	**4,361**	**21,437**

Goodwill

Goodwill in amount of CZK 13,320 million resulted from the acquisition of the remaining 49% ownership interest in Eurotel Praha spol. s r.o. (“Eurotel”). The initially recognized goodwill of CZK 14,087 million resulted from comparison of cost of business combination of CZK 29,215 million and fair value of net assets acquired of CZK 15,128 million. Until 31 December 2004 goodwill was amortised on a straight line basis over a period of 20 years and assessed for an indication of impairment at each balance sheet date.

Due to a revision of IFRS 3, IAS 36 and IAS 38 the Group ceased amortisation of the previously recognized goodwill from 1 January 2005. Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (CZK 767 million). Since the year ending 31 December 2005 onwards, goodwill is classified as an asset with indefinite useful life which has been tested annually for the impairment, as well as when there are indications of impairment.

The Group performed impairment tests resulting into no impairment losses of goodwill were being recognised in 2011 and 2010. The impairment test involves determining the recoverable amount of the mobile cash-generating unit, which corresponds to the value in use. Value in use is a present value of the future cash flows expected to be derived from a cash-generating unit.

Value in use is determined on the basis of an enterprise valuation model and is assessed from a Group internal perspective. Value in use is determined based on cash flow budgets, which are based on the medium-term business plan for a period of 3 years, have been approved by the management and are valid when the impairment test is performed. This business plan is based on the past experience, as well as on future market trends. Further, the business plan is based on general economic data derived from macroeconomic and financial studies. Cash flows beyond the three-year period are extrapolated using appropriate growth rates. Key assumptions on which management has based its determination of business plan and growth rates include development of gross domestic product, interest rates, nominal wages, average revenue per user (“ARPU”), customer acquisition and retention costs, churn rates, capital expenditure, market share, growth rates and discount rates.

Any significant future changes in the market and competitive environments could have an adverse effect on the value of the cash-generating units.

The calculations of value in use for all cash-generating units are the most sensitive to the following assumptions:

Estimated growth rate – the basis used to determine the value assigned to estimated growth rate is the forecast of the market and regulatory environment, where the Group conducts its business.

Discount rate – discount rates reflect management’s estimate of the risk specific to the cash generating unit. The basis used to determine the value assigned is a weighted average of cost of capital (“WACC”).

There is no other intangible asset with indefinite useful life except for goodwill.

Goodwill on WiFi acquisitions

In accordance with principles of standard IFRS 3, the acquirer measures the identifiable assets acquired and liabilities assumed at their acquisition-date fair values. Identifiable assets and liabilities assumed are recognised separately from goodwill. For this purpose Purchase Price Allocation of all acquired assets and assumed liabilities at their fair values was carried out in all acquired entities.

By purchasing network infrastructure, customer base and related assets and liabilities from local providers of Internet access using WiFi technology a goodwill in the amount of CZK 5 million was recognised. Goodwill is presented separately on the balance sheet and is tested annually for impairment. Gain on a bargain purchase in the total amount of CZK 14 million was calculated in several cases of acquired providers and recognised in other income in profit or loss. The goodwill and the gain on a bargain purchase resulted from comparison of the present value of the purchase price in the amount of CZK 225 million and fair value of net assets acquired of CZK 234 million. Before recognising a gain on a bargain purchase it was reassessed whether all of the assets acquired and all of the liabilities assumed were identified.

Licences

Acquired licences are represented by rights to operate cellular networks in the Czech Republic, the UMTS (Universal Mobile Telecommunication System, the third generation mobile cellular technology for networks), GSM (Global System for Mobile Communication, the second generation technology) and NMT (Nordic Mobile Telephone, the first generation technology).

In the course of 2012, the Czech Telecommunication Office is expected to announce a tender for licences to operate a cellular network. These licences concern rights to operate the 1800 MHz, 800 MHz (Digital dividend), 2.6 GHz FDD and 2.6 GHz TDD spectrums.

The Company participates in a public discussion about tender conditions that should occur during the first half of 2012 with a consecutive tender process to be called later by the Czech Telecommunication Office.

With respect to the operation launch in 2007, the license for GSM and UMTS networks was awarded to Telefónica Slovakia, s.r.o. on 7 September 2006 for SKK 150 million (EUR 4.1 million).

Carrying value of licences:

In CZK million	Force by	31 December 2011	31 December 2010
GSM 900 license	2016	330	402
GSM 1800 license	2016	266	324
NMT 450 license	2013	13	19
UMTS license	2022	2,519	2,769
GSM and UMTS license – Slovakia	2026	108	114
Total		**3,236**	**3,628**

No borrowing costs were capitalized during the years 2011 and 2010.

Cost of fully amortised intangible assets was CZK 18,109 million as at 31 December 2011 (2010 CZK: 19,063 million).

All of the Group's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and revision of useful life.

9. Impairment of fixed assets

Fixed assets of the fixed line business

During 2003, external factors relating to the telecommunication market and regulatory environment namely uncertainty regarding tariff rebalancing, termination charges for internet dial-up, interconnection charges and other regulatory decisions in the Czech Republic led the management to assess and adjust the recoverable amount of the fixed line segment assets. The fixed line segment assets constitute one cash-generating unit (the "CGU").

As at 30 June 2010 and 31 December 2010, the management of the Group reviewed the indicators which could have indicated that a previously recognised impairment loss of fixed line segment assets which constitute a cash generating unit made in 2003 may no longer be relevant. The Group considered both external and internal sources of information.

Value in use has been calculated by a method of cumulated discounted cash flows generated by the CGU in future. Primarily, the following key elements have been used in the impairment testing model: latest version of four-year business plan (revenues, operating expenses, capital expenditures, etc.), estimation of consecutive development of key indicators (estimated growth rates applied on revenues, margin, investments, etc.), terminal value, discount rate derived from weighted average cost of capital.

As at 30 June 2010, the management of the Group performed a detailed impairment review. As a result of the review, the recoverable amount of the fixed line segment assets (impairment test model) was estimated. While performing the review, the Group considered all relevant external and internal sources of information when determining the recoverable amount.

The Group has taken into account certain favourable effects like improvements and efficiencies occurred, changes during the period and further expected in the near future in the technological, market and economic environment that will have favourable effect, manner in which assets are used and are expected to be used, economic performance of assets. The Group has taken into account primarily following effects – continuously implemented measures to improve cost efficiency of operations, demand for complex ICT solutions as well as a generally increasing demand on capacity for data transfers (driven by Broadband Internet, IP-TV, Very High Speed DSL), providing of a large variety of data services besides traditional fixed line voice services, etc.

Impairment test has proved the recoverable amount is sufficient to reverse the previously recognised impairment loss. Based on the impairment test performed as at 30 June 2010 the Group reversed the previously recognised impairment loss of CZK 4,344 million (as limited by recoverable amount) attributable to the CGU's assets. Carrying amount of CGU's assets was increased to the recoverable amount. Increased amount did not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised in prior years.

Carrying amount of identifiable assets (subject to reversal) before reversal was CZK 34 billion, after reversal CZK 38 billion. The value of assets at costs (subject to reversal) was CZK 111 billion.

Reversal of previously recognised impairment loss led to increased carrying amount of assets, hence prospective increase of depreciation charge as well.

As a consequence of June's impairment reversal the management of the Group reviewed again the indicators by 31 December 2010 as well as 31 December 2011, which could have indicated whether the CGU's assets might be impaired. Assessment carried out as at 31 December 2010 and 2011 confirmed that no such indicator exists and the values of the existing assets are fairly stated.

10. Inventories

In CZK million	31 December 2011	31 December 2010
Telecommunication material	134	255
Goods and work in progress	354	351
Total	**488**	**606**

The inventories noted above are stated net of an allowance of CZK 43 million (2010: CZK 61 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories at net realisable value amounts to CZK 47 million (2010: CZK 67 million). The amount of inventories recognised as an expense is CZK 2,775 million (2010: CZK 2,477 million).

11. Receivables and prepayments

In CZK million	31 December 2011	31 December 2010
Trade receivables from the third parties (net)	6,912	7,087
Group trade receivables	350	446
Prepayments	543	821
Other debtors (net)	468	284
Total	**8,273**	**8,638**

Trade receivables and other debtors are stated net of bad debt provision of CZK 3,718 million (2010: CZK 3,831 million). In order to preserve the tax-deductible status of the bad debt expense, the Group's trade receivables have been fully provided for, however not derecognised from the primary books and records until certain statutory collection requirements are satisfied.

As at 31 December 2011, other debtors contained restricted cash of CZK 22 million (2010: CZK 0 million).

Receivables from related parties are disclosed in Note 21.

Trade receivables In CZK million	Carrying amount	Neither Impaired nor overdue	Not impaired but overdue			
			Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2011	7,262	3,594	246	25	38	67
At 31 December 2010	7,533	3,333	377	27	32	119

Bad debt provisions In CZK million	
At 1 January 2010	3,661
Additions	3,488
Retirements/amount paid	(3,318)
At 31 December 2010	**3,831**
Additions	2,519
Retirements/amount paid	(2,632)
At 31 December 2011	**3,718**

The Group's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Group's trade receivables.

As at 31 December 2011, the Group presented non-current assets of CZK 149 million (2010: CZK 170 million) consisting of long-term credits and advance payments for long-term expenses, which are classified as other financial assets. As at 31 December 2011 non-current financial assets contained restricted cash of CZK 20 million (2010: CZK 0 million) resulting for the Company from legal requirements set by Czech National Bank Authority for payment services providers.

12. Cash and cash equivalents

In CZK million	31 December 2011	31 December 2010	Interest rate
Cash at current bank accounts	192	220	Floating
Cash at cash-pooling structures (inter-company)	6,763	4,578	Floating
Total cash and cash equivalents	**6,955**	**4,798**	

As at 31 December 2011 and 2010, cash equivalents of the Group comprised interest bearing deposits with maximum maturity of three months.

Since April 2006, the Group has been taking part in Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective cash flow management.

At 31 December 2011, the Group had available equivalent of CZK 1,884 million (2010: CZK 4,240 million) of undrawn committed facilities.

For the purposes of the statement of cash flows, the year-end cash and cash equivalents comprise only the following component:

In CZK million	31 December 2011	31 December 2010
Cash and cash equivalents	6,955	4,798

As at 31 December 2011 and 2010 no cash and cash equivalents were pledged.

13. Trade and other payables

In CZK million	31 December 2011	31 December 2010
Trade creditors (net)	10,334	9,766
Tax and social security liability	681	697
Other deferred revenue	396	485
Prepaid cards	560	527
Employee wages and benefits	541	586
Other creditors	370	347
Total payables	**12,882**	**12,408**
Other non-current liabilities	**108**	**25**

As at 31 December 2011 and 2010, other non-current liabilities were made up primarily of deposits placed by recharging partners for prepaid cards and liabilities with due date in more than 12 months.

14. Financial debt

In CZK million	31 December 2011	31 December 2010
Bank loans in foreign currencies	2,969	2,883
Interest obligation and derivatives	92	141
Total financial debt	**3,061**	**3,024**
Repayable:		
— Within one year	3,061	141
— Between two and five years (total non-current)	–	2,883
Total financial debt	**3,061**	**3,024**

In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity date on 30 July 2012. As at 31 December 2011, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2011 the Group utilized bank overdrafts of CZK 2 million (2010: CZK 0 million).

The Group's loan interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2011	31 December 2010
At fixed rate	2,969	2,883

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate estimated by the management of the Group as reachable at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2011	2010
Bank loans in foreign currencies	6.64%	6.64%

Loans are not secured over any assets of the Group.

The table below summarizes the maturity profile of the Group's financial and trade liabilities at 31 December 2011 based on contractual undiscounted payments.

At 31 December 2011 In CZK million	**Less than 3 months**	**3 to 12 months**	**1 to 5 years**	**> 5 years**
Interest bearing loans and borrowings	2	3,165	–	–
Trade and other payables (except for Deferred revenue and Prepaid cards)	10,495	1,431	–	–
Total	**10,497**	**4,596**	**–**	**–**
Non-current other liabilities	–	–	102	6

At 31 December 2010 In CZK million	**Less than 3 months**	**3 to 12 months**	**1 to 5 years**	**> 5 years**
Interest bearing loans and borrowings	–	191	3,074	–
Trade and other payables (except for Deferred revenue and Prepaid cards)	10,007	1,389	–	–
Total	**10,007**	**1,580**	**3,074**	**–**
Non-current other liabilities	–	–	16	9

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements.

	Carrying amount		**Fair value**	
In CZK million	**2011**	**2010**	**2011**	**2010**
Financial assets				
Cash and cash equivalents	6,955	4,798	6,955	6,955
Short-term loans (incl. accrued interest)	5	3	5	5
Derivatives	101	9	101	101
Other financial assets	149	170	149	149
Financial liabilities				
Interest bearing loans and borrowings:				
— Fixed rate borrowings (incl. accrued interest)	3,052	2,963	3,115	3,169
— Derivatives	9	61	9	61

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: techniques which use inputs that have a significant effect on the recorded fair value and that are not based on observable market data.

As at 31 December 2011 and 31 December 2010, the Group held only the foreign currency forward and swap contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2011, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Financial risk analysis

The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange rates and interest rates.

	Effect on profit before tax	
In CZK million	**2011**	**2010**
FX risk		
Value at Risk [1]	(149)	(163)
Stress testing [2]	(47)	(52)
IR risk		
Stress testing[3]	(94)	(108)

[1] The Value at Risk (VaR) Model enables the Group estimate the probability of maximum possible loss to the portfolio value in the given time frame which will not be exceeded given the defined reliability level. For conducting a VaR calculation, the Group uses the risk variance and covariance method using the normal distribution (e.g. parametric method). The time frame used is one month with a 95% reliability rate. Considering the importance of net open positions resulting from financial assets and financial liabilities of the Group in individual foreign currencies, the Group models VaR from a position of translation and transaction in EUR and USD.

[2] FX risk used stress scenario represents the immediate loss caused by one-off change in the foreign exchange rate by 1% in a negative direction.

[3] IR risk used stress scenario represents immediate one-off change of interest rates along the whole yield curve by 1% in an unfavourable direction. The calculation of unfavorable impact on Group cash flows (due to an increase in interest expense or drop in interest received relating to financial assets and financial liabilities) is made each month on the floating basis within a time frame of 12 months.

Financial derivatives

The following nominal value of foreign exchange contracts was used by the Group to manage the currency risk:

	Nominal value In EUR million		Fair value In CZK million	
	2011	**2010**	**2011**	**2010**
Foreign exchange contracts	165	136	92	(52)

15. Deferred income taxes

Deferred income taxes are calculated using currently enacted tax rates expected to apply when the asset is realized or the liability settled.

Short-term and long-term deferred taxes were calculated at 19% for both years 2010 and 2011.

In CZK million	2011	2010
At 1 January	3,931	3,333
Profit or loss tax charge / (credit) (Note 4)	(907)	598
Foreign exchange translation reserve	(34)	–
At 31 December	2,990	3,931

In 2011 deferred tax asset in Telefónica Slovakia, s.r.o. amounting to CZK 744 million was recognized resulting mainly from possible utilization of tax losses suffered in prior periods.

The following amounts, determined after offsetting, are shown in the consolidated balance sheet:

In CZK million	31 December 2011	31 December 2010
Deferred tax assets	(966)	(254)
Deferred tax liabilities	3,956	4,185
Total	**2,990**	**3,931**

The deferred tax asset includes CZK 419 million (2010: CZK 225 million) recoverable in less than twelve months and CZK 547 million (2010: CZK 29 million) recoverable after more than twelve months.
The deferred tax liability includes CZK 497 million (2010: CZK 452 million) payable in less than twelve months and CZK 3,459 million (2010: CZK 3,733 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Consolidated balance sheet		Consolidated profit or loss	
In CZK million	**2011**	**2010**	**2011**	**2010**
Temporary differences relating to:				
— Tax losses	(559)	–	(533)	–
— Property, plant and equipment and intangible assets	3,695	4,160	(458)	537
— Trade receivables, inventories and other differences	(146)	(229)	84	61
Total	**2,990**	**3,931**	**(907)**	**598**

As at 31 December 2011 the total amount of unused tax losses from previous years totals to CZK 3,054 million. This amount includes tax losses of CZK 112 million, which were not taken into account, when the deferred tax asset was recognized as it is not probable that taxable profit will be available against which the tax losses can be utilised.

The tax loss in the Slovak Republic generated before 31 December 2009 can be carried forward up to five years, while the tax loss generated after 1 January 2010 can be carried forward up to seven years.

16. Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Other provisions	Total
At 1 January 2011	**129**	**94**	**223**
Additions during the year	16	383	399
Utilised during the year	(121)	(408)	(529)
At 31 December 2011	**24**	**69**	**93**
Short-term provisions 2011	5	62	67
Long-term provisions 2011	19	7	26
	24	**69**	**93**
Short-term provisions 2010	87	84	171
Long-term provisions 2010	42	10	52
	129	**94**	**223**

With the exception of the regulatory and court decision provisions and other small provisions for which the expected timing of payments is not certain all other provisions are expected to be utilised within the next twelve months from the balance sheet date.

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Group (see Note 17).

Other provisions

Other provisions consist mainly of expected costs associated with untaken holiday compensation, share plans and provision to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold.

17. Contingencies

The Company is involved in a number of legal disputes arising from standard business interactions. Throughout 2011 the Company continued the successful trend of defending itself against law-suits filed by the third parties in the past. The only new lawsuit against the Company was brought by VOLNÝ, a.s. During 2011, an official administrative proceeding has been opened by Office for Protection of Economic Competition (see II). Major legal disputes and other proceedings relating to the Company are shown below.

I. Vodafone Czech Republic a.s. – Interconnect agreement dispute

On 30 June 2005, Vodafone Czech Republic a.s. (former Český Mobil/Oskar Mobil) filed a legal action with the Municipal Court in Prague against the Company for damages worth CZK 538 million with interests and the return of unjust enrichment of CZK 117 million with interests. The Company allegedly did not transit the traffic to a network operated by the mobile operator in compliance with relevant interconnect agreements. The High Court in Prague confirmed the conclusion of the Company that this case had already been decided before by the Czech Telecommunication Office in favour of the Company and that Vodafone Czech Republic, a.s. was seeking only to by-pass this court decision. In the light of the above, in September 2008 the Municipal Court in Prague terminated the proceeding. The High Court in Prague partly confirmed this decision. Subsequently, the Municipal Court in Prague dismissed the remaining part of the legal action as groundless by its verdict of 30 September 2009. The High Court confirmed this verdict in appeal proceeding in February 2011 and the proceeding is legally closed. Though, Vodafone Czech Republic a.s. filed extraordinary appeal regarding CZK 26 million claiming that the decision is incorrect in this extent. The Supreme Court has not decided on extraordinary appeal yet.

II. ÚOHS (Office for Protection of Economic Competition)

i. *Administrative proceeding on alleged abuse of dominant position on fix broadband market*
The Office for the Protection of Economic Competition (ÚOHS) has been conducting so called "preliminary investigation" since November 2008 to determine whether the Company had abused its dominant position in the broadband market. The Company cooperated with the Office while repeatedly stating and proving that it had not held a dominant position in the market and, as such, no abuse could have been committed. Although the extent of information and documents required by the Office during more than a two-year long investigation grew immensely, the Company was never allowed to inspect the file to check its content and control how the information was interpreted by the Office. In the light of the above, the Company requested for court protection by legal action filed to the Regional Court in Brno. In December 2010, the Regional Court in Brno preliminarily banned the Office from the continuation of the preliminary investigation and, in February 2011, issued a verdict stating that the preliminary investigation has to be stopped immediately. This verdict was later confirmed by Supreme Administrative Court in September 2011. The Office reacted by opening official administrative proceeding on dominant position on fix broadband market by ADSL technology in March 2011. The Company filed its statement proving that the Office incorrectly defines relevant market on which Company would allegedly hold dominant position and moreover even abuse it. Company's statement about strong competition between technological platforms such as xDSL, cable and WiFi in the Czech Republic was repeatedly confirmed by the Czech Telecommunication Office and European Commission. The Company also provided the Office with numerous documents proving that all steps of the Company were correct. More records are continuously filed into the file. The Company cannot estimate when the proceeding will be closed due to extreme length and volume of information. As at the date of the financial statements approval it was not possible to make a reliable estimate of the financial impact of this administrative proceeding.

ii. *Proceeding for CZK 81.7 million*
In December 2009, the Regional Court in Brno cancelled the decision of the Office over the penalty of CZK 81.7 million imposed in December 2003 on the Company in the proceeding on the alleged abuse of the dominant position in the fixed voice services market. As a consequence of the dismissal, the Company asked the Office for returning the penalty including interests. Although the principal was returned by the Office, before it was decided on the returning of interests, the Supreme Administrative Court had in the meantime cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. After all in March 2011 the Regional Court in Brno cancelled the decision regarding the penalty and returned the case back to the Office where the Office should in compliance with law justify the penalty in relation to the judged period.

III. Disputes with AUGUSTUS spol. s r.o. company

i. AUGUSTUS spol. s r.o. had sued the Company for an alleged loss of profit in the period from 1995 to 2001 in the amount of CZK 183 million with interests. AUGUSTUS spol. s r.o. claims that the Company has illegally terminated the contract for the issue and distribution of phone cards signed for an open period of time. Based on the decision of the High Court in Prague, in August 2006, the Company paid a sum of CZK 83 million plus relevant interests (total of CZK 139 million). Later on, we could see a positive turn in the proceeding in favour of the Company when the Supreme Court based on the Company's appeal cancelled the previous verdicts in June 2009 and the Municipal Court in Prague ultimately dismissed the lawsuit in April 2010. The High Court finally confirmed this dismissal in August 2011. In reaction to this, the Company filed a lawsuit against AUGUSTUS spol. s r.o.to return the amount of CZK 139 million. The Municipal Court in Prague granted the claim in September 2011. AUGUSTUS spol. s r.o. filed an appeal. Meanwhile it turned out that at least CZK 94 million had been transferred to third parties based on agreements with the statutory representative. The Company is taking all legal steps to secure the property and to avoid additional losses.

ii. AUGUSTUS spol. s r.o. subsequently filed another legal action against the Company for the amount of CZK 294 million. Again, the action was based on the contract for the issue of phone cards which ended in 1995. Claims had no legal grounds and in the light of development in the main case indefensible. The proceeding was finally terminated due to the non-payment of the court fee in January 2011.

IV. MEDIATEL, spol. s r.o. – dispute on CZK 359 million

MEDIATEL, spol. s r.o., which was cooperating with the Company on the publishing of the phone directory distributed to all telecommunications subscribers since 1992 (known under brand name "Zlaté stránky"), filed a legal action against the Company for the compensation of an alleged damage exceeding CZK 359 million in December 2009. After the delivery of the legal action in January 2010, the Company presented its position with a detailed analysis of the groundlessness of the lawsuit. The Court in the first hearing pointed out deficiencies in the legal action and burden of proof (claim is not satisfactory justified). Next hearing will take place in 2012.

V. CNS a.s. – dispute on CZK 137 milion

In 2009, the employees of CNS a.s., dealing with the development and updates of IT applications and the employees of Telefónica O2 Business Solutions, spol. s r.o. were having negotiations over the potential collaboration relating to the operation of data boxes. However, no agreement was signed between the parties and, due to commercial reasons, the project was never materialised. CNS a.s. filed in August 2010 a legal action against the Company for the compensation of damage and lost profit worth CZK 137.2 million for not signing any contract. The Company regards this claim as fabricated and the amount evidently exaggerated which can be demonstrated by the fact that in accordance with the annual profit and loss statement 2009, CNS a.s. generated a yearly profit of less than CZK 5.5 million. The hearing will take place during the year 2012.

VI. VOLNÝ, a.s. – dispute on CZK 4 billion

On 28 March 2011, VOLNÝ, a.s. filed a legal action with the Municipal Court in Prague against the Company for an amount exceeding CZK 4 billion for an alleged abuse of a dominant position on the market of Internet broadband connection provided to households via ADSL. The amount is meant to represent the lost profit for years 2004 to 2010. VOLNÝ, a.s. claims to have had 30% share on the dial-up Internet market in 2003 and thus implies in its legal action that it should automatically have the same result on the broadband market, which it does not. Allegedly, it is due to the margin squeeze applied by the Company on the fix broadband market. The Company replied to the petition in July 2011 by noting that both the claim and the calculations submitted by the plaintiff were unsubstantiated and by pointing at discrepancies in the petition claims. The lawsuit has not been heard by the Court yet. Oral hearing could be expected during 2012.

The Company is involved in other legal disputes. The aggregate value of all disputes over CZK 5 million not closed with a verdict in 2011 totals to nearly CZK 12 million. The annual profit and loss statement takes into account also some minor disputes, however, with risks of less importance.

The Company considers disclosing other information regarding the said litigations not advisable, as it could endanger the strategy of the Company in these cases.

The Group is convinced that all risks relating to the litigations have been duly reflected in the financial statements.

18. Commitments

Operating leases – lessee

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2011	31 December 2010
No later than 1 year	1,386	1,421
Later than 1 year and not later than 5 years	4,617	4,630
Later than 5 years	3,981	4,087
Total	**9,984**	**10,138**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2011 were CZK 1,456 million (2010: CZK 1,522 million). These lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Group's consolidated results of operations, financial position, or cash flow and therefore are not accounted for.

The Group leases the majority of its car fleet under operating leases. Total future lease payments relating to these operating leases in 2011 were CZK 346 million (2010: CZK 438 million).

Operating leases – lessor

The aggregate future minimum lease payments under non-cancellable operating leases, where the Group is a lessor and give rise to future revenues consist of the buildings and other telecommunication equipment rentals as follows::

In CZK million	31 December 2011	31 December 2010
No later than 1 year	112	104
Later than 1 year and not later than 5 years	409	348
Later than 5 years	90	89
Total	**611**	**541**

Capital and other commitments

In CZK million	31 December 2011	31 December 2010
Capital and other expenditure contracted but not provided for in the financial statements	1,881	4,699

The majority of contracted amounts relate to the telecommunications network and service contracts.

19. Service concession arrangements

The Company performs communication activities as defined under the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunication Office num. 516 as amended by later changes num. 516/1, 516/2, 516/3, 516/4 and 516/5.

The communication activities include (territory of the Czech Republic):

a) public fixed network of electronic communications,
b) public mobile network of electronic communications,
c) public network for the transfer of radio and TV signal,
d) public fixed telephone network,
e) public mobile telephone network,
f) publicly accessible telephone services,
g) other voice services – service is provided as publicly available,
h) rent of circuits – service is provided as publicly available,
i) transmission of radio and TV signal – service is provided as publicly available,
j) transfers of data – service is provided as publicly available,
k) internet access services – service is provided as publicly available,
l) other voice services – service is not provided as publicly available,
m) rent of circuits – service is not provided as publicly available,
n) transmission of radio and TV signal – service is not provided as publicly available,
o) transfers of data – service is not provided as publicly available,
p) internet access services – service is not provided as publicly available.

The Company provides mobile services of electronic communications in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (GSM) standard on the basis of radio frequency assignment from CTO valid until 7 February 2016, in the 2100 MHz frequency band under the Universal Mobile Telecommunications System (UMTS) standard on the basis of radio frequency assignment from CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access – CDMA), where on the basis of individual authorisation to use radio frequencies issued by CTO and valid until 30 November 2013 is provided broadband mobile access to Internet.

Validity of radio frequency license is possible to prolong for next period on the basis of application submitted to CTO in accordance with the Act on Electronic Communications. Relative to the current regulatory and business environment in the Czech Republic, contractual, legal, regulatory, competitive or other economic factors may limit the period during which the Company can benefit from the use of these radio frequency assignments in the future.

Provision of electronic communications services in Slovakia

In 2006 Telefónica Slovakia, s.r.o. was granted a licence for providing of electronic communications services by the means of the public electronic communications network – GSM and UMTS mobile telephone network within the area of the Slovak Republic. The licence has been granted for 20 years, i.e. until 2026. The validity of the licence can be prolonged by an additional period on the basis of an application submitted to the Telecommunication Office of the Slovak Republic.

Imposition of obligations related to provision of universal service

During 2011 and 2010, the Company provided the following selective services under CTO imposed obligations to provide universal service:

a) public pay telephones services,
b) access for disabled to the public telephone,
c) special price schemes, which are different from the price schemes used under normal business conditions, for low income persons, persons with special social needs and disabled persons.

Until 2009, universal service was reimbursed by electronic communication market participants. Since 2010, the Czech Telecommunication Office has received funding from the state budget, which is without delay transferred to Company's account. Positive effect of this change is a decrease of direct expenses due to zero of Company's share, full reimbursement of Company's costs, faster process of settlement and lower internal costs resulting from disputes concerning participant's contributions.

20. Share capital and reserves

	31 December 2011	31 December 2010
Nominal value per ordinary registered share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)	1,000	1,000
Number of shares	1	1
Ordinary shares (in CZK million)	32,209	32,209

Struktura akcionářů Společnosti:

	31 December 2011	31 December 2010
Telefónica, S.A.	69.41%	69.41%
Other shareholders	30.59%	30.59%

Funds include a statutory reserve fund of CZK 6,442 million (2010: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve amounted CZK 56 million (2010: CZK 38 million) is not distributable.

Capital management

The Group is not subject to any externally imposed capital requirements.

The Group's objectives when managing its capital are:

a) to safeguard the Group's ability to continue as a going concern so that it can provide value for its shareholders, and
b) to comply with all relevant legal requirements.

The investment strategy in the light of managing capital of the Group is to direct investment activities in pro-growth areas, i.e. development and improvement of fixed and mobile broadband internet and data networks, mobile services, corporate and public administration ICT solutions and further in the expansion and development of the mobile services (including data) in Slovakia. IT systems renewal and upgrade are among other investment activities with the aim to simplify and improve processes that will lead to better operational effectiveness.

At present, the approach that the Group follows is not to retain surplus cash and distribute it to shareholders. In the following periods, the Board of Directors will continue to carry out and evaluate an in-depth analysis of the current and anticipated results of the Group, including scheduled and potential investments and cash flow generation and will establish the most adequate capital structure for accomplishment of the plans.

There is no other specific objective.

With regards to the dividend capacity (capped by retained earnings from previous years and profit for the current year) which will be lower than surplus cash amount, in 2011 the Group has been undertaking an analysis of other options, which might allow to distribute other available funds. These options comprise:

a) distribution of share premium
b) share capital reduction through a decrease in nominal value of shares
c) share buy back

Equity structure of the Company as at 31 December 2011:

In CZK million	**31 December 2011**
Share capital	32,209
Share premium	24,374
Funds and reserves	6,503
Retained earnings from previous years	1,658
Net income for current year	7,648
Total	**72,392**

21. Related party transactions

The Telefónica Group has been reorganized in 2011 into four divisions – two geographic and two global ones.

Two geographic divisions are Telefónica Europe and Telefónica Latin America while the Group belongs to the former.

Two global cross-business divisions are Telefónica Digital and Telefónica Global Resources. Telefónica Digital seeks to strengthen the role of Telefónica in the digital world and exploit all growth opportunities while strengthening the portfolio of products and services. Telefónica Global Resources was created to increase the profitability by using all benefits of global exposure.

The Group operates in roaming, interconnection and telecommunications services in regional divisions. In the area of support services it uses cooperation within global divisions.

The Group cooperates with Telefónica Global Services GmbH in performing centralized demand aggregation, negotiation activities related to the purchases of selected product categories and services and carrying out centralized commercial supplier management.

The Group cooperates with Telefónica Global Roaming GmbH in managing wholesale roaming business, negotiation and execution of roaming discounts agreements with roaming partners, which enables the Group to be granted discounts by the roaming partners and to grant discounts to the roaming partners.

The Group provides services to all related parties on regular commercial terms. Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest free (excl. financial assets and liabilities used for financing) and the settlement occurs either in cash or by offsetting. The financial assets balances are tested for the impairment at the balance sheet date, and neither allowance nor write off were incurred.

The following transactions were carried out with related parties:

I. Parent company:

Balance sheet In CZK million	31 December 2011	31 December 2010
a) Receivables	6	1
b) Payables	800	1,072

Profit or loss In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
a) Sales of services and goods	–	4
b) Purchases of services and goods (excl. Royalty fees)	40	32

The total amount of dividend paid as at 31 December 2011 to Telefónica, S.A. was CZK 8,943 million (31 December 2010: CZK 8,943 million).

For the period ended 31 December 2011, the royalty fees to Telefónica, S.A. amounted to CZK 768 million (for the period ended 31 December 2010: 844 CZK million).

II. Other related parties – Telefónica Group:

Balance sheet In CZK million	31 December 2011	31 December 2010
a) Receivables	344	445
b) Payables [1]	2,202	1,536
c) Short-term receivables (interest)	5	3
d) Cash equivalents (Note 12)	6,763	4,578

[1] As at 31 December 2011 payables to TELEFÓNICA FACTORING E.F.C., S.A. of CZK 1,486 million were included (2010: CZK 1,280 million).

Profit or loss In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
a) Sales of services and goods	844	804
b) Purchases of services and goods	776	745
c) Management fees	312	213
d) Interest income	76	53

For the period ended 31 December 2011, capital expenditures amounted CZK 1 million (there were no capital expenditures carried out with related parties for the period ended or the period ended 31 December 2010).

The list of the Telefónica companies with which the Group had any transaction in 2011 and 2010 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica Germany GmbH& CO.OHG, Telefónica UK Ltd., Telefónica Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., O2 Holdings Ltd., Telefónica Deutschland GmbH, ALTAIR ASSURANCES S.A., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A., Telefónica Móviles Columbia, S.A., Telefónica Investigación y Desrrollo, S.A., Telecom Italia S.p.A., Telfisa Global BV, Telfisa, Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., S.A., Atento Chequia, Portugal Telecom, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Peru, S.A., Telefónica Venezuela, S.A., China Unicom (Hong Kong) Limited, Telefónica Global Roaming GmbH, Vivo, S.A., Telefónica Europe People Services Limited, Jajah Ltd., Telefónica USA, Telefonica Global Technology Chequia, Telefonica Global Technology, Telefonica Global Services GmbH, MOPET CZ a.s., TELEFÓNICA FACTORING E.F.C., S.A.

Liabilities to TELEFÓNICA FACTORING E.F.C., S.A. represent due balances arising from the assigned receivables by the suppliers using Group factoring and are considered as a due amount to the associate company.

III. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Company were provided with benefits as follows:

In CZK million	31 December 2011	31 December 2010
Salaries and other short-term benefits	109	110
Personal indemnification insurance	4	5
Total	**113**	**115**

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2011 and 2010.

No other loan was provided to related parties by the Group.

22. Principal subsidiary undertakings and associates

As at 31 December 2011

Subsidiaries	Group's interest	Cost of investment in CZK million	Country of incorporation	Activity	Method of consolidation
1. Telefónica O2 Business Solutions, spol. s r.o.	100%	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services	Full consolidation
2. CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission services	Full consolidation
3. CZECH TELECOM Austria GmbH	100%	6	Austria	Data transmission services	Full consolidation
4. Telefónica Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services	Full consolidation
5. Internethome, s.r.o.	100%	55	Czech Republic	Providing of internet access on WiFi technology	Full consolidation
Associates					
6. První certifikační autorita, a.s.	23%	9	Czech Republic	Rendering of certification services	Not consolidated
7. AUGUSTUS, spol. s r.o.	40%	–	Czech Republic	Sales by auctions and advisory services	Not consolidated
8. MOPET CZ a.s.	14%	13	Czech Republic	Real time payment services via mobile phones	Not consolidated

As at 31 December 2010

Subsidiaries	Group's interest	Cost of investment in CZK million	Country of incorporation	Activity	Method of consolidation
1. Telefónica O2 Business Solutions, spol. s r.o.	100%	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services	Full consolidation
2. CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission services	Full consolidation
3. CZECH TELECOM Austria GmbH	100%	11	Austria	Data transmission services	Full consolidation
4. Telefónica O2 Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services	Full consolidation
Associates					
5. První certifikační autorita, a.s.	23%	9	Czech Republic	Rendering of certification services	Not consolidated
6. AUGUSTUS, spol. s r.o.	40%	–	Czech Republic	Sales by auctions and advisory services	Not consolidated
7. MOPET CZ a.s.	14%	13	Czech Republic	Real time payment services via mobile phones	Not consolidated

In 2011, the Company became the sole shareholder of the new subsidiary with registered capital of CZK 200 thousand. The company Internethome, s.r.o., was established by demerging by spin-off of Telefónica O2 Business Solutions, spol. s.r.o. The change was recorded in the Commercial Register on 1 October 2011.

In December 2011, the Board of Directors approved increase of the other equity funds of Internethome, s.r.o. by CZK 55 million in the form of cash contribution. Effective date of increase of the other equity funds was 16 December 2011.

23. Post balance sheet events

On 1 January 2012 the subsidiary Informační linky, a.s. was founded by registration in the Commercial Register. The company was established by a non monetary investment of the part of enterprise running its core business in call-based information and on-line business catalogue. By preparation of these financial statements the Group had been in progress with reaching an Agreement for the sale and purchase of shares with Hapalo Estates s.r.o. As a result of this contract 80% of shares of the subsidiary Informační linky, a.s. are to be sold and revenues from this transaction are to be recognised in profit or loss. The buyer will receive an option for acquisition of the remaining 20% of shares and it is highly probable that the buyer will execute this option. Remaining 20% of shares will not constitute substantial influence, it will be recognised in financial investments in costs, it will not be included in consolidation.

There were no other events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2011.

Financial statements

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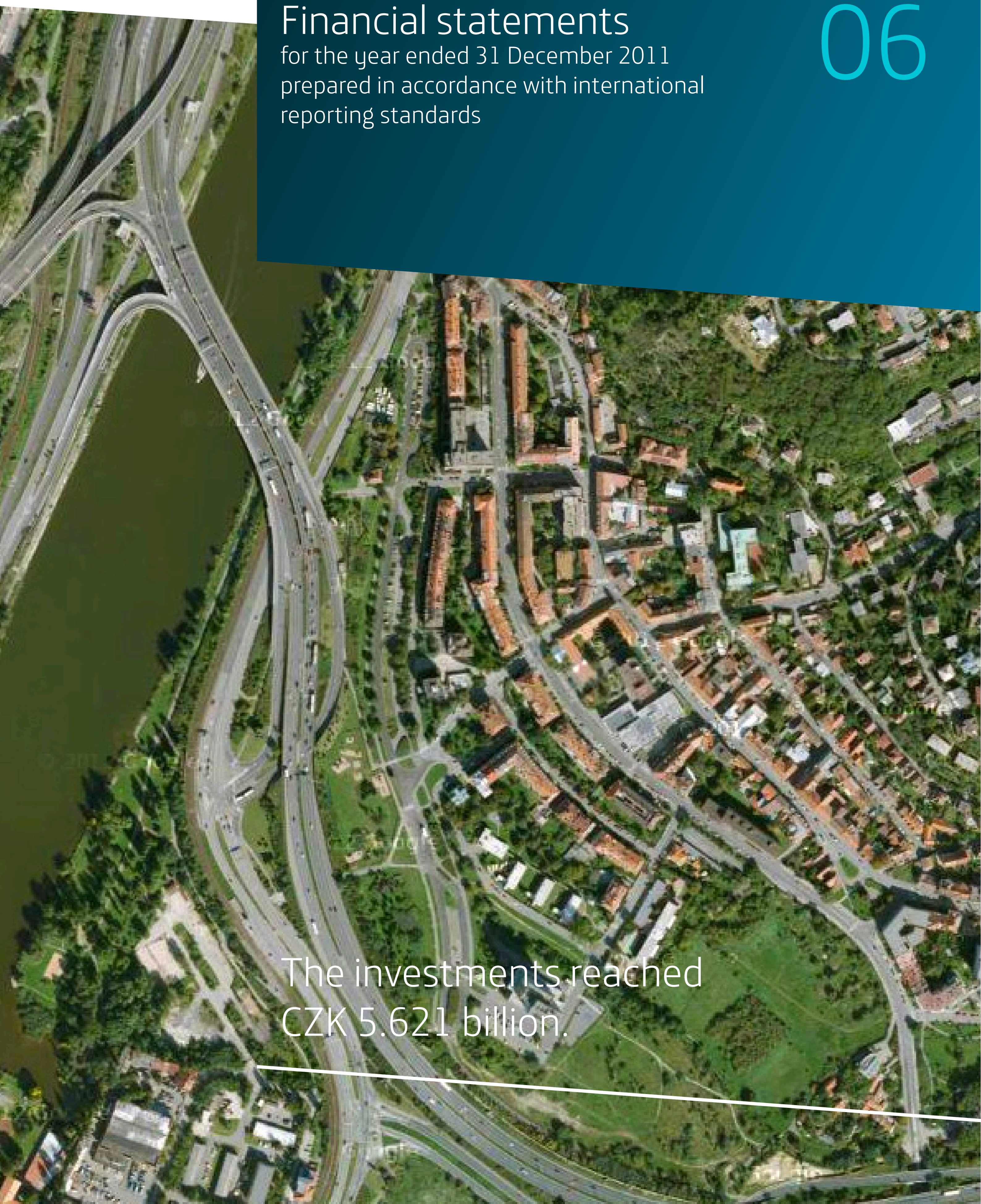
for the year ended 31 December 2011 prepared in accordance with international reporting standards



The investments reached CZK 5.621 billion.

Financial statements

for the year ended 31 December 2011
prepared in accordance with international reporting standards

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Content

General information

Telefónica Czech Republic, a.s. (the "Company") has a form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

The Company is a member of the Telefónica Group of companies (the "Telefónica Group") with a parent company, Telefónica, S.A. (the "Telefónica").

The Company is the principal supplier of fixed line telecommunication services and is one of the four suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Company amounted in average to 6,734 in 2011 (2010: 7,511).

The Company's shares are traded on the Prague Stock Exchange.

These financial statements were approved for issue by the Company's Board of Directors on 17 February 2012.

Corporate name change

Effective from 16 May 2011 the Company changed its name Telefónica O2 Czech Republic, a.s. to Telefónica Czech Republic, a.s. and the new corporate name is entered in the Commercial Register. The Company will continue to operate under its O2 brand for its clients and all customers.

The 3G network sharing

The Company and T-Mobile Czech Republic a.s. signed an agreement on sharing the 3G network. The agreement concerns currently unserved areas and will accelerate construction of the network and significantly expand the 3G coverage of both operators. The pilot commercial operation has been launched in the second quarter of the 2011. The Company's high speed data service presently covers 73% of the Czech population.

Joint network monitoring

The Company and Telefónica Germany signed contracts regulating a joint project implementing Fixed and Mobile Networks Management for Telefónica networks in both countries. The project includes the integration of monitoring of several Telefónica Group networks in the Czech Republic, Slovakia and Germany – contributing to a more efficient use of resources and considerable operating costs savings. The entire project fits within the global Telefónica Group strategy, resulting in considerable annual savings.

Restructuring

During 2010, the Company restructured its activities mainly in Field Line Management areas of its business. Restructuring projects resulted in transfer of some activities to outsourcing partners.

During 2011, the Company went on achieving efficiency and cost optimization by introducing new projects in various areas of its business. Restructuring projects focused among others on call center consolidation and optimization. During the restructuring process more than 500 employees were made redundant and the Company incurred restructuring costs of CZK 173 million (see Note 2).

Branch of Telefónica Global Technology

On 1 December 2011, a Czech branch of Telefónica Global Technology started to operate. The branch employs for more than 200 people, mostly assigned from the Company. Telefónica Global Technology S.A.U. (a parent company of Telefónica Global Technology, S.A., branch) is a 100% owned subsidiary of Telefónica S.A. and was founded with the aim to provide IT services to individual operating departments of Telefónica Group. One of the two new European data centers is going to be build in the Czech Republic, where IT infrastructure for the Czech Republic, Slovakia and Germany will be located and operated.

Independent auditors' report to the shareholders of Telefónica Czech Republic, a.s.

Independent auditor's report

To the shareholders of Telefónica Czech Republic, a.s.:

We have audited accompanying financial statements of Telefónica Czech Republic, a.s. („the Company"), which comprise the balance sheet as at 31 December 2011, and the statement of total comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management' Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with international Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Ernst & Young Audit, s.r.o.
License No. 401
Represented by

Brian Welsh
Partner

Petr Vácha
Auditor, License No. 1984

17. února 2012
Praha, Česká republika

Statement of total comprehensive income for the year ended 31 December 2011

In CZK million	Notes	Year ended 31 December 2011	Year ended 31 December 2010
Revenues from voice services	2	15,923	18,989
Monthly charges		12,412	13,328
Data services	2	11,275	11,410
Other revenues	2	9,253	9,265
Revenues		**48,863**	**52,992**
Other income	2	488	258
Interconnection and roaming expenses		(8,179)	(9,386)
Cost of goods sold		(2,087)	(1,833)
Other direct cost of sales	2	(3,215)	(3,061)
Other expenses	2	(9,184)	(9,518)
Staff costs	2	(5,690)	(6,512)
Impairment reversal/(loss)		(9)	4,325
Operating income before depreciation and amortization ("OIBDA")		**20,987**	**27,265**
Depreciation and amortisation	7,8	(11,207)	(11,421)
Operating profit		9,780	15,844
Finance income	3	626	457
Finance costs	3	(744)	(572)
Profit before tax		9,662	15,729
Corporate income tax	4	(2,014)	(3,033)
Profit for the year		**7,648**	**12,696**
Other comprehensive income			
Other comprehensive income, net of tax		–	–
Total comprehensive income, net of tax		**7,648**	**12,696**
Profit attributable to:			
Equity holders of the Company	5	7,648	12,696
Total comprehensive income attributable to:			
Equity holders of the Company		7,648	12,696
Earnings per share (CZK) – basic [1]	5	24	39

[1] There is no dilution of earnings as no convertible instruments have been issued by the Company.

Balance sheet
as at 31 December 2011

In CZK million	Notes	31 December 2011	31 December 2010
ASSETS			
Property, plant and equipment	7	49,276	54,516
Intangible assets	8	19,795	20,735
Investment in subsidiaries and associates	22	6,446	6,396
Other financial assets	11	145	165
Non-current assets		**15,454**	**14,442**
Inventories	10	446	577
Receivables and prepayments	11	7,905	8,641
Income tax receivable	4	162	443
Cash and cash equivalents	12	6,941	4,781
Current assets		**15,454**	**14,442**
Non-current assets classified as held for sale	**7**	**1**	**12**
Total assets		**91,117**	**96,266**
EQUITY AND LIABILITIES			
Ordinary shares	20	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		15,809	21,026
Total equity		**72,392**	**77,609**
Long-term financial debts	14	–	2,883
Deferred tax liability	15	3,735	3,936
Non-current provisions for liabilities and charges	16	25	51
Non-current other liabilities	13	88	21
Non-current liabilities		**3,848**	**6,891**
Short-term financial debts	14	3,060	141
Trade and other payables	13	11,761	11,468
Provisions for liabilities and charges	16	56	157
Current liabilities		**14,877**	**11,766**
Total liabilities		**18,725**	**18,657**
Total equity and liabilities		**91,117**	**96,266**

These financial statements were approved by the Board of Directors on 17 February 2012 and were signed on its behalf by:

Luis Antonio Malvido
Chairman of the Board of Directors
Chief Executive Officer

Jésus Pérez de Uriguen
1st Vice Chairman of the Board of Directors
Vice-President, Finance Division

Statement of changes in equity for the year ended 31 December 2011

In CZK million	Notes	Share capital	Share premium	Equity settled share based payments reserve	Funds[1]	Retained earnings	Total
At 1 January 2010		**32,209**	**24,374**	**36**	**6,450**	**14,721**	**77,79**
Profit for the year		–	–	–	–	12,696	12,696
Total comprehensive income		**–**	**–**	**–**	**–**	**12,696**	**12,696**
Capital contribution and other transfers		–	–	(2)	–	9	7
Dividends declared in 2010	6	–	–	–	–	(12,884)	(12,884)
At 31 December 2010		**32,209**	**24,374**	**34**	**6,450**	**14,542**	**77,609**
At 1 January 2011		**32,209**	**24,374**	**34**	**6,450**	**14,542**	**77,609**
Profit for the year		–	–	–	–	7,648	7,648
Total comprehensive income		**–**	**–**	**–**	**–**	**7,648**	**7,648**
Capital contribution and other transfers		–	–	19	–	–	19
Dividends declared in 2011	6	–	–	–	–	(12,884)	(12,884)
At 31 December 2011		**32,209**	**24,374**	**53**	**6,450**	**9,306**	**72,392**

[1] Refer to Note 20 regarding amounts not available for distribution.

Statement of cash flows
for the year ended 31 December 2011

In CZK million	Notes	Year ended 31 December 2011	Year ended 31 December 2010
Cash from operating activities			
Cash received from operations		53,271	56,679
Cash paid to suppliers and employees		(31,249)	(32,877)
Dividends received		7	111
Net interest and other financial expenses paid		(97)	(211)
Taxes paid		(1,935)	(2,178)
Net cash from operating activities		**19,997**	**21,524**
Cash flow from investing activities			
Proceeds on disposals of property, plant and equipment and intangible assets		609	224
Payments on investments in property, plant and equipment and intangible assets		(5,725)	(5,019)
Payments made on financial investments		(77)	(1,048)
Net cash used in investing activities		**(5,193)**	**(5,843)**
Cash flow from financing activities			
Dividends paid		(12,878)	(12,876)
Proceeds on loans, borrowings and promissory notes		342	1,214
Repayments of loans, borrowings and promissory notes		(130)	(472)
Net cash used in financing activities		**(12,666)**	**(12,134)**
Effect of foreign exchange rate changes on collections and payments		**22**	**(7)**
Net increase / (decrease) in cash and cash equivalents during the period		**2,160**	**3,540**
Cash and cash equivalents at the beginning of the period		**4,781**	**1,241**
Cash and cash equivalents at the end of the period	**12**	**6,941**	**4,781**
Balance at the beginning of the period		**4,781**	**1,241**
Cash on hand and at banks		4,762	1,224
Other cash equivalents		19	17
Balance at the end of the period	**12**	**6,941**	**4,781**
Cash on hand and at banks		6,922	4,762
Other cash equivalents		19	19

Accounting policies

Contents

A Basis of preparation

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

The financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS") and all applicable IFRSs adopted by the EU. IFRS comprise standards and interpretations approved by the International Accounting Standards Board ("IASB") and the IFRS Interpretations Committee (formerly called the International Financial Reporting Interpretations Committee, IFRIC).

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll. requires the Company to prepare its financial statements in accordance with IFRS adopted by the EU (Regulation (EC) No 1606/2002). At the year-end, there is no difference in the IFRS policies applied by the Company and IFRS adopted by the EU.

The financial statements are the separate financial statements of the Company and meet requirements of IFRS with respect to the preparation of parent's separate financial statements. The Company also issued consolidated financial statements prepared for the same period in accordance with IFRS, which were approved for issue by the Board of Directors on 17 February 2012.

The financial statements were prepared under the historical cost convention except for non-current assets held for sale, inventory held at net realizable value, financial derivatives, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS required the Company to use certain critical accounting estimates. It also required management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note T.

The amounts shown in these financial statements are presented in millions Czech Crowns ("CZK"), if not stated otherwise.

Adoption of new or revised IFRS standards and interpretations (includes standards and interpretations applicable for the Company)

In 2011, the Company applied the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Company:

IAS 24 – Related Party Transactions – Amendment (effective 1 January 2011)

The IASB issued an amendment to IAS 24 that clarifies the definitions of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarifies the circumstances in which persons and key management personnel affect related party relationships of an entity. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity.

The adoption of the amendment did not have any impact on the financial position or performance of the Company.

IAS 32 – Financial instruments: Presentation – Amendment (effective 1 February 2010)

The amendments address the classification of certain rights issues denominated in a foreign currency as either equity instruments or as financial liabilities. Under the amendments, rights, options or warrants issued by an entity for the holders to acquire a fixed number of the entity's equity instruments for a fixed amount of any currency are classified as equity instruments in the financial statements of the entity provided that the offer is made pro rata to all of its existing owners of the same class of its non-derivative equity instruments. Before the amendments to IAS 32, rights, options or warrants to acquire a fixed number of an entity's equity instruments for a fixed amount in foreign currency were classified as derivatives. The amendments require retrospective application.

The application of the amendments had no effect on the amounts reported in the current and prior years because the Company did not issue instruments of this nature.

IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments (effective 1 July 2010)

The Interpretation provides guidance on the accounting for the extinguishment of a financial liability by the issue of equity instruments. Specifically, under IFRIC 19, equity instruments issued under such arrangement will be measured at their fair value, and any difference between the carrying amount of the financial liability extinguished and the consideration paid will be recognised in profit or loss.

The application of IFRIC 19 has had no effect on the amounts reported in the current and prior years because the Company has not entered into any transactions of this nature.

Amendments to IFRIC 14 – Prepayments of a Minimum Funding Requirements (effective 1 January 2011)

The amendments correct an unintended consequence of IFRIC 14 – IAS 19 the Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. Without the amendments, in some circumstances entities are not permitted to recognise as an asset some voluntary prepayments for minimum funding contributions. This was not intended when IFRIC 14 was issued, and the amendments correct the problem. The amendments must be applied retrospectively to the earliest comparative period presented.

There were not any material changes to the disclosure in the notes to the financial statements.

Improvements to IFRSs

IFRS 3 – Business Combinations (applicable to annual periods beginning on or after 1 July 2010)

a) Measurement of non-controlling interests

Specifies that the option to measure non-controlling interests either at fair value or at the proportionate share of the acquiree's net identifiable assets at the acquisition date under IFRS 3 (2008) applies only to non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the acquiree's net assets in the event of liquidation. All other components of non-controlling interests should be measured at their acquisition date fair value, unless another measurement basis is required by IFRSs.

b) Un-replaced and voluntary replaced share-based payment awards

Specifies that the current requirement to measure awards of the acquirer that replace acquiree share-based payment transactions in accordance with IFRS 2 at the acquisition date applies also to share-based payment transactions of the acquiree that are not replaced.

Specifies that the current requirement to allocate the market-based measure of replacement awards between the considerations transferred for the business combination and post-combination remuneration applies to all replacement awards regardless of whether the acquirer is obliged to replace the awards or does so voluntarily.

c) Transitional requirements for contingent consideration from a business combination that occurred before the effective date of IFRS 3 (2008)

Clarifies that IAS 32 – Financial Instruments: Presentation, IAS 39 – Financial Instruments: Recognition and Measurement and IFRS 7 – Financial Instruments: Disclosures do not apply to contingent consideration that arose from business combinations whose acquisition dates preceded the application of IFRS 3 (2008).

There was not any material effect relating to the adoption of this amendment on the Company financial statements.

IFRS 7 – Financial instruments: Disclosures (effective 1 January 2011)

Encourages qualitative disclosures in the context of the quantitative disclosure required to help users to form an overall picture of the nature and extent of risks arising from financial instruments.

Clarifies the required level of disclosure around credit risk and collateral held and provides relief from disclosure of renegotiated loans.

There were not any material changes to the disclosure in the notes to the financial statements.

IAS 1 – Presentation of Financial Statements (effective 1 January 2011)

Clarifies that an entity may present the analysis of other comprehensive income by item either in the statement of changes in equity or in the notes to the financial statements.

There was not any material effect relating to the adoption of this amendment on the Company financial statements.

IAS 27 – Consolidated and Separate Financial Statements (effective for annual periods beginning on or after 1 July 2010)

Clarifies that the amendments made to IAS 21 The Effects of Changes in Foreign Rates, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures as a result of IAS 27 (2008) should be applied prospectively (with the exception of paragraph 35 of IAS 28 and paragraph 46 of IAS 31, which should be applied retrospectively).

There was not any material effects relating to the adoption of this amendment on the Company's financial statements.

IAS 34 – Interim Financial Reporting (effective 1 January 2011)

Emphasises the principle in IAS 34 that the disclosure about significant events and transactions in interim periods should update the relevant information presented in the most recent annual financial report.

Clarifies how to apply this principle in respect of financial instruments and their fair values.

There were no material changes to the disclosure in the notes to the financial statements.

New IFRS of the IFRS Interpretations Committee not effective as at 31 December 2011 (includes standards and interpretations applicable for the Company)

At the date of preparation of the accompanying financial statements, the following IFRS and IFRIC interpretations had been published, but their application was not mandatory. The Company intends to adopt those standards when they become effective.

Standards and amendments, Interpretations		Mandatory application: annual periods beginning on or after
IFRS 7	Disclosures – Transfers of Financial Assets (Amendment)	1 July 2011
IAS 1	Presentation of Items of Other Comprehensive Income (Amendment)	1 July 2012
IAS 12	Deferred Tax – Recovery of Underlying Assets (Amendment)	1 January 2012
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2013
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 19	Employee benefits (Amendment)	1 January 2013
IAS 27	Separate Financial Statements (as revised in 2011)	1 January 2013
IAS 28	Investments in Associates and Joint Ventures (as revised in 2011)	1 January 2013

The Company is currently assessing the impact of the application of these standards, amendments and interpretations. Based on the analyses made to date, the Company estimates that their adoption will not have a significant impact on the consolidated financial statements in the initial period of application.

The Company is currently monitoring the development in the area of IFRSs being prepared regarding to leases and revenue recognition which are planned to be submitted in 2012.

B Foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates ("the functional currency"). The financial statements are presented in Czech Crowns ("CZK"), which is the Company's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss, except when deferred in other comprehensive income as qualifying cash flow hedges. Such balances of monetary items are translated at period-end exchange rates. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

C Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less impairment charges.

Property, plant and equipment acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less depreciation and impairment charges.

Property, plant and equipment include all costs directly attributable to bringing the asset to working condition for its intended use. With respect to the construction of the network, this comprises every expenditure up to the customers' premises, including the cost of contractors, materials, direct labour costs and interest cost incurred during the course of construction.

Subsequent costs are recognised as property, plant and equipment only if it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably.

Repairs and maintenance costs are expensed as incurred.

Items of property, plant and equipment that are retired are not intended for sale and are not expected to create any future economic benefits or are otherwise disposed of, are eliminated from the balance sheet, along with the corresponding accumulated depreciation. Any gain or loss arising from retirement or disposal is included in net operating income, i.e. net gain or loss is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is either de-recognised or at the date the asset is classified as held for sale.

Depreciation does not cease, when the asset becomes temporarily idle or retired from active use, unless the asset is fully depreciated.

Estimated useful lives adopted in these financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	10 to 25
Exchanges and related equipment	up to 25
Other fixed assets	up to 20

Freehold land is not depreciated as it is deemed to have an indefinite life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater then its estimated recoverable amount (refer to Note F Impairment of assets).

D Intangible assets

Intangible assets include computer software, purchased goodwill, licenses and customer bases. Computer software mainly represents the external acquisition costs of the Company's information systems that are intended for use within the Company. Generally, costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Company and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally from one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less amortisation and impairment charges and are amortised on a straight-line basis over their estimated useful lives. Customer bases are amortised over a period of the remaining average terms of the binding contracts.

Acquired licenses are recorded at cost and amortised on a straight-line basis over the remaining life of the license (i.e. over 15 to 20 years), from the start of commercial service, which best reflects the pattern by which the economic benefits of the intangible assets will be utilised by the Company.

Intangible assets with an indefinite useful life are not amortised. They are subject to the regular impairment reviews (see Note 8 and Note 9).

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired. Goodwill is not amortised but is tested for impairment at least annually or anytime there are indications of a decrease in its value.

The Company reviews at least at the balance sheet date the useful lives of intangible assets that are not amortised to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate.

On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

Intangible assets that are no longer in use and no future economic benefits are expected or that are disposed of for any other reason are de-recognised from the balance sheet together with the corresponding accumulated amortisation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with an indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is de-recognised, the date the asset is classified as having the indefinite useful life or the date the asset is classified as held for sale.

E Non-current assets classified as held for sale

The Company classifies separately in the balance sheet a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups), its sale is highly probable and sale is expected within one year.

The Company measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Company recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as an impairment loss with impact in profit or loss of the relevant period.

From the moment the asset is classified as held for sale and eventually revalued, it ceases to be depreciated/amortised is reviewed only from impairment point of view.

Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in profit or loss.

F Impairment of assets

Property, plant and equipment and other assets, including goodwill and intangible assets, are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or at least on an annual basis for goodwill and for intangibles with an indefinite useful life and for intangibles not yet in use. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level, for which there are separately identifiable cash flows (cash-generating units).

Impairment losses are recognised in expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss in the period in which the reversal occurs.

The Company makes an assessment at least at each balance sheet date whether there is any indication that an impairment loss may no longer exist, may have decreased or may have increased. If any such indication exists, the Company estimates a recoverable amount of the assets and compares to the carrying value (net of the impairment allowance). In assessing whether there is any indication that the impairment loss recognised in the past may no longer exist, the Company considers both external and internal sources of information (asset's market value, changes expected in the market, including technological, economic or legal changes, market interest rates, significant changes with effect on the Company in the extent to which, or manner in which, the assets are used or are expected to be used, evidence available from internal reporting indicating economic performance of assets etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions used.

G Investments and other financial assets

The Company classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets.

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2011 and 2010, the Company did not hold any financial assets in this category.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are measured at amortised cost using an effective interest rate method and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis, as required under IAS 39.

All purchases and sales of investments are recognised on the trade date, which is the date that the Company commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets at fair value through profit or loss and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective interest rate method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in profit or loss in the period in which they arise. On the contrary, unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in other comprehensive income in the period in which they arise, except for impairment losses, until the financial asset is de-recognised, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in profit or loss.

Impairment of financial assets

The Company assesses at each balance sheet date whether financial assets or groups of financial assets are impaired.

(1) Assets carried at amortized costs

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in profit or loss.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for individually assessed financial assets, whether significant or not, it is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in profit or loss and only to the extent that the carrying amount of the financial asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible or sold.

(2) Available-for-sale financial assets

If this asset is impaired, the cumulative loss that had been previously recognised (due to fair value revaluation) in other comprehensive income shall be removed from other comprehensive income and recognised in profit or loss even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from other comprehensive income and recognised in profit or loss shall be the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in profit or loss.

Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

De-recognition of financial assets

A financial asset is de-recognised when:

a) the rights to receive cash flow from the asset have expired,
b) the Company retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement, or
c) the Company has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

H Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of specific asset or assets and the arrangement conveys a right to use the assets.

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment that is required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Company bears substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of interest. The corresponding lease obligations, net of finance charges, are included in other long-term payables (depending on maturity).

The interest element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. If there is a reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

I Inventories

Inventory is stated at the lower of cost or net realisable value. Costs of inventories include the purchase price and related costs of acquisition (transport, customs duties and insurance). The cost of inventory is determined using weighted average cost. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

J Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the initial market rate of interest for similar borrowers. Cash flows relating to short-term receivables are usually not discounted. The amount of the allowance is recognized in profit or loss.

K Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the statement of cash flows, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities section of the balance sheet.

L Financial debt

Borrowings are recognised initially as the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest rate method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in profit or loss over the period of the borrowings.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Interest costs on borrowings used to finance the acquisition and construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

M Current and deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws, used to compute the amount, are those that are enacted or substantively enacted by the balance sheet date.

Income tax relating to items recognised in other comprehensive income is recognised in other comprehensive income and not in profit or loss.

Deferred income taxation is calculated using the liability method applied to all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates and laws expected to apply when the asset is realised or the liability is settled are used to determine the deferred income tax.

The principal temporary differences arise from differences in the tax and accounting values of property, plant and equipment, impairment of receivables and allowance for obsolete and slow moving inventories, non tax deductible allowances and provisions, unused tax credits and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Company accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill.

Deferred income tax assets and tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority. The same applies for offsetting of current tax assets and liabilities.

N Employee benefits

(1) Pension obligations

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates applicable during the period and are based on gross salary payments. The arrangements of the Government's health, retirement benefit and unemployment schemes correspond to the arrangements for defined contribution plans. The Company has no further payment obligations once the contributions have been paid. The expense for the contributions is charged to profit or loss in the same period as the related salary expense. The Company also makes contributions to defined contribution schemes operated by external pension companies. These contributions are charged to profit or loss in the period to which the contributions relate.

(2) Redundancy and termination benefits

Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Company recognises provision for redundancy and termination benefits when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after the balance sheet date.

(3) Bonus plans

The Company recognises a liability for bonuses based on a formula that takes into consideration certain performance related measures, such as turnover or free cash flow, after certain adjustments. The Company recognises a provision where the Company is contractually obliged or where there is a past practice that has created a constructive obligation.

O Share-based compensation

During 2006, the Company introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Certain compensation plans are settled in cash, while the others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price with the following accounting treatment:

Option plans that can be either cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted.

In the cash-settled share option plan, the total cost of the rights to granted shares are expensed over the period during which the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Company revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through profit or loss for the period, if appropriate.

For the equity-settled share option plan, fair value at the grant date is measured using the binominal methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Company revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity. As the plan will be settled by a physical delivery of equity instruments of the parent, Telefónica, S.A., to the employees, the personnel expense accrued is recognised against equity.

P Provisions

Provisions are recognised when the Company has either present legal or constructive obligation resulting from past events, and it is probable that an outflow of resources will be required to settle the obligation assuming that a reliable estimate of the amount can be made. Where the Company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Q Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Company, comprises goods sold and services provided. Revenues are measured at their fair value of the consideration received or receivable. The amount of revenue is recognised if it can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company. If necessary, revenue is split into separately identifiable components.

The Company offers customers free minutes for a selected price based on a chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Company is not obliged to reimburse the customer for unused minutes and the option of rolling over any unused minutes is valid for only one month.

The Company recognises revenue for free minutes in the period when the related services are provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

In assessing whether revenue should be recognised gross, i.e. with separate disclosure of costs to arrive at gross profit, or on a net basis, the Company considers these indicators of gross revenue reporting:

a) the Company is the primary obligor in the arrangement,
b) the Company has general inventory risk,
c) the Company has price latitude,
d) the Company changes the product or performs part of the service,
e) the Company has discretion in supplier selection,
f) the Company is involved in the determination of product or service specifications,
g) the Company has credit risk,
h) the Company has the ability to set the terms of the transaction,
i) the Company has the managerial control over the transaction.

The relative strength of each indicator is considered while deciding the accounting treatment.

If a transaction is considered to meet conditions of an agency arrangement, the revenue is recognised only at the amount of the commission received/realised.

Revenue from fixed price construction contracts (long-term contracts) is recognised using the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. A loss expected from the construction contract is recognised as an expense immediately, when it is probable that total contract costs will exceed total contract revenue.

(1) Fixed line business revenues

Revenue is recognized as follows:

Domestic and international call revenues

Domestic and international call revenues are recognised in profit or loss at the time the call is made.

Universal service

The Company is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. Relevant costs are compensated by the Czech Telecommunication Office (CTO). The Company recognises the compensation using gross principle on standard accrual basis of revenue recognition.

Subscription revenues

Revenue is recognised in profit or loss in the period in which the services are rendered.

Revenues from sales of prepaid cards

Prepaid call card sales are deferred until the customer uses the stored value in the card to pay for the relevant calls. The expiry date for prepaid cards is not longer than 36 months.

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and other sale of goods

Revenue from the sale of telephone equipment, accessories and other goods is recognised at the time of sale i.e. when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods.

Local loop unbundling

Revenue from access to the local loop unbundling is deferred in profit or loss and recognised in the period in which the service is rendered. Regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the location (collocation) for an alternative operator is recognized upfront in profit or loss when it occurs.

Audiotex

Revenues from audiotex, service offering content to which a special tariff applies and enables to transfer money and to pay for goods or services from the third parties, are recognised using netto principle.

Information and communication technologies services

Information and communication technologies services (ICT) include complex customer solutions and managed services, mainly system integration, outsourcing services, project solutions, software development. Revenue recognition of such services reflects substance of the provided services.

(2) Mobile business revenues

The Company earns mobile services revenue from customers usage of the Company's network, interconnection and roaming. The Company also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues

Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is recognised as their airtime and other services are used. Prepaid customers recharge a credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognised as the airtime and other services are used. An estimate of unused airtime is recognised in Statement of comprehensive income and spread over an average top up life cycle at the moment of every top up. For calculation of the estimate, the Company applies a percentage of expiry rate based on historical experience of expired airtime.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime that are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and mobile services

Monthly service revenues and revenues from handset sales are recognized as revenue when the product or service is delivered to the distributor or to the end customer. Resulting losses from sale of handsets at a discount are recognised at the date of sale.

Roaming revenues

Mobile segment derives roaming revenue as a result of airtime and other services used by the mobile segment's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled net on a regular basis.

Premium SMS

Revenues from premium SMS, short text messages that enable customers to use their mobile phones to send money transfer requests and pay for goods and services from third parties, are recognised using netto principle.

Costs

Discounts directly related to the sale of equipment, SIM cards and activations are netted against revenue in the period the product is sold to the dealer, distributor or the end customer. Commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

(3) Interconnect revenues

Interconnect revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but use the Company's network. These revenues are recognised in profit or loss at the time when the call is received in the Company's network. The Company pays a proportion of the call revenue it collects from its customers to other domestic and foreign operators' for calls and other traffic that originate in the Company's network but use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet, IPTV and data services

The Company earns revenue from providing Internet services, IPTV and other data services. Revenue from such services is recognised at the time the service is provided.

(5) Dividend income

Dividend income is recognized when the right to receive payment is established.

(6) Interest

Revenue is recognised as interest accrues (using the effective interest method).

(7) Instalment sales

Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, using the effective interest method.

R Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

S Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives. Detailed figures are described in Note 14.

Financial risk management

The Company's is exposed to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates as a result of ordinary business, debt taken on to finance its business and net investment in foreign operations. The Company's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Company. The Company uses either derivative financial instruments (such as forward and swap contracts) or non-derivative instruments (such as cash instruments) to hedge certain exposures.

The Company does not conduct any speculative trading activities.

Risk management is carried out by the treasury department under approved policies. The Board of Directors provides written principles for overall risk management. In line with these principles, policies exist for specific areas, such as foreign exchange risk, interest rate risk, credit risk, liquidity risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign currency risk

The Company is exposed to foreign currency risk arising from various currency exposures, primarily with respect to the Euro and partially to US Dollar:

a) balance sheet items (such as debt, receivables, payables) denominated in foreign currency,
b) probable forecasted transactions or firm commitments (such as purchases or sales) denominated in foreign currency,
c) net investment in Slovak subsidiary (functional currency differs from CZK).

The Company's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes.

The Company primarily hedges the balance sheet foreign currency exposure, mainly long term debt denominated in EUR and net payables in EUR or USD. Just plain-vanilla instruments are currently used for hedging this kind of exposure.

(ii) Interest rate risk

The Company is exposed to interest rate risk arising from:

a) floating interest rate bearing cash investments and debt instruments,
b) fair value of debt on fixed interest rate.

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The cash assets and short term debt are currently maintained on floating rates while long term debt instruments are on fixed rates. The Company may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable interest rates.

(iii) Liquidity rate risk

The Company's essential objective of liquidity risk management is having access to the cash resources sufficient to meet all its cash payment obligations as they fall due, allowing some flexibility. The cash resources consist of generated cash position (maintained in quickly liquid instruments), and committed credit facilities arranged with banks.

The Company is particularly focusing on the liquidity profile within the time horizon of the next 12 months considering projected cash flow from operations and maturity structure of both debt obligations and financial investments. The balance between funding continuity and flexibility is managed through maintaining the possible use of bank overdrafts or bilateral credit lines.

(iv) Credit risk

Credit risk concentration, with respect to trade accounts receivable, is limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Company does not currently foresee a dramatically higher credit risk associated with these receivables, repayment is significantly impacted by the financial stability of a particular national economy.

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that all customers wishing to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the resulting into the non significant Company's exposure to bad debts. The maximum exposure is the carrying amount as disclosed in Note 11. There is no significant concentration of credit risk within the Company.

With respect to credit risk arising from the financial assets of the Company, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Company's exposure arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Credit Risk is managed by the Credit Management Unit and is based on three main activities:

a) monitoring of accounts receivables: regular monitoring of payment moral of existing customers and monitoring and analyzing of the receivable aging structure (internal and external indicators of any potential bad debts). Those activities are processed in the integrated system solution for scoring, maintenance and collection of receivables called RMCA.
b) prevention: scoring of new customers – checking procedures (Black Lists, External Debtors Register, other information), set up the limits or/and collection of the deposit according to customer segments, products and set up the credit limits for indirect sales partners (dealers, distributors, retailers) for purchase of our products, „securing" of credit limits (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc.). Guarantees are either in cash (deposits) or by other securing tools (receivables insurance etc.),
c) collection process: Credit Management cooperate with Customer Care on set up of reasonable, effective and continual collection process. Collection process competence is divided. Collection of active customers is in competence of Customer Care unit, following collection process after contract cancellation is in responsibility of Credit Management.

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are re-measured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Company designates certain derivatives as either:

a) hedge of the fair value of a recognised asset or liability (fair value hedge), or
b) hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective are recorded in profit or loss, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective are recognised in other comprehensive income. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the gains and losses previously deferred in other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in other comprehensive income are transferred to profit or loss and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects profit or loss.

Certain derivative transactions, while providing effective economic hedges under the Company's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Company has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the fair value of such derivative instruments that do not qualify for hedge accounting are recognised immediately in profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting under IAS 39, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in profit or loss when the committed or forecasted transaction ultimately is recognised in profit or loss. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to profit or loss.

The Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The Company also documents its assessment, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Fair value estimation

Except for currency options, the fair values of the derivative financial instruments reflect estimates based on calculations performed using the Company's own discounted cash flows models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Company's bankers.

T Use of estimates, assumptions and judgements

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The estimates and assumptions that might have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next year are discussed below:

(1) Income taxes and deferred taxes

The Company created a provision for current income taxes and in consideration of the temporary differences also for deferred tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business and the measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of assets and liabilities. Where the final tax-non-deductible/non-taxable items are different from the amounts that were calculated, such differences will impact the current income and deferred tax provisions in the period in which such determination is made (See Note 4 and Note 15).

(2) Property, plant and equipment, intangible assets and goodwill

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognized in profit or loss. The decision to recognize an impairment loss involves estimates of amount of the impairment, as well as analysis of the reasons for the potential loss. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The Company evaluates its cash-generating units' performance regularly to identify potential impairments. Determining the recoverable amount of the cash-generating units also entails the use of assumptions and estimates and requires a significant element of judgment. The Company assesses at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, The Company estimates the recoverable amount where an impairment loss recognised in prior periods shall be subject to the reversal (see Note 9).

The Company tests goodwill for an impairment at each reporting date. However goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. In accordance with the requirement of IAS 36, goodwill is tested annually for its recoverable amount, as well as when there are indications of impairment (see Note 8).

(3) Provisions and contingent liabilities

As set out in Note 17 the Company is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Company's treatment of obligations with uncertain timing and amount depends on the management's estimation of the amount and timing of the obligation and probability of an outflow of resources embodying economic benefits that will be required to settle the obligation (both legal or constructive). A provision is recognised when the Company has a present obligation as a result of past events, it is probable that an outflow of resources to settle the obligation will be required and a reliable estimate of the amount of the obligation can be made (see Note 16). Contingent liabilities are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. Contingent liabilities are assessed continually to determine whether an outflow of resource embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

U Investments in subsidiary and associated undertakings

A subsidiary is an enterprise that is controlled by the Company, which means that the Company has the power to govern the financial and operating policies so as to obtain benefits from its activities.

An associated undertaking is an enterprise where the Company has significant influence, which is the power to participate in the financial and operating policy decisions, but not exercise control.

Equity investments in subsidiaries and associates are recorded at cost less an allowance for diminution in value.

No consolidation of subsidiaries or associates has been performed as these financial statements are presented on a stand-alone basis. In accordance with the requirements of the Act on Accounting, the Company prepares consolidated financial statements in accordance with IFRS.

V Change in accounting policy

No significant changes in accounting policies were applied in 2011 and 2010.

W Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, interest expense, other financial expense (which includes primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

Notes to the financial statements

Content

1. Segment information

Business segments recognised by the Company are as follows:

— fixed – network communication services using a fixed network and IS/ICT services
— mobile – mobile communication services

Year ended 31 December 2011 In CZK million	Fixed	Mobile	Company
Revenues from voice services	6,725	9,863	16,588
Monthly charges	4,298	8,114	12,412
Data services	8,776	2,499	11,275
Other revenues	2,942	6,311	9,253
Revenues incl. inter-segment sales	22,741	26,787	49,528
Inter-segment sales	(318)	(347)	(665)
Total revenues	22,423	26,440	48,863
Other income	481	7	488
Total costs	(14,043)	(14,312)	(28,355)
Impairment charge	(9)	–	(9)
Depreciation	(7,150)	(1,826)	(8,976)
Amortisation	(889)	(1,342)	(2,231)
Total depreciation and amortization	(8,039)	(3,168)	(11,207)
Operating income	813	8,967	9,780
Net financial loss			(118)
Profit before tax			9,662
Corporate income tax			(2,014)
Profit for the year			**7,648**
Assets (excluding goodwill)	40,507	37,290	77,797
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	–	13,320	13,320
Total assets	**40,507**	**50,610**	**91,117**
Trade and other payables	5,825	5,936	11,761
Other liabilities	3,449	3,515	6,964
Total liabilities	**9,274**	**9,451**	**18,725**
Capital expenditure	**3,198**	**2,007**	**5,205**

Year ended 31 December 2010 In CZK million	Fixed	Mobile	Company
Revenues from voice services	7,375	12,410	19,785
Monthly charges	5,133	8,195	13,328
Data services	9,107	2,303	11,410
Other revenues	2,906	6,359	9,265
Revenues incl. inter-segment sales	24,521	29,267	53,788
Inter-segment sales	(345)	(451)	(796)
Total revenues	24,176	28,816	52,992
Other income	232	26	258
Total costs	(14,624)	(15,686)	(30,310)
Impairment reversal	4,325	–	4,325
Depreciation	(6,675)	(2,522)	(9,197)
Amortisation	(1,034)	(1,190)	(2,224)
Total depreciation and amortization	(7,709)	(3,712)	(11,421)
Operating income	6,400	9,444	15,844
Net financial loss			(115)
Profit before tax			15,729
Corporate income tax			(3,033)
Profit for the year			**12,696**
Assets (excluding goodwill)	52,588	30,358	82,946
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	–	13,320	13,320
Total assets	**52,588**	**43,678**	**96,266**
Trade and other payables	5,561	5,907	11,468
Other liabilities	3,486	3,703	7,189
Total liabilities	**9,047**	**9,610**	**18,657**
Capital expenditure	**2,843**	**2,539**	**5,382**

Revenue of the Company is predominantly derived from domestic trading activities. With respect to the issue of IFRS 8 Operating segments and the deep integration process from the past convergence of fixed and mobile operations, the Company has analysed criteria for segment identification.
As a result of the analysis, concept of fix and mobile segment is still valid and most appropriate for segment recognition.

The inter-segment pricing rates applied in 2011 and 2010 were determined on the same basis as rates applicable for other mobile operators and are consistent with rates applied for pricing with other mobile operators.

Capital expenditures comprise additions to property, plant and equipment and intangible assets.

2. Revenues and costs

Revenues from voice services In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Voice – outgoing	8,964	10,745
Interconnection and other wholesale services	6,959	8,244
Total revenues from voice services	**15,923**	**18,989**

Data services In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Leased lines and fixed data services	2,837	3,132
Internet (including monthly and one-off charges)	5,428	5,384
Mobile data	2,499	2,303
IPTV	511	591
Total revenues from data services	**11,275**	**11,410**

Other revenues In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
SMS & MMS & PRMS and Contents	4,219	4,374
Equipment and activation charges	1,593	1,409
ICT and business solutions	2,226	2,407
Other telecommunication revenues	1,215	1,075
Total other revenues	**9,253**	**9,265**

Other income In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Rental and non-telco income	105	112
Gains from fixed assets disposal	340	91
Indemnities, penalties and similar income	43	55
Total other income	**488**	**258**

Výnosy od spřízněných osob jsou uvedeny v Poznámce č. 21.

Other direct cost of sales In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Telco services, Contents and other cost of sales	(612)	(936)
Sub-deliveries	(1,134)	(1,003)
Commissions	(1,469)	(1,122)
Total other direct cost of sales	**(3,215)**	**(3,061)**

Other expenses In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Billing and collection, provision for bad and doubtful debts	(792)	(905)
Network & IT repairs and maintenance	(2,581)	(2,486)
Rentals, buildings and vehicles	(1,906)	(1,995)
Utilities supplies	(1,057)	(1,017)
Marketing and call centers	(1,334)	(1,475)
Consultancy and professional fees and other external services	(571)	(684)
Royalties and management fees	(1,065)	(1,049)
Administrative fees and other operating expenses	(494)	(475)
Capitalized own expense on fixed assets	616	568
Total other expenses	**(9,184)**	**(9,518)**

Staff costs In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Wages and salaries	(3,935)	(4,363)
Redundancy payments	(173)	(454)
Health and Social security contributions	(1,331)	(1,481)
Staff welfare costs	(251)	(214)
Total staff costs	**(5,690)**	**(6,512)**

Company does not participate in any pension plan.

A restructuring plan covering both employees and members of management was approved and subsequently implemented by the Company during 2010 and 2011. As a result of the restructuring process the Company incurred restructuring costs of CZK 173 million during the year ended 31 December 2011 that have been recognised for the redundancy payments (2010: CZK 422 million).

Statutory auditor's fees were as follows:

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Auditor's fees	21	22

Purchases from related parties are disclosed in Note 21.

3. Financial income and costs

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Financial income		
Interest income	119	86
Gain on fair value adjustments of financial instruments	185	0
Other financial income [1]	322	371
Total financial income	**626**	**457**
Financial costs		
Interest expenses	(224)	(240)
Loss on fair value adjustments of financial instruments	0	(175)
Other financial costs [1]	(520)	(157)
Total financial costs	**(744)**	**(572)**
Net financial loss	**(118)**	**(115)**

[1] Vast majority consists of gains/(losses) arising from foreign exchange differencies

4. Income tax

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Total income tax expense is made up of:		
— Current income tax charge	2,215	2,430
— Deferred income tax charge (Note 15)	(201)	603
Taxes on income	**2,014**	**3,033**

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Company as follows:

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Profit before tax	9,662	15,729
Income tax charge calculated at the statutory rate of 19% (2010: 19%)	1,836	2,989
Not taxable income	–	(21)
Expenses not deductible for tax purposes	120	129
Tax related to prior periods	58	(64)
Taxes on income	**2,014**	**3,033**
Effective tax rate	21%	19%

As at 31 December 2011, the total amount of provision for current income taxes is CZK 2,205 million (2010: CZK 2,478 million), advances paid for income taxes amount to CZK 2,367 million (2010: CZK 2,921 million) and the net deferred tax liability is CZK 3,735 million (2010: CZK 3,936 million).

5. Income tax

Basic earnings per share are calculated by dividing the standalone net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	31 December 2011	31 December 2010
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	7,648	12,696
Basic earnings per share (CZK)	24	39

There is no dilution of earnings as no convertible instruments have been issued by the Company.

6. Dividends

In CZK million	31 December 2011	31 December 2010
Dividends declared (including withholding tax)	12,884	12,884

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2011. Approval of the 2011 profit and the decision regarding the amount of any dividend payment for the 2011 financial year will take place at the Annual General Shareholders Meeting.

Dividend per share for the years ended 31 December were as follows:

In CZK	Year ended 31 December 2011	Year ended 31 December 2010
Dividend per share (nominal value of 100 CZK)	40	40

7. Property, plant and equipment

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Communication technology and related equipment	Other fixed assets	Total
At 31 December 2011					
Opening net book amount	10,945	33,685	8,108	1,778	54,516
Additions	269	818	2,401	441	3,929
Disposals and other movements	(22)	(4)	43	–	17
Assets classified as held for sale	(199)	(2)	–	–	(201)
Depreciation charge	(876)	(4,858)	(2,458)	(784)	(8,976)
Impairment charge	–	–	(9)	–	(9)
Closing net book amount	**10,117**	**29,639**	**8,085**	**1,435**	**49,276**
At 31 December 2011					
Cost	19,125	102,990	88,458	7,986	218,559
Accumulated depreciation and impairment allowance	(9,008)	(73,351)	(80,373)	(6,551)	(169,283)
Net book amount	**10,117**	**29,639**	**8,085**	**1,435**	**49,276**
At 31 December 2010					
Opening net book amount	10,976	33,539	8,660	2,011	55,186
Additions	265	926	2,297	611	4,099
Disposals and other movements	2	74	45	(25)	96
Assets classified as held for sale	(3)	(1)	–	–	(4)
Depreciation charge	(660)	(4,636)	(3,079)	(822)	(9,197)
Impairment charge	(1)	–	(7)	–	(8)
Impairment reversal	366	3,783	192	3	4,344
Closing net book amount	**10,945**	**33,685**	**8,108**	**1,778**	**54,516**
At 31 December 2010					
Cost	19,612	102,470	88,962	8,490	219,534
Accumulated depreciation and impairment allowance	(8,667)	(68,785)	(80,854)	(6,712)	(165,018)
Net book amount	**10,945**	**33,685**	**8,108**	**1,778**	**54,516**

The net book amount at 31 December 2011 includes 1,569 million CZK of assets in the course of construction (31 December 2010: 2,614 million CZK) and assets in the course of construction are spread in all disclosed categories of property, plant and equipment following their nature.

As at 31 December 2011, the carrying value of non-depreciated assets amounted to CZK 191 million (2010: CZK 215 million).

No property, plant and equipment were pledged as at 31 December 2011.

No borrowing costs were capitalized during the years 2011 and 2010.

Classes of property, plant and equipment can be broken down into main categories as follows:

Land, buildings and construction In CZK million	Closing balance 31 December 2011	Closing balance 31 December 2010
Buildings [1]	5,590	6,056

[1] Majority of buildings are buildings for telecommunication technologies.

Ducts, cables and related plant In CZK million	Closing balance 31 December 2011	Closing balance 31 December 2010
Twin cables	21,539	24,735
Terrestrial optic fibre	5,159	5,618

Communication technology and related equipment In CZK million	Closing balance 31 December 2011	Closing balance 31 December 2010
Exchanges	1,235	1,095
Transmission equipment	1,196	1,170
IP technology, routers, modems	941	989

Other fixed assets In CZK million	Closing balance 31 December 2011	Closing balance 31 December 2010
Information process equipment	1,098	1,160

The Company reports and classifies the following assets held for sale at the balance sheet date:

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Other fixed assets	Total
At 31 December 2011				
Cost	6	–	–	6
Accumulated depreciation and impairment allowance allowance	(5)	–	–	(5)
Net book amount	**1**	**–**	**–**	**1**
At 31 December 2010				
Cost	502	86	69	657
Accumulated depreciation and impairment allowance	(490)	(86)	(69)	(645)
Net book amount	**12**	**–**	**–**	**12**

Assets intended for sale in most cases represent buildings with lands that have become idle and ready to be sold. It is expected that the sale will take place within one year. Spaces in sold buildings were partially leased by the Company.

The non-current assets classified as held for sale are presented in the fixed segment.

In 2011, the Company achieved a total gain from the sale of the above fixed assets amounting to CZK 340 million (2010: CZK 91 million) and total losses in amount CZK 42 million (2010: CZK 16 million).

In 2011, the Company conducted a copper project, which consisted of sale of unused copper cables (twin cables) achieving total gain CZK 223 million.

Cost of fully depreciated property, plant and equipment was CZK 70,290 million as at 31 December 2011 (2010: CZK 71,491 million).

8. Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2011				
Opening net book amount	13,320	3,514	3,901	20,735
Additions	–	–	1,276	1,276
Disposals and other movements	–	–	15	15
Amortisation charge	–	(386)	(1,845)	(2,231)
Closing net book amount	**13,320**	**3,128**	**3,347**	**19,795**
At 31 December 2011				
Cost	13,320	6,073	25,669	45,062
Accumulated amortisation and impairment allowance	–	(2,945)	(22,322)	(25,267)
Net book amount	**13,320**	**3,128**	**3,347**	**19,795**
At 31 December 2010				
Opening net book amount	13,320	3,901	4,456	21,677
Additions	–	–	1,283	1,283
Disposals and other movements	–	(1)	–	(1)
Amortisation charge	–	(386)	(1,838)	(2,224)
Closing net book amount	**13,320**	**3,514**	**3,901**	**20,735**
At 31 December 2010				
Cost	13,320	6,073	26,655	46,048
Accumulated amortisation and impairment allowance	–	(2,559)	(22,754)	(25,313)
Net book amount	**13,320**	**3,514**	**3,901**	**20,735**

Goodwill

Goodwill in amount of CZK 13,320 million resulted from the acquisition of the remaining 49% ownership interest in Eurotel Praha spol. s r.o. (“Eurotel”). From the effective date of merger with Český Telecom, a.s. this goodwill is presented in the standalone financial statements of the Company. The initially recognized goodwill of CZK 14,087 million resulted from comparison of cost of business combination of CZK 29,215 million and fair value of net assets acquired of CZK 15,128 million.

Until 31 December 2004 goodwill was amortised on a straight line basis over a period of 20 years and assessed for an indication of impairment at each balance sheet date.

Due to a revision of IFRS 3, IAS 36 and IAS 38 the Company ceased amortisation of the previously recognized goodwill from 1 January 2005. Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (CZK 767 million). Since the year ending 31 December 2005 onwards, goodwill is classified as an asset with indefinite useful life which has been tested annually for the impairment, as well as when there are indications of impairment.

The Company performed impairment tests resulting into no impairment losses of goodwill were being recognised in 2011 and 2010. The impairment test involves determining the recoverable amount of the mobile cash-generating unit, which corresponds to the value in use. Value in use is the present value of the future cash flows expected to be derived from a cash-generating unit.

Value in use is determined on the basis of an enterprise valuation model and is assessed from a Company internal perspective. Value in use is determined based on cash flow budgets, which are based on the medium-term business plan for a period of 3 years, have been approved by the management and are valid when the impairment test is performed. This business plan is based on the past experience, as well as on future market trends. Further, the business plan is based on general economic data derived from macroeconomic and financial studies. Cash flows beyond the three-year period are extrapolated using appropriate growth rates. Key assumptions on which management has based its determination of business plan and growth rates include development of gross domestic product, interest rates, nominal wages, average revenue per user (ARPU), customer acquisition and retention costs, churn rates, capital expenditure, market share, growth rates and discount rates.

Any significant future changes in the market and competitive environments could have an adverse effect on the value of the cash-generating units.

The calculations of value in use for all cash-generating units are the most sensitive to the following assumptions:

Estimated growth rate – the basis used to determine the value assigned to estimated growth rate is the forecast of the market and regulatory environment, where the Company conducts its business.

Discount rate – discount rates reflect management's estimate of the risk specific to the cash generating unit. The basis used to determine the value assigned is a weighted average of cost of capital ("WACC").

There is no other intangible asset with indefinite useful life except for goodwill.

Licences

Acquired licences are represented by rights to operate cellular networks in the Czech Republic, the UMTS (Universal Mobile Telecommunication System, the third generation mobile cellular technology for networks), GSM (Global System for Mobile Communication, the second generation technology) and NMT (Nordic Mobile Telephone, the first generation technology).

In the course of 2012, the Czech Telecommunication Office is expected to announce a tender for licences to operate cellular network. These licences concern rights to operate the 1800MHz, 800 MHz (Digital dividend), 2.6GHz FDD and 2.6 GHz TDD spectrums.

The Company participates in a public discussion about tender conditions that should occur during the first half of 2012 with a consecutive tender process to be called later by the Czech Telecommunication Office.

All considered spectrums will be offered in one tender.

Carrying value of licences:

In CZK million	Force by	31 December 2011	31 December 2010
GSM 900 license	2016	330	402
GSM 1800 license	2016	266	324
NMT 450 license	2013	13	19
UMTS license	2022	2,519	2,769
Total		**3,128**	**3,514**

No borrowing costs were capitalized during the years 2011 and 2010.

Cost of fully amortised intangible assets was CZK 18,015 million as at 31 December 2011 (2010: CZK 19,003 million).

All of the Company's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and revision of useful life.

9. Impairment of fixed assets

Fixed assets of the fixed line business

During 2003, external factors relating to the telecommunication market and regulatory environment namely uncertainty regarding tariff rebalancing, termination charges for internet dial-up, interconnection charges and other regulatory decisions in the Czech Republic led the management to assess and adjust the recoverable amount of the fixed line segment assets. The fixed line segment assets constitute one cash-generating unit (the "CGU").

As at 30 June 2010 and 31 December 2010, the management of the Company reviewed the indicators which could have indicated that a previously recognised impairment loss of fixed line segment assets which constitute a cash generating unit made in 2003 may no longer be relevant. The Company considered both external and internal sources of information.

Value in use has been calculated by a method of cumulated discounted cash flows generated by the CGU in future. Primarily, the following key elements have been used in the impairment testing model: latest version of four-year business plan (revenues, operating expenses, capital expenditures, etc.), estimation of consecutive development of key indicators (estimated growth rates applied on revenues, margin, investments, etc.), terminal value, discount rate derived from weighted average cost of capital.

As at 30 June 2010, the management of the Company performed a detailed impairment review. As a result of the review, the recoverable amount of the fixed line segment assets (impairment test model) was estimated. While performing the review, the Company considered all relevant external and internal sources of information when determining the recoverable amount.

The Company has taken into account certain favourable effects like improvements and efficiencies occurred, changes during the period and further expected in the near future in the technological, market and economic environment that will have favourable effect, manner in which assets are used and are expected to be used, economic performance of assets. The Company has taken into account primarily following effects – continuously implemented measures to improve cost efficiency of operations, demand for complex ICT solutions as well as a generally increasing demand on capacity for data transfers (driven by Broadband Internet, IP-TV, Very High Speed DSL), providing of a large variety of data services besides traditional fixed line voice services, etc.

Impairment test has proved the recoverable amount is sufficient to reverse the previously recognised impairment loss. Based on the impairment test performed as at 30 June 2010 the Company reversed the previously recognised impairment loss of CZK 4,344 million (as limited by recoverable amount) attributable to the CGU's assets. Carrying amount of CGU's assets was increased to the recoverable amount. Increased amount did not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised in prior years.

Carrying amount of identifiable assets (subject to reversal) before reversal was CZK 34 billion, after reversal CZK 38 billion. The value of assets at costs (subject to reversal) was CZK 111 billion.

Reversal of previously recognised impairment loss led to increased carrying amount of assets, hence prospective increase of depreciation charge as well.

As a consequence of June's impairment reversal the management of the Company reviewed again the indicators by 31 December 2010 as well as 31 December 2011, which could have indicated whether the CGU's assets might be impaired. Assessment carried out as at 31 December 2010 and 2011 confirmed that no such indicator exists and the values of the existing assets are fairly stated.

10. Inventories

In CZK million	31 December 2011	31 December 2010
Telecommunication material	124	251
Goods and work in progress	322	326
Total	**446**	**577**

The inventories noted above are stated net of an allowance of CZK 41 million (2010: CZK 59 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories at net realisable value amounts to CZK 47 million (2010: CZK 67 million).
The amount of inventories recognised as an expense is CZK 2,611 million (2010: CZK 2,345 million).

11. Receivables and prepayments

In CZK million	31 December 2011	31 December 2010
Trade receivables from the third parties (net)	6,413	6,696
Group trade receivables	463	595
Prepayments	515	768
Other debtors (net)	514	582
Total	**7,905**	**8,641**

Trade receivables and other debtors are stated net of a bad debt provision of CZK 3,539 million (2010: CZK 3,604 million). In order to preserve the tax-deductible status of the bad debt expense, the Company's trade receivables have been fully provided for, however not derecognised from the primary books and records until certain statutory collection requirements are satisfied.

As at 31 December 2011, other debtors contained restricted cash of CZK 22 million (2010: CZK 0 million).

Receivables from related parties are disclosed in Note 21.

			Not impaired but overdue			
Trade receivables In CZK million	**Carrying amount**	**Neither Impaired nor overdue**	Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2011	6,876	3,449	210	16	32	59
At 31 December 2010	7,291	3,308	273	25	30	119

Bad debt provisions In CZK million	
At 1 January 2010	3,448
Additions	3,474
Retirements/amount paid	(3,318)
At 31 December 2010	**3,604**
Additions	2,492
Retirements/amount paid	(2,557)
At 31 December 2011	**3,539**

The Company's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Company's trade receivables.

As at 31 December 2011, the Company presented non-current assets of CZK 145 million (2010: CZK 165 million) consisting of other long-term credits and advance payments for long-term expenses, which are classified as other financial assets. As at 31 December 2011, non-current financial assets contained restricted cash of CZK 20 million (2010: CZK 0 million) resulting for the Company from legal requirements set by Czech National Bank Authority for payment services providers.

12. Cash and cash equivalents

In CZK million	31 December 2011	31 December 2010	Interest rate
Cash at current bank accounts	178	203	Floating
Cash at cash-pooling structures (inter-company)	6,763	4,578	Floating
Total cash and cash equivalents	**6,941**	**4,781**	

As at 31 December 2011 and 2010, cash equivalents of the Group comprised interest bearing deposits with maximum maturity of three months.

Since April 2006, the Company has been taking part in Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective cash flow management.

At 31 December 2011, the Company had available equivalent of CZK 1,802 million (2010: CZK 4,135 million) of undrawn committed facilities.

For the purposes of the statement of cash flows, the year-end cash and cash equivalents comprise only the following component:

In CZK million	31 December 2011	31 December 2010
Cash and cash equivalents	6,941	4,781

As at 31 December 2011 and 2010 no cash and cash equivalents were pledged.

13. Trade and other payables

In CZK million	31 December 2011	31 December 2010
Trade creditors (net)	9,605	9,078
Tax and social security liability	597	613
Other deferred revenue	371	480
Prepaid cards	409	404
Employee wages and benefits	487	546
Other creditors	292	347
Total payables	**11,761**	**11,468**
Other non-current liabilities	**88**	**21**

Payables to related parties are disclosed in Note 21.

As at 31 December 2011 and 2010, other non-current liabilities were made up primarily of deposits placed by recharging partners for prepaid cards and liabilities with due date in more than 12 months.

14. Financial debt

In CZK million	31 December 2011	31 December 2010
Bank loans in foreign currencies	2,968	2,883
Interest obligation and derivatives	92	141
Total financial debt	**3,060**	**3,024**
Repayable:		
— Within one year	3,060	141
— Between two and five years (total non-current)	–	2,883
Total financial debt	**3,060**	**3,024**

In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity date on 30 July 2012. As at 31 December 2011, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2011 and 2010, the Company did not utilize bank overdrafts.

The Company's loan interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2011	31 December 2010
At fixed rate	2,968	2,883

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate estimated by the management of the Company as reachable at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2011	2010
Bank loans in foreign currencies	6.64%	6.64%

Loans are not secured over any assets of the Company.

The table below summarizes the maturity profile of the Company's financial and trade liabilities at 31 December 2011 based on contractual undiscounted payments.

At 31 December 2011 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	–	3,165	–	–
Trade and other payables (excluding deferred revenue and prepaid cards)	9,654	1,327	–	–
Total	**9,654**	**4,492**	**–**	**–**
Non-current other liabilities	–	–	82	6

At 31 December 2010 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	–	191	3,074	–
Trade and other payables (excluding deferred revenue and prepaid cards)	9,252	1,332	–	–
Total	**9,252**	**1,523**	**3,074**	**–**
Non-current other liabilities	–	–	16	5

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the financial statements.

	Carrying amount		Fair value	
In CZK million	**2011**	**2010**	**2011**	**2010**
Financial assets				
Cash and cash equivalents	6 941	4 781	6 941	4 781
Short-term loans (incl. accrued interest)	67	284	67	284
Derivatives	101	9	101	9
Other financial assets	145	165	145	165
Financial liabilities				
Interest bearing loans and borrowings:				
— Fixed rate borrowings (incl. accrued interest)	3 051	2 963	3 115	3 169
— Derivatives	9	61	9	61

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Fair value hierarchy

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: techniques which use inputs that have a significant effect on the recorded fair value and that are not based on observable market data.

As at 31 December 2011 and 31 December 2010, the Company held only the foreign currency forward and swap contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2011, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Financial risk analysis

The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange rates and interest rates.

	Effect on profit before tax	
In CZK million	**2011**	**2010**
FX risk		
Value at Risk[1]	(149)	(163)
Stress testing[2]	(47)	(52)
IR risk		
Stress testing[3]	(91)	(110)

[1] The Value at Risk (VaR) Model enables the Company estimate the probability of maximum possible loss to the portfolio value in the given time frame which will not be exceeded given the defined reliability level. For conducting a VaR calculation, the Company uses the risk variance and covariance method using the normal distribution (e.g. parametric method). The time frame used is one month with a 95% reliability rate. Considering the importance of net open positions resulting from financial assets and financial liabilities of the Company in individual foreign currencies, the Company models VaR from a position of translation and transaction in EUR and USD.

[2] FX risk used stress scenario represents the immediate loss caused by one-off change in the foreign exchange rate by 1% in a negative direction.

[3] IR risk used stress scenario represents immediate one-off change of interest rates along the whole yield curve by 1% in an unfavorable direction. The calculation of unfavourable impact on Company cash flows (due to an increase in interest expense or drop in interest received relating to financial assets and financial liabilities) is made each month on the floating basis within a time frame of 12 months.

Financial derivatives

The following nominal value of foreign exchange contracts was used by the Company to manage the currency risk:

	Nominal value In EUR million		Fair value In CZK million	
	2011	**2010**	**2011**	**2010**
Foreign exchange contracts	165	136	92	(52)

15. Deferred income taxes

Deferred income taxes are calculated using currently enacted tax rates expected to apply when the asset is realized or the liability settled.

Short-term and long-term deferred taxes were calculated at 19% for both years 2010 and 2011.

In CZK million	**2011**	**2010**
At 1 January	3,936	3,333
Profit or loss tax charge / (credit) (Note 4)	(201)	603
At 31 December	3,735	3,936

The following amounts, determined after offsetting, are shown in the balance sheet:

In CZK million	31 December 2011	31 December 2010
Deferred tax assets	(218)	(248)
Deferred tax liabilities	3,953	4,184
Total	**3,735**	**3,936**

The deferred tax asset includes CZK 196 million (2010: CZK 220 million) recoverable in less than twelve months and CZK 22 million (2010: CZK 28 million) recoverable after more than twelve months. The deferred tax liability includes CZK 494 million (2010: CZK 452 million) payable in less than twelve months and CZK 3,459 million (2010: CZK 3,732 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Balance sheet		Profit or loss	
In CZK million	**2011**	**2010**	**2011**	**2010**
Temporary differences relating to:				
— Property, plant and equipment and intangible assets	3,852	4,162	(310)	541
— Trade receivables, inventories and other differences	(117)	(226)	109	62
Total	**3,735**	**3,936**	**(201)**	**603**

16. Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Other provisions	Total
At 1 January 2011	126	82	208
Additions during the year	16	374	390
Utilised during the year	(120)	(397)	(517)
At 31 December 2011	**22**	**59**	**81**
Short-term provisions 2011	3	53	56
Long-term provisions 2011	19	6	25
	22	**59**	**81**
Short-term provisions 2010	84	73	157
Long-term provisions 2010	42	9	51
	126	**82**	**208**

With the exception of the regulatory and court decision provisions and other small provisions for which the expected timing of payments is not certain all other provisions are expected to be utilised within the next twelve months from the balance sheet date.

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 17).

Other provisions

Other provisions consist mainly of expected costs associated with untaken holiday compensation, share plans and provision to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold.

17. Contingencies

The Company is involved in a number of legal disputes arising from standard business interactions. Throughout 2011 the Company continued the successful trend of defending itself against law-suits filed by the third parties in the past. The only new lawsuit against the Company was brought by VOLNÝ, a.s. During 2011, an official administrative proceeding has been opened by Office for Protection of Economic Competition (see II). Major legal disputes and other proceedings relating to the Company are shown below.

I. Vodafone Czech Republic a.s. – Interconnect agreement dispute

On 30 June 2005, Vodafone Czech Republic a.s. (former Český Mobil/Oskar Mobil) filed a legal action with the Municipal Court in Prague against the Company for damages worth CZK 538 million with interests and the return of unjust enrichment of CZK 117 million with interests. The Company allegedly did not transit the traffic to a network operated by the mobile operator in compliance with relevant interconnect agreements. The High Court in Prague confirmed the conclusion of the Company that this case had already been decided before the Czech Telecommunication Office in favour of the Company and that Vodafone Czech Republic a.s. was seeking only to by-pass this court decision. In the light of the above, in September 2008 the Municipal Court in Prague terminated the proceeding. The High Court in Prague partly confirmed this decision. Subsequently the Municipal Court in Prague dismissed the remaining part of the legal action as groundless by its verdict of 30 September 2009. The High Court confirmed this verdict in appeal proceeding in February 2011 and the proceeding is legally closed. Though, Vodafone Czech Republic a.s. filed extraordinary appeal regarding CZK 26 million claiming that the decision is incorrect in this extent. The Supreme Court has not decided on extraordinary appeal yet.

II. ÚOHS (Office for Protection of Economic Competition)

i. *Administrative proceeding on alleged abuse of dominant position on fix broadband market*
   The Office for the Protection of Economic Competition (ÚOHS) has been conducting so called "preliminary investigation" since November 2008 to determine whether the Company had abused its dominant position in the broadband market. The Company cooperated with the Office while repeatedly stating and proving that it had not held a dominant position in the market and, as such, no abuse could have been committed. Although the extent of information and documents required by the Office during more than a two-year long investigation grew immensely, the Company was never allowed to inspect the file to check its content and control how the information was interpreted by the Office. In the light of the above, the Company requested for court protection by legal action filed to the Regional Court in Brno. In December 2010, the Regional Court in Brno preliminarily banned the Office from the continuation of the preliminary investigation and, in February 2011, issued a verdict stating that the preliminary investigation has

to be stopped immediately. This verdict was later confirmed by Supreme Administrative Court in September 2011. The Office reacted by opening official administrative proceeding on dominant position on fix broadband market by ADSL technology in March 2011. The Company filed its statement proving that the Office incorrectly defines relevant market on which Company would allegedly hold dominant position and moreover even abuse it. Company's statement about strong competition between technological platforms such as xDSL, cable and WiFi in the Czech Republic was repeatedly confirmed by the Czech Telecommunication Office and European Commission. The Company also provided the Office with numerous documents proving that all steps of the Company were correct. More records are continuously filed into the file. The Company cannot estimate when the proceeding will be closed due to extreme length and volume of information. As at the date of the financial statements approval it was not possible to make a reliable estimate of the financial impact of this administrative proceeding.

ii. *Proceeding for CZK 81.7 million*
In December 2009, the Regional Court in Brno cancelled the decision of the Office over the penalty of CZK 81.7 million imposed in December 2003 on the Company in the proceeding on the alleged abuse of the dominant position in the fixed voice services market. As a consequence of the dismissal, the Company asked the Office for returning the penalty including interests. Although the principal was returned by the Office, before it was decided on the returning of interests, the Supreme Administrative Court had in the meantime cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. After all in March 2011 the Regional Court in Brno cancelled the decision regarding the penalty and returned the case back to the Office where the Office should in compliance with law justify the penalty in relation to the judged period.

III. Disputes with AUGUSTUS spol. s r.o. company

i. AUGUSTUS spol. s r.o. had sued the Company for an alleged loss of profit in the period from 1995 to 2001 in the amount of CZK 183 million with interests. AUGUSTUS spol. s r.o. claims that the Company has illegally terminated the contract for the issue and distribution of phone cards signed for an open period of time. Based on the decision of the High Court in Prague, in August 2006, the Company paid a sum of CZK 83 million plus relevant interests (total of CZK 139 million). Later on, we could see a positive turn in the proceeding in favour of the Company when the Supreme Court based on the Company's appeal cancelled the previous verdicts in June 2009 and the Municipal Court in Prague ultimately dismissed the lawsuit in April 2010. The High Court finally confirmed this dismissal in August 2011. In reaction to this the Company filed a lawsuit against AUGUSTUS spol. s r.o. to return the amount of CZK 139 million. The Municipal Court in Prague granted the claim in September 2011. AUGUSTUS spol. s r.o. filed an appeal. Meanwhile it turned out that at least CZK 94 million had been transferred to third parties based on agreements with the statutory representative. The Company is taking all legal steps to secure the property and to avoid additional losses.

ii. AUGUSTUS spol. s r.o. subsequently filed another legal action against the Company for the amount of CZK 294 million. Again, the action was based on the contract for the issue of phone cards which ended in 1995. Claims had no legal grounds and in the light of development in the main case indefensible. The proceeding was finally terminated due to the non-payment of the court fee in January 2011.

IV. MEDIATEL, spol. s r.o. – dispute on CZK 359 million

MEDIATEL, spol. s r.o., which was cooperating with the Company on the publishing of the phone directory distributed to all telecommunications subscribers since 1992 (known under brand name "Zlaté stránky"), filed a legal action against the Company for the compensation of an alleged damage exceeding CZK 359 million in December 2009. After the delivery of the legal action in January 2010, the Company presented its position with a detailed analysis of the groundlessness of the lawsuit. The Court in the first hearing pointed out deficiencies in the legal action and burden of proof (claim is not satisfactory justified). Next hearing will take place in 2012.

V. CNS a.s. – dispute on CZK 137 milion

In 2009, the employees of CNS a.s., dealing with the development and updates of IT applications and the employees of Telefónica O2 Business Solutions, spol. s r.o. were having negotiations over the potential collaboration relating to the operation of data boxes. However, no agreement was signed between the parties and, due to commercial reasons, the project was never materialised. CNS a.s. filed in August 2010 a legal action against the Company for the compensation of damage and lost profit worth CZK 137.2 million for not signing any contract. The Company regards this claim as fabricated and the amount evidently exaggerated which can be demonstrated by the fact that in accordance with the annual profit and loss statement 2009, CNS a.s. generated a yearly profit of less than CZK 5.5 million. The hearing will take place during the year 2012.

VI. VOLNÝ, a.s. – dispute on CZK 4 billion

On 28 March 2011, VOLNÝ, a.s. filed a legal action with the Municipal Court in Prague against the Company for an amount exceeding CZK 4 billion for an alleged abuse of a dominant position on the market of Internet broadband connection provided to households via ADSL. The amount is meant to represent the lost profit for years 2004 to 2010. VOLNÝ, a.s. claims to have had 30% share on the dial-up Internet market in 2003 and thus implies in its legal action that it should automatically have the same result on the broadband market, which it does not. Allegedly, it is due to the margin squeeze applied by the Company on the fix broadband market. The Company replied to the petition in July 2011 by noting that both the claim and the calculations submitted by the plaintiff were unsubstantiated and by pointing at discrepancies in the petition claims. The lawsuit has not been heard by the Court yet. Oral hearing could be expected during 2012.

The Company is involved in other legal disputes. The aggregate value of all disputes over CZK 5 million not closed with a verdict in 2011 totals to nearly CZK 12 million. The annual profit and loss statement takes into account also some minor disputes, however, with risks of less importance.

The Company considers disclosing other information regarding the said litigations not advisable, as it could endanger the strategy of the Company in these cases.

The Company is convinced that all risks relating to the litigations have been duly reflected in the financial statements.

18. Commitments

Operating leases – lessee

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2011	31 December 2010
No later than 1 year	1,303	1,311
Later than 1 year and not later than 5 years	4,498	4,431
Later than 5 years	3,966	4,079
Total	**9,767**	**9,821**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2011 were CZK 1,362 million (2010: CZK 1,425 million). These lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Company's results of operations, financial position, or cash flow and therefore are not accounted for.

The Company leases the majority of its car fleet under operating leases. Total future lease payments relating to these operating leases in 2011 were CZK 313 million (2010: CZK 369 million).

Operating leases – lessor

The aggregate future minimum lease payments under non-cancellable operating leases, where the Company is a lessor and give rise to future revenues consist of the buildings and other telecommunication equipment rentals as follows:

In CZK million	31 December 2011	31 December 2010
No later than 1 year	104	100
Later than 1 year and not later than 5 years	391	338
Later than 5 years	90	89
Total	**585**	**527**

Capital and other commitments

In CZK million	31 December 2011	31 December 2010
Capital and other expenditure contracted but not provided for in the financial statements	1,881	4,699

The majority of contracted amounts relate to the telecommunications network and service contracts.

19. Service concession arrangements

The Company performs communication activities as defined under the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunication Office num. 516 as amended by later changes num. 516/1, 516/2, 516/3, 516/4 and 516/5.

The communication activities include (territory of the Czech Republic):

a) public fixed network of electronic communications,
b) public mobile network of electronic communications,
c) public network for the transfer of radio and TV signal,
d) public fixed telephone network,
e) public mobile telephone network,
f) publicly accessible telephone services,
g) other voice services – service is provided as publicly available,
h) rent of circuits – service is provided as publicly available,
i) transmission of radio and TV signal – service is provided as publicly available,
j) transfers of data – service is provided as publicly available,
k) internet access services – service is provided as publicly available,
l) other voice services – service is not provided as publicly available,
m) rent of circuits – service is not provided as publicly available,
n) transmission of radio and TV signal – service is not provided as publicly available,
o) transfers of data – service is not provided as publicly available,
p) internet access services – service is not provided as publicly available.

The Company provides mobile services of electronic communications in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (GSM) standard on the basis of radio frequency assignment from CTO valid until 7 February 2016, in the 2100 MHz frequency band under the Universal Mobile Telecommunications System (UMTS) standard on the basis of radio frequency assignment from CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access – CDMA), where on the basis of individual authorisation to use radio frequencies issued by CTO and valid until 30 November 2013 is provided broadband mobile access to Internet.

Validity of radio frequency license is possible to prolong for next period on the basis of application submitted to CTO in accordance with the Act on Electronic Communications. Relative to the current regulatory and business environment in the Czech Republic, contractual, legal, regulatory, competitive or other economic factors may limit the period during which the Company can benefit from the use of these radio frequency assignments in the future.

Imposition of obligations related to provision of universal service

During 2011 and 2010, the Company provided the following selective services under CTO imposed obligations to provide universal service:

a) public pay telephones services,
b) access for disabled to the public telephone,
c) special price schemes, which are different from the price schemes used under normal business conditions, for low income persons, persons with special social needs and disabled persons.

Until 2009, universal service was reimbursed by electronic communication market participants. Since 2010, the Czech Telecommunication Office has received funding from the state budget, which is without delay transferred to Company's account. Positive effect of this change is a decrease of direct expenses due to zero of Company's share, full reimbursement of Company's costs faster process of settlement and lower internal cost resulting from disputes concerning participant's contributions.

20. Share capital and reserves

	31 December 2011	31 December 2010
Nominal value per ordinary registered share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)	1,000	1,000
Number of shares	1	1
Ordinary shares (in CZK million)	32,209	32,209

Struktura akcionářů Společnosti:

	31 December 2011	31 December 2010
Telefónica, S.A.	69.41%	69.41%
Other shareholders	30.59%	30.59%

Funds include a statutory reserve fund of CZK 6,442 million (2010: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve amounted CZK 53 million (2010: CZK 34 million) is not distributable.

Capital management

The Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing its capital are:

a) to safeguard the Company's ability to continue as a going concern so that it can provide value for its shareholders, and
b) to comply with all relevant legal requirements.

The investment strategy in the light of managing capital of the Company is to direct investment activities in pro-growth areas, i.e. development and improvement of fixed and mobile broadband internet and data networks, mobile services, corporate and public administration ICT solutions and further in the expansion and development of the mobile services (including data) in Slovakia. IT systems renewal and upgrade are among other investment activities with the aim to simplify and improve processes that will lead to better operational effectiveness.

At present, the approach that the Company follows is not to retain surplus cash and distribute it to shareholders. In the following periods, the Board of Directors will continue to carry out and evaluate an in-depth analysis of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation and will establish the most adequate capital structure for accomplishment of the plans.

There is no other specific objective.

With regards to dividend capacity (capped by retained earnings from previous years and profit for the current year) which will be lower than surplus cash amount, in 2011 the Company has been undertaking out an analysis of other options, which might allow to distribute other available funds. These options comprise:

a) distribution of share premium
b) share capital reduction through a decrease in nominal value of shares
c) share buy back

Equity structure of the Company as at 31 December 2011:

In CZK million	31 December 2011
Share capital	32,209
Share premium	24,374
Funds and reserves	6,503
Retained earnings from previous years	1,658
Net income for current year	7,648
Total	**72,392**

21. Related party transactions

The Telefónica Group has been reorganized in 2011 into four divisions – two geographic and two global ones.

Two geographic divisions are Telefónica Europe and Telefónica Latin America while the Company belongs to the former.

Two global cross-business divisions are Telefónica Digital and Telefónica Global Resources. Telefónica Digital seeks to strengthen the role of Telefónica in the digital world and exploit all growth opportunities while strengthening the portfolio of products and services. Telefónica Global Resources was created to increase the profitability by using all benefits of global exposure.

The Company operates in roaming, interconnection and telecommunications services in regional divisions. In the area of support services, the Company uses cooperation within global divisions.

The Company cooperates with Telefónica Global Services GmbH in performing centralized demand aggregation, negotiation activities related to the purchases of selected product categories and services and carrying out centralized commercial supplier management.

The Company cooperates with Telefónica Global Roaming GmbH in managing wholesale roaming business, negotiation and execution of roaming discounts agreements with roaming partners which enables the Company to be granted discounts by the roaming partners and to grant discounts to the roaming partners.

The Company provides services to all related parties on regular commercial terms. Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest free (excl. financial assets and liabilities used for financing) and the settlement occurs either in cash or by offsetting. The financial assets balances are tested for the impairment at the balance sheet date, and neither allowance nor write off were incurred.

The following transactions were carried out with related parties:

I. Parent company:

Balance sheet In CZK million	31 December 2011	31 December 2010
a) Receivables	6	1
b) Payables	798	1,072

Profit or loss In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
a) Sales of services and goods	–	4
b) Purchases of services and goods (excl. Royalty fees)	38	32

The total amount of dividend paid as at 31 December 2011 to Telefónica, S.A. was CZK 8,943 million (31 December 2010: CZK 8,943 million).

For the period ended 31 December 2011 the royalty fees to Telefónica, S.A. amounted to CZK 768 million (for the period ended 31 December 2010: 844 CZK million).

II. Other related parties – Company´s subsidiaries and associates:

Balance sheet In CZK million	31 December 2011	31 December 2010
a) Receivables	143	173
b) Payables	206	155
c) Short-term loans (Note 14)	62	281

Profit or loss In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
a) Sales of services and goods	479	356
b) Purchases of services and goods	341	393
c) Interest income	2	7

III. Other related parties – Telefónica Group:

Balance sheet In CZK million	31 December 2011	31 December 2010
a) Receivables	314	421
b) Payables [1]	2,034	1,531
c) Short-term receivables – interest (Note 14)	5	3
d) Cash equivalents (Note 12)	6,763	4,578

[1] As at 31 December 2011 payables to TELEFÓNICA FACTORING E.F.C., S.A. of CZK 1,348 million were included (2010: CZK 1,280 million).

Profit or loss In CZK million	For the period ended 31 December 2011	For the period ended 31 December 2010
a) Sales of services and goods	806	786
b) Purchases of services and goods	768	731
c) Management fees	297	205
d) Interest income	76	53

There were capital expenditures of CZK 37 million carried out with related parties for the period ended 31 December 2011 (for the period ended 31 December 2010 capital expenditures amounted to CZK 25 million).

The list of the Telefónica companies with which the Company had any transaction in 2011 and 2010 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica Germany GmbH& CO.OHG, Telefónica UK Ltd., Telefónica Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., O2 Holdings Ltd., Telefónica Deutschland GmbH, ALTAIR ASSURANCES S.A., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A., Telefónica Móviles Columbia, S.A., Telefónica Investigación y Desrrollo, S.A., Telecom Italia S.p.A., Telfisa Global BV, Telfisa, Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., S.A., Atento Chequia, Portugal Telecom, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Peru, S.A., Telefónica Venezuela, S.A., China Unicom (Hong Kong) Limited, Telefónica Global Roaming GmbH, Vivo, S.A., Telefónica Europe People Services Limited, Jajah Ltd., Telefónica USA, Telefonica Global Technology Chequia, Telefonica Global Technology, Telefonica Global Services GmbH, MOPET CZ a.s., TELEFÓNICA FACTORING E.F.C., S.A., Telefónica O2 Business Solutions, spol. s r.o., Internethome, s.r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica Slovakia, s.r.o.

Liabilities to TELEFÓNICA FACTORING E.F.C., S.A. represent due balances arising from the assigned receivables by the suppliers using Group factoring and are considered as a due amount to the associate company.

IV. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Company were provided with benefits as follows:

In CZK million	31 December 2011	31 December 2010
Salaries and other short-term benefits	109	110
Personal indemnification insurance	4	5
Total	**113**	**115**

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2011 and 2010.

As at 31 December 2011 the Company provided a short-term loan of CZK 19 million (2010: CZK 281 million) to Telefónica Slovakia, s.r.o. presented in short-term loans (Note 14). The loan bears a floating interest based on 1M EURIBOR. The loan conditions are based on the arm´s length principle.

As at 31 December 2011 the Company provided a short-term loan of CZK 43 million to Internethome, s.r.o. presented in short-term loans (Note 14). The loan bears a floating interest based on 1M PRIBOR. The loan conditions are based on the arm´s length principle.

No other loan was provided to related parties by the Company.

22. Principal subsidiary undertakings and associates

As at 31 December 2011

Subsidiaries		Company's interest	Cost of investment in CZK million	Country of incorporation	Activity
1.	Telefónica O2 Business Solutions, spol. s r.o.	100%	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission services
3.	CZECH TELECOM Austria GmbH	100%	6	Austria	Data transmission services
4.	Telefónica Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services
5.	Internethome, s.r.o.	100%	55	Czech Republic	Providing of internet access on WiFi technology
Přidružené společnosti					
6.	První certifikační autorita, a.s.	23%	9	Czech Republic	Rendering of certification services
7.	AUGUSTUS, spol. s r.o.	40%	–	Czech Republic	Sales by auctions and advisory services
8.	MOPET CZ a.s.	14%	13	Czech Republic	Real time payment services via mobile phones

As at 31 December 2010

Subsidiaries		Company's interest	Cost of investment in CZK million	Country of incorporation	Activity
1.	Telefónica O2 Business Solutions, spol. s r.o.	100%	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission services
3.	CZECH TELECOM Austria GmbH	100%	11	Austria	Data transmission services
4.	Telefónica O2 Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services
Přidružené společnosti					
5.	První certifikační autorita, a.s.	23%	9	Czech Republic	Rendering of certification services
6.	AUGUSTUS, spol. s r.o.	40%	–	Czech Republic	Sales by auctions and advisory services
7.	MOPET CZ a.s.	14%	13	Czech Republic	Real time payment services via mobile phones

In 2011, the Company became the sole shareholder of the new subsidiary with registered capital of 200 thousand CZK. The company Internethome, s.r.o., was established by demerging by spin-off of Telefónica O2 Business Solutions, spol. s.r.o. The change was recorded in the Commercial Register on 1 October 2011.

In December 2011, the Board of Directors approved increase of the other equity funds of Internethome, s.r.o. by CZK 55 million in the form of cash contribution. Effective date of increase of the other equity funds was 16 December 2011.

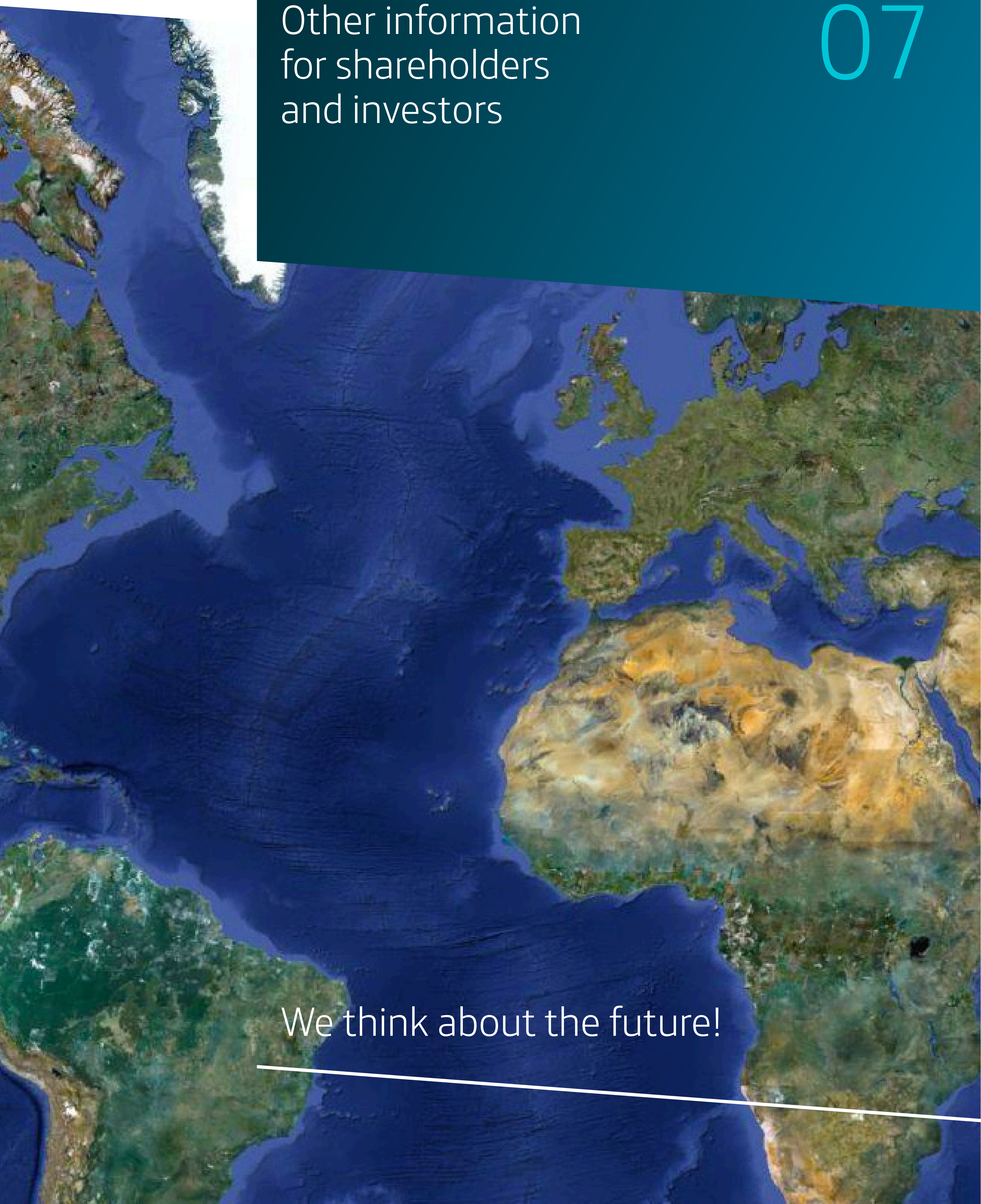
23. Post balance sheet events

On 1 January 2012 the subsidiary Informační linky, a.s. was founded by registration in the Commercial Register. The company was established by a non monetary investment of the part of enterprise running its core business in call-based information and on-line business catalogue. By preparation of these financial statements the Company had been in progress with reaching an Agreement for the sale and purchase of shares with Hapalo Estates s.r.o. As a result this contract 80% of shares of the subsidiary Informační linky, a.s. are to be sold and revenues from this transaction are to be recognised in profit or loss. The buyer will receive an option for acquisition of the remaining 20% of shares and it is highly probable that the buyer will execute this option. Remaining 20% of shares will not constitute substantial influence, it will be recognised in financial investments in costs, it will not be included in consolidation.

There were no events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2011.

Other information for shareholders and investors

07



We think about the future!

Other information for shareholders and investors

07

Basic information

Corporate name:	Telefónica Czech Republic, a.s. (Telefónica CR, the Company)
Registered address:	Praha 4, Za Brumlovkou 266/2, postal code 140 22
Company identification number:	60193336
Taxpayer registration number:	CZ60193336
Date of incorporation:	16 December 1993
Legally existing from:	1 January 1994
Duration of the company:	the company was founded for an indefinite period of time
Legal form:	joint-stock company
Statute of law under which the issuer was incorporated:	provisions of Section 171(1) and Section 172 (2) and (3) of the Commercial Code
Commercial court:	Prague Municipal Court
Commercial court record number:	Section B, File 2322

Effective from 16 May 2011, the company name of Telefónica O2 Czech Republic, a.s., was changed to Telefónica Czech Republic, a.s.

Trading in Telefónica CR shares in 2011

	2011	2010
Number of shares (in millions)	322.1	322.1
Net profit/(loss) per share (in CZK) [1]	23.7	39.4
Highest share price (in CZK) [2]	439.6	452.5
Lowest share price (in CZK) [2]	372.0	369.0
Share price at the end of period (in CZK) [2]	383.1	381.5
Market capitalization (in CZK billions) [2]	123.4	122.9

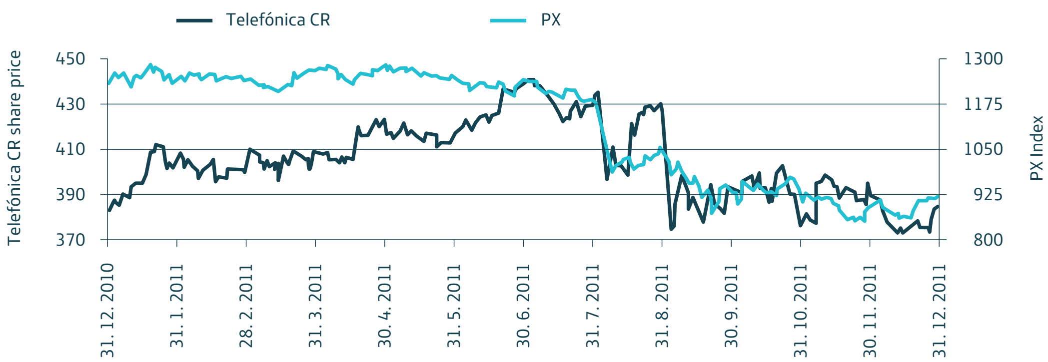
[1] Unconsolidated net profit under IFRS
[2] Source: Prague Stock Exchange

In 2011, Telefónica CR once again ranked among the most important companies on the Czech capital markets according to market capitalization and trading volumes. The total volume of trades in company shares on the main stock market of the Prague Stock Exchange (PSE) in 2011 was CZK 34.0 billion, compared to CZK 43.0 billion in 2010. Trading in Telefónica CR Czech Republic shares, measured by the total volume of shares traded, made up 9.2% of all trades on the PSE stock market. Telefónica CR shares confirmed in 2011 the position of the fourth most traded issue on the PSE from 2010. The average daily volume of trades in company shares in 2011 was down to CZK 133.7 million, compared to CZK 166.7 million in 2010.

As at 30 December 2011 (the last trading day on the PSE in 2011), the market capitalization reached CZK 123.4 billion, which ranked Telefónica CR the fourth on the PSE equities market. The price of the Company's shares on the last trading day of 2011 reached CZK 383.1, up 0.42% on the year before, while the main PX index of the PSE closed on 911.1 points with a year-on-year decline of 25.61%. The share price of Telefónica CR reached its maximum of CZK 439.6 on 4 July 2011, and its minimum of CZK 372 on 13 and 15 December 2011. The average share price in 2011 was CZK 403.8, compared to CZK 416.2 in 2010.

The above-average dividend yield, aided by the high free cash flow generation and a low level of debt, makes Telefónica CR still a very highly regarded investment opportunity by investors.

Trading in Telefónica CR shares against the PX index in 2011



Dividends

At the Ordinary General Meeting of 3 April 2009 in Prague, the shareholders approved a dividend payment from a part of the 2008 net profit and a part of the retained earnings from previous years in the total amount of CZK 16.104 billion, i.e. CZK 50 per share of nominal value of CZK 100 and CZK 500 per share of nominal value of CZK 1,000, before tax. The record day for the payment of dividends was 9 September 2009 and the disbursement date 7 October 2009.

At the Ordinary General Meeting of 7 May 2010 in Prague, the shareholders approved a dividend payment from a part of the 2009 net profit and a part of the retained earnings from previous years in the total amount of CZK 12.884 billion, i.e. CZK 40 per share of nominal value of CZK 100 and CZK 400 per share of nominal value of CZK 1,000, before tax. The record day for the payment of dividends was 8 September 2010 and the disbursement date 6 October 2010.

At the Ordinary General Meeting of 28 April 2011 in Prague, the shareholders approved a dividend payment from a part of the 2010 net profit and a part of the retained earnings from previous years in the total amount of CZK 12.884 billion, i.e. CZK 40 per share of nominal value of CZK 100 and CZK 400 per share of nominal value of CZK 1,000, before tax. The record day for the payment of dividends was 7 September 2011 and the disbursement date 6 October 2011.

Dividend policy

The Company does not have an official long-term dividend policy at present. The Company has indicated several times that it did not intend to retain surplus cash and distribute it to shareholders. In the following periods, the Board of Directors will make annual proposals for the payment of dividend, based on a diligent analysis of the current and future performance of the Company, including the projected future cash flows and investments, business development costs and acquisition costs. This approach is in line with the investment strategy of directing investment into pro-growth areas, such as improvements to the fixed and mobile broadband service, mobile services, ICT solutions for business and the government, and the development of the mobile operation in Slovakia. Other investment plans include the modernisation and upgrade of IT systems with the view to simplify processes and make them more efficient, with the ultimate goal of greater operating efficiency.

To provide for the eventuality that the dividend capacity (limited by the amount of retained earnings from previous years and the profit of the current year) in the future is lower than the balance of cash surpluses, in 2011 the Company analysed other options for the distribution of other disposable funds. These options included:

a) Payment of a share premium;
b) Reducing the share capital through the nominal value of shares;
c) Acquisition of own shares.

Details of patents or licenses, industrial, commercial or financial contracts which have a significant bearing on the business:

1) Patents and licences

Telefónica CR has licence agreements for the following software products: application middleware (BEA), database environment (Oracle), operating systems (Hewlett-Packard, SUN and Microsoft), workstation software (Microsoft), CRM (Oracle), customer care and billing software with detailed billing functionality (Amdocs and LHS) and enterprise resource planning software ERP (SAP).

2) Industrial and commercial contracts

Telefónica CR maintained a diverse portfolio of technology suppliers in 2011. The main objective of the Company with respect to the contracted suppliers was to have competition on the supply side. All principal technology supply contracts are awarded by tender.

In 2011, the main suppliers of technology and related services to the Company were IBM Česká republika, Alcatel-Lucent Czech, AutoCont CZ, Vegacom, Siemens, Accenture Central Europe B.V., Indra, DNS, NextiraOne Czech, Amdocs Development Limited, LHS, Hewlett-Packard and Huawei Technologies Co.

3) Financing agreements

Financial obligations as at 31 December 2011 divided into short-term and long-term (in CZK million):

Short-term (maturing within a year)	3,061
Long-term	0
Total	**3,061**

Loans, bonds issued and other financial obligations:

	Currency	Balance in currency as at 31 December 2011	Balance in CZK thousands as at 31 December 2011	Redemption
Private Placement – debt instrument	EUR	115,040,673	**2,968,049**	**2012**
Other financial obligations			**93,165**	

EUR/CZK exchange used in the table for conversion purposes (as at 31 December 2011) is CZK 25.800/EUR.

The above loan and the other financial obligations were repaid in accordance with the relevant loan agreements or the Terms and Conditions of Issue. As at 31 December 2011, Telefónica CR had no overdue loan obligations.

Bonds issued by Telefónica CR

Bond programme	
Maximum volume of unredeemed bonds:	CZK 20,000,000,000
Programme duration:	2002–2012
Maturity of issues in the programme:	maximum of 15 years.

As at 31 December 2011, no bond issue was made under the bond programme.

Investments

Main investments made by Telefónica CR in the last two accounting periods (in CZK millions):

	2011	2010
Network & Operations	2,779	3,011
Business Solutions	567	569
IT & Products	922	931
Property & Security	163	169
Brand stores	29	19
Subsidiary companies and other investments [1]	706	658
Projects of the Telefónica Group	0	0
Investments related to Telefónica Slovakia made in the Czech Republic	63	49
Telefónica Slovakia	393	254
Total (excluding acquisition in the WiFi segment)	5,621	5,660
WiFi acquisitions	235	3
Total	**5,856**	**5,663**

[1] Including additional internal work – capitalized

All principal investments were in the Czech Republic and in Slovakia and were financed from the Company's own resources and on credit.

In 2011, Telefónica CR continued to implement an investment policy, which clearly favours the development and support of customer-oriented technologies with a growth potential for the future, and investments leading to a greater operating efficiency. As in the previous years, Telefónica CR invested in projects aimed at internal integration of mobile and fixed line services, and in the modernisation of its technology infrastructure.

The structure of investment expenditure reflected the existing customer demands for new trends in telecommunications services with a high standard and quality of execution, and the efforts to complete the integration processes for the delivery of convergent services, aimed at the strengthening of our market position of the converged operator.

The mobile segment was dominated mainly by investments in the implementation of the Company's Mobile Broadband strategy (3G technology). The 3G covered approximately 73% of the population at the end of 2011. The market boom of the so-called 'smart' phones and devices, and the related surge in the use of data services, required that the Company invests significantly in the capacity of its networks, in particular the 3G network. In the area of fixed networks, investments were directed mainly to improvements in the transmission speed in connection with the successful launch of the VDSL technology in May 2011; and also in the quality of xDSL, IPTV, Voice over IP and value-added services.

As far as business solutions are concerned, the volume of investment followed the projects executed for customers; data connectivity and ICT projects continued to dominate this segment. The flagship solutions for business and the government in 2011 included the ongoing implementation of the data box information system for the public sector and the construction of an optical data network in the Pilsen and Karlovy Vary regions.

Investments in information systems, where the pursuit of enhanced customer experience and the foundations for new products and services (e.g. investments in the CRM systems and the new online portal through which customers can keep track of all their services and which allows for more targeted and effective marketing of new offers) were the common denominator, tallied with the strategy of convergent process integration. Customer experience improved also with the implementation of a project to reduce the number of complaints and claims from customers.

In Slovakia, the construction of a proprietary network continued, and investments went also into quality improvements of the existing CRM system, e-applications and project propositions for the business segment. Investments in the GSM network followed the requirements and conditions of the licence and system development. By the end of the year, Telefónica Slovakia had 975 2G BTS in operation, of which were commissioned in 2011, and the 2G network reached 95.2% of the population with signal at the end of 2011. Furthermore, by the end of the year, Telefónica Slovakia had 428 3G BTS in operation and its 3G network covered 31% of the population.

Key investments in the future

In the period 2012–2013, the key focus of investments in the Czech Republic will lay in the fixed and mobile broadband area, which is seen as a vehicle for future improvements, greater efficiency and broader uptake of telecommunications and data services. The Company will also invest in technology innovations in the area of ICT and innovative solutions in the area of marketing new services to customers. At the same time, it will continue to invest in improving the operating efficiency and in the modernisation of the existing technology infrastructure. In the future period, the Company will monitor and analyse the licensing conditions for the new generation (LTE) networks. In the area of fixed-line data services, the Company plans to focus on developing xDSL access and on highly-targeted investments in broadband over optical fibre.

The Slovak operation will continue to pursue a standard investment policy in the telecommunications sector, with an emphasis on efficiency improvements in the area of implementation of progressive technologies and customer policies, in order to deliver on the overall strategy and grow the share of the Slovak telecommunications market.

Fees paid to auditors in the accounting period

The cost of external audit activities performed by Ernst & Young for Telefónica CR in 2011:

Type of service	Fee in CZK thousands
Audit	26,533
Other audit-related consultancy	0
Other services	0
Total	**26,533**

Financial calendar

Date of release of the running financial results

For the first quarter of 2012	10 May 2012 [1]
For the first half of 2012	25 July 2012 [1]
For three quarters of 2012	6 November 2012 [1]
For the year 2012	28 February 2013 at the latest

[1] tentative date

Institutional investors and shareholders please contact

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E-mail: investor.relations@o2.com
URL: http://www.telefonica.cz/en/investor-relations/
Address: Telefónica CR Czech Republic, a.s.
Za Brumlovkou 266/2
140 22 Praha 4

Information on persons responsible for the Annual Report

Information on persons responsible for the Annual Report

Luis Antonio Malvido, Chairman of the Board of Directors and Chief Executive Officer of Telefónica Czech Republic, a.s.

Jesús Pérez de Uriguen, 1st Vice-chairman of the Board of Directors and Director, Finance Division of Telefónica Czech Republic, a.s.

hereby declare that, to their best knowledge, the Annual Report gives a true and faithful reflection of the financial situation, business activity and the results of the Company and its consolidated whole for the past accounting period, and of the outlook on the future development of the financial situation, business activity and the results.

Luis Antonio Malvido
Chairman of the Board of Directors
and Chief Executive Officer

Jésus Pérez de Uriguen
1st Vice-chairman of the Board of Directors
and Director, Finance Division

In Prague on 15th March 2012

Appendix:

Report of the Board of Directors
of Telefónica Czech Republic, a.s.

Appendix:
Report of the Board of Directors of Telefónica Czech Republic, a.s.

on relationships between the controlling and the controlled entity and on relationships between the controlled entity and other entities controlled by the same controlling entity for 2011

(pursuant to provisions of Section 66a(9) of the Act No. 513/1991 Coll., the Commercial Code)

Content

Part A Applicable period

The report pursuant to Section 66a(9) of the Commercial Code, on relationships between the controlling and the controlled entity and on relationships between the controlled entity and other entities – related undertakings controlled by the same controlling entity (Report) is compiled for the last accounting period, i.e. for the period started on 1 January 2011 and ended on 31 December 2011.

Part B Entities forming a holding

Section I. Identification details of the controlled entity – Telefónica Czech Republic, a.s. (Company)

The company is registered in the Commercial Register of the Municipal Court in Prague, Section B, File 2322.

Registration date:	1 January 1994
Corporate name:	Telefónica Czech Republic, a.s.
Registered address:	Prague 4, Michle, Za Brumlovkou 266/2, postal code 140 22
Identification number:	60 19 33 36
Legal form:	Joint-stock company

Section II. Identification details of the controlling entity

Controlling entity:	Telefónica, S.A.
Registered address:	Gran Vía, 28, 28013 Madrid, Spain
Identification number:	A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 69.41% of the share capital of the controlled entity.

Overall summary of shares in Telefónica Czech Republic, a.s.:
69,41% Telefónica, S.A
30,59% ostatní investoři

Section III. Related undertakings

Entities controlled by Telefónica, S.A.:

The list of relevant undertakings controlled directly or indirectly by Telefónica, S.A. forms the Appendix to this Report. The list was compiled from inputs from Telefónica, S.A. and verified using information from Commercial Registers or other available data.

Part C Contracts and agreements between the controlled entity and the controlling entity and contracts and agreements between the controlled entity and other related undertakings including details of performance and counter-performance provided under these contracts and agreements.

In the applicable period, contracts between the controlled entity and the controlling entity and the related undertakings were entered into and performed under in the following areas: IT maintenance and service (warranty and post-warranty service and systems support), IT operations, SMC network management services, telecommunications services (carrier capacity), sale and installation of telecommunications technology, quality assurance in telecommunications networks, fixed-term deposits, organisational support, sharing of intellectual property and industrial ownership rights, trademark sub-licensing, email server capacity and related software protection, insurance, global wholesale roaming services at preferential rates, services of external call centres, foreign internships and training for employees, foreign currency accounts, derivatives transactions (ISDA), HR management services, global employee share plan programme, secondment of employees,

accounting and bookkeeping, monitoring of the fixed electronic communications network and the mobile electronic communications network.

These contracts were concluded with either the controlling entity Telefónica S.A., or with the following related undertakings: Telefónica O2 Business Solutions, spol. s r.o., TELEFONICA GLOBAL TECHNOLOGY S.A. UNIPERSONAL, CZECH TELECOM Austria GmbH, CZECH TELECOM Germany GmbH, Telefónica Slovakia, s.r.o., Telfisa Global, B.V., O2 Holdings Ltd., Altair Assurances, S.A., Telefónica UK Ltd., Telefónica Global Services GmbH, Telefónica Global Roaming GmbH, Atento Česká republika a.s., Telefónica Europe plc, Telefónica Finanzas, S.A. (TELFISA), Telefonica Europe People Services Ltd, Telefónica Germany GmbH & Co. OHG.

In keeping with the Commercial Code and other internal governance documents, the details of the contracts are regarded as a trade secret by the controlled entity. The controlled entity has not suffered any damage in connection with contracts and agreements concluded in 2011 between the controlled entity and controlling entity and between controlled entity and other related undertakings, under which performance and counter-performance was given, or in connection with the provision of performance and counter-performance in 2011 under contracts and agreements concluded before 1 January 2011.

In terms of the price and quality, performance provided under the above contracts always corresponded to the customary market conditions for third party services, while on selected occasions the Company benefited from synergies and the possibility to participate in globally negotiated conditions in various areas.

Part D Other legal acts between holding entities in the accounting period 2011

In accounting period 2011, no other unilateral or other legal acts were made by the controlled entity on behalf of or instigation from the controlling entity or related undertakings, which would result in damage or profit, an advantage or a disadvantage to the controlled entity.

Part E Measures between holding entities in the accounting period 2011

In accounting period 2011, no other unilateral or other legal acts were made by the controlled entity on behalf of or instigation from the controlling entity or related undertakings, which would result in damage or profit, an advantage or a disadvantage to the controlled entity.

Part F Conclusion

a) The Report was prepared by the Board of Directors of the controlled entity, Telefónica Czech Republic, a.s., and approved at the meeting of the Board of Directors held on 8 March 2012.
b) The Report was prepared using data and information obtained from the controlling entity and other related undertakings, other available documents, and using results of examinations of relationships between the controlled entity on the one hand and the controlling entity and other related undertakings on the other hand. The Board of Directors of the controlled entity, Telefónica Czech Republic, a.s., declares that it proceeded with the duty of care when collecting the data and information.
c) With regard to the fact that the controlled entity, Telefónica Czech Republic, a.s., is obliged by law to make an Annual Report pursuant to Act No. 563/1991 Coll., on accounting, as amended this Report will be appended to the 2011 Annual Report. Shareholders will have the opportunity to read the Report at the same time and under the same conditions as the financial statements.

In Prague, on 8 March 2012

Telefónica Czech Republic, a.s.
Board of Directors

Appendix

List of companies directly or indirectly controlled by Telefónica, S.A. in the period from 1 January 2011 to 31 December 2011

Name and corporate purpose	Country	% Telefónica Group	Holding company
Parent company:			
Telefónica, S.A.	Spain		
Telefónica Spain			
Telefónica de España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Móviles España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Acens Technologies, S.L.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Soluciones Sectoriales, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Teleinformática y Comunicaciones, S.A.U. (TELYCO)	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Serv. de Informática y Com. de España, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Cable, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Iberbanda, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Telecomunicaciones Públicas, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Interdomain, S.A.U.	Spain	100%	Telefónica Soluciones Sectoriales, S.A. (100%)
Telefónica Remesas, S.A.	Spain	100%	Telefónica Telecomunicaciones Públicas, S.A.U. (100%)
Tuenti Technologies, S.L.	Spain	91.38%	Telefónica Móviles España, S.A.U. (91.38%)
Telefónica Latin America			
Telefónica Internacional, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica International Holding, B.V.	Netherlands	100%	Telefónica Internacional, S.A.U. (100%)
Latin American Cellular Holdings, B.V.	Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Datacorp, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Brasil, S.A.	Brazil	73.92%	Telefónica Internacional, S.A.U. (29.42%) Sao Paulo Telecomunicaçoes Participaçoes, Ltda. (19.72%) Telefónica, S.A. (24.72%) Telefónica Chile, S.A. (0.06%)
Vivo, S.A.	Brazil	73.9%	Telefónica Brasil, S.A.(100%)
Compañía Internacional de Telecomunicaciones, S.A.	Argentina	100%	Telefónica Holding de Argentina, S.A. (47.22%) Telefónica Móviles Argentina Holding, S.A. (42.77%) Telefónica International Holding, B.V. (10.01%)
Telefónica de Argentina, S.A.	Argentina	100%	Compañía Internacional de Telecomunicaciones, S.A. (51.49%), Telefónica Internacional, S.A. (16.20%) Telefónica Móviles Argentina, S.A. (29.56%) Telefónica International Holding, B.V. (0.95%) Telefónica, S.A. (1.80%)

Name and corporate purpose	Country	% Telefónica Group	Holding company
Telefónica Latin America (pokračování)			
Telefónica Móviles Argentina Holding, S.A.	Argentina	100%	Telefónica, S.A. (75%) Telefónica Internacional, S.A.U. (25%)
Telefónica Venezolana, C.A.	Venezuela	100%	Latin America Cellular Holdings, B.V. (97.05%) Telefónica, S.A. (0.09%) Comtel Comunicaciones Telefónicas, S.A. (2.86%)
Telefónica Móviles Chile, S.A.	Chile	99.99%	TEM Inversiones Chile Ltda. (99.99%)
Telefónica Chile, S.A.	Chile	97.89%	Inversiones Telefónica Internacional Holding Ltda. (53%) Telefónica Internacional de Chile, S.A. (44.89%)
Telefónica del Perú, S.A.A.	Peru	98.33%	Telefónica Internacional, S.A.U. (49.90%) Latin America Cellular Holdings, B.V. (48.28%) Telefónica, S.A. (0.15%)
Telefónica Móviles Perú, S.A.C.	Peru	99.99%	Telefónica del Perú, S.A.A. (99.99%)
Colombia Telecomunicaciones, S.A. ESP	Columbia	52.03%	Telefónica Internacional, S.A.U. (52.03%)
Telefónica Móviles Colombia, S.A.	Columbia	100%	Olympic, Ltda. (50.60%) Telefónica, S.A. (49.40%)
Telefónica Móviles México, S.A. de C.V. (MEXICO)	Mexico	100%	Telefónica, S.A. (100%)
Pegaso Comunicaciones y Sistemas, S.A. de C.V.	Mexico	100%	Telefónica Móviles México, S.A. de C.V. (100%)
Telefónica Móviles del Uruguay, S.A.	Uruguay	100%	Latin America Cellular Holdings, B.V. (68%) Telefónica, S.A. (32%)
Telefónica Larga Distancia de Puerto Rico, Inc.	Puerto Rico	98%	Telefónica Internacional Holding, B.V. (98%)
Telefónica Móviles Panamá, S.A.	Panama	100%	Telefónica, S.A. (56.31%) Panamá Cellular Holdings, B.V. (43.69%)
Telefónica Móviles El Salvador, S.A. de C.V.	El Salvador	99.18%	Telefónica El Salvador Holding, S.A. de C.V. (99.18%)
Telefónica Móviles Guatemala, S.A.	Guatemala	99.98%	TCG Holdings, S.A. (65.99%) Telefónica, S.A. (13.60%) Guatemala Cellular Holdings, B.V. (13.12%) Panamá Cellular Holdings, B.V. (7.27%)
Telefonía Celular de Nicaragua, S.A.	Nicaragua	100%	Latin America Cellular Holdings, B.V. (100%)
Otecel, S.A.	Ecuador	100%	Ecuador Cellular Holdings, B.V. (100%)
Telefónica de Costa Rica TC, S.A.	Costa Rica	100%	Telefónica, S.A. (100%)
Wayra Investigacion y Desarrollo, S.L.	Spain	100%	Telefónica Internacional, S.A.U. (100%)
WY Telecom, S.A. de C.V.	Mexico	100%	Telefónica Móviles México, S.A. de C.V. (99,98%) Pegaso PCS, S.A. de C.V. (0,02%)
Wayra Argentina, S.A.	Argentina	100%	Telefónica Móviles Argentina, S.A. (90%) Telefónica Internacional Holding, B.V. (10%)
Wayra Colombia, S.A.S.	Columbia	100%	Telefónica Móviles Colombia, S.A. (100%)
Proyecto Wayra, C.A.	Venezuela	100%	Telefónica Venezolana, C.A. (100%)

Name and corporate purpose	Country	% Telefónica Group	Holding company
Telefónica Latin America (pokračování)			
Wayra Perú Aceleradora de Proyectos, S.A.C.	Peru	100%	Telefónica del Perú, S.A.A. (99.99%) Telefónica Móviles Perú, S.A.C. (0.01%)
Terra Networks Brasil, S.A.	Brazil	100%	Sao Paulo Telecomunicaçoes Participaçoes, Ltda. (100%)
Terra Networks México, S.A. de C.V.	Mexico	99.99%	Terra Networks Mexico Holding, S.A. de C.V. (99.99%)
Terra Networks Perú, S.A.	Peru	99.99%	Telefónica Internacional, S.A.U. (99.99%)
Terra Networks Argentina, S.A.	Argentina	100%	Telefónica Internacional, S.A.U. (99.99%) Telefónica International Holding, B.V. (0.01%)
Terra Networks Guatemala, S.A.	Guatemala	99.99%	Telefónica Internacional, S.A.U. (99.99%)
Telefónica Holding Atticus, B.V.	Netherlands	100%	Telefónica Internacional, S.A.U. (100%)
Telefónica Europe			
Telefónica Europe plc	UK	100%	Telefónica, S.A. (100%)
MmO2 plc	UK	99.99%	Telefónica Europe plc (99.99%)
O2 Holdings Ltd.	UK	100%	MmO2 plc (100%)
Telefónica UK Ltd.	UK	100%	O2 Networks Ltd. (80%) O2 Cedar Ltd. (20%)
Tesco Mobile Ltd. [1]	UK	50%	O2 Communication Ltd. (50%)
O2 (Europe) Ltd.	UK	100%	Telefónica, S.A. (100%)
Telefónica Germany GmbH & Co. OHG	Germany	100%	Telefónica Germany Verwaltungs GmBh (99.99%) Telefónica O2 Germany Management GmBh (0.01%)
Telefonica Ireland Ltd.	Ireland	100%	O2 Netherland Holdings B.V. (99%) Kilmaine, Ltd. (1%)
Jajah Inc.	US	100%	Telefónica Europe plc (100%)
Telefónica Czech Republic, a.s.	Czech Republic	69.41%	Telefónica, S.A. (69.41%)
Telefónica Slovakia, s.r.o.	Slovak Republic	69.41%	Telefónica Czech Republic, a.s. (100%)
Telefónica International Wholesale Services II, S.L.	Spain	100%	Telefónica, S.A. (100%)
Telefónica International Wholesale Services, S.L.	Spain	100%	Telefónica, S.A. (92.51%) Telefónica International Wholesale Services, S.L. (7.49%)
Telefónica International Wholesale Services America, S.A.	Uruguay	100%	Telefónica, S.A. (74.36%) Telefónica International Wholesale Services, S.L. (25.64%)
Telefónica International Wholesale Services USA, Inc.	US	100%	T. International Wholesale Services America, S.A. (100%)
Ostatní společnosti			
Telefónica Global Services, GmbH	Germany	100%	Telefónica Germany GmbH & Co. OHG (100%)
Telefónica Global Roaming, GmbH	Germany	100%	Telefónica Global Services, GmbH (100%)
Telefónica Compras Electrónicas, S.L.	Spain	100%	Telefónica Global Services, GmbH (100%)

Name and corporate purpose	Country	% Telefónica Group	Holding company
Ostatní společnosti (pokračování)			
Telefónica de Contenidos, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Televisión Federal S.A.- TELEFE	Argentina	100%	Atlántida Comunicaciones S.A. (79.02%) Enfisur S.A. (20.98%)
Atlántida Comunicaciones, S.A.	Argentina	100%	Telefónica Media Argentina S.A. (93.02%) Telefónica Holding de Argentina, S.A. (6.98%)
Telefónica Servicios Audiovisuales, S.A.U.	Spain	100%	Telefónica de Contenidos, S.A.U. (100%)
Telefónica On The Spot Services, S.A.U.	Spain	100%	Telefónica de Contenidos, S.A.U. (100%)
Telefónica Broadcast Services, S.L.U.	Spain	100%	Telefónica Servicios Audiovisuales, S.A.U. (100%)
Telefónica Learning Services, S.L.	Spain	100%	Telefónica Digital España, S.L. (100%)
Red Universal de Marketing y Bookings Online, S.A. (RUMBO) [1]	Spain	50%	Telefónica Digital España, S.L. (50%)
Atento Inversiones y Teleservicios, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Atento Česká Republika, a.s.	Czech Republic	100%	Atento Inversiones y Teleservicios, S.A. (100%)
Atento Teleservicios España, S.A.U.	Spain	100%	Atento N.V. (100%)
Atento Impulsa, S.L.U.	Spain	100%	Atento Teleservicios España, S.A. (100%)
Atento N.V.	Netherlands	100%	Atento Inversiones y Teleservicios, S.A. (100%)
Atento Brasil, S.A.	Brazil	100%	Atento N.V. (100%)
Atento Colombia, S.A.	Columbia	100%	Atento N.V. (94.98%) Atento Mexicana, S.A. De C.V. (5%) Atento Venezuela, S.A. (0.01%) Atento Brasil, S.A. (0.004%) Teleatento del Perú, S.A.C. (0.004%)
Atento Argentina, S.A.	Argentina	100%	Atento Holding Chile, S.A. (75.56%) Atento N.V. (24.44%)
Atento Mexicana, S.A. de C.V.	Mexico	100%	Atento N.V. (100%)
Teleatento del Perú, S.A.C.	Peru	100%	Atento N.V. (83.33%) Atento Holding Chile, S.A. (16.67%)
Atento Chile, S.A.	Chile	100%	Atento Holding Chile, S.A. (71.16%) Telefónica Chile, S.A. (27.44%) Telefónica Empresas Chile, S.A. (0.96%) Telefónica Larga Distancia, S.A. (0.44%)
Atento Centroamérica, S.A.	Guatemala	100%	Atento N.V. (99.99%) Atento El Salvador, S.A. de C.V. (0.01%)
Telfin Ireland Ltd.	Ireland	100%	Telefónica, S.A. (100%)
Telefónica Digital España, S.L.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Ingeniería de Seguridad, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Engenharia de Segurança do Brasil, Ltda.	Brazil	99.99%	Telefónica Ingeniería de Seguridad, S.A. (99.99%)
Telefónica Capital, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Lotca Servicios Integrales, S.L.	Spain	100%	Telefónica, S.A. (100%)

Name and corporate purpose	Country	% Telefónica Group	Holding company
Ostatní společnosti (pokračování)			
Fonditel Pensiones, Entidad Gestora de Fondos de Pensiones, S.A.	Spain	70%	Telefónica Capital, S.A. (70%)
Fonditel Gestión, Soc. Gestora de Instituciones de Inversión Colectiva, S.A.	Spain	100%	Telefónica Capital, S.A. (100%)
Telefónica Investigación y Desarrollo, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Investigación y Desarrollo de México, S.A. de C.V.	Mexico	100%	Telefónica Investigación y Desarrollo, S.A. (100%)
Telefónica Luxembourg Holding, S.à.r.L.	Luxembourg	100%	Telefónica, S.A. (100%)
Casiopea Reaseguradora, S.A.	Luxembourg	100%	Telefónica Luxembourg Holding, S.à.r.L. (100%)
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A.	Spain	100%	Telefónica Finanzas, S.A.U. (TELFISA) (83.33%) Telefónica, S.A. (16.67%)
Telefónica Insurance, S.A.	Luxembourg	100%	Casiopea Reaseguradora, S.A. (95%) Seguros de Vida y Pensiones Antares, S.A. (5%)
Seguros de Vida y Pensiones Antares, S.A.	Spain	100%	Telefónica, S.A. (89.99%) Casiopea Reaseguradora, S.A. (10.01%)
Telefónica Finanzas, S.A.U. (TELFISA)	Spain	100%	Telefónica, S.A. (100%)
Fisatel Mexico, S.A. de C.V.	Mexico	100%	Telefónica, S.A. (100%)
Telfisa Global, B.V.	Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Europe, B.V.	Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Finance USA, L.L.C. [2]	US	0.01%	Telefónica Europe, B.V. (0.01%)
Telefónica Emisiones, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Spiral Investments, B.V.	Netherlands	100%	Telefónica Móviles España, S.A.U. (100%)
Telefónica Global Technology, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Móviles Soluciones y Aplicaciones, S.A.	Chile	100%	Telefónica S.A. (100%)
Aliança Atlântica Holding B.V.	Netherlands	93.99%	Telefónica, S.A. (50%) Telefónica Brasil, S.A. (43.99%)
Telefónica Gestión de Servicios Compartidos España, S.A.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Gestión de Servicios Compartidos, S.A.	Argentina	99.99%	T. Gestión de Servicios Compartidos España, S.A. (95%) Telefónica, S.A. (4.99%)
Telefónica Gestión de Servicios Compartidos, S.A.	Chile	97.9%	Telefónica Chile, S.A. (97.89%)
Telefónica Gestión de Servicios Compartidos, S.A.	Peru	100%	T. Gestión de Servicios Compartidos España, S.A. (99.99%) Telefónica del Perú, S.A.A. (0.01%)
Cobros Serviços de Gestao, Ltda.	Brazil	99.33%	T. Gestión de Servicios Compartidos España, S.A. (99.33%)
Tempotel, Empresa de Trabajo Temporal, S.A.	Spain	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)

Name and corporate purpose	Country	% Telefónica Group	Holding company
Ostatní společnosti (pokračování)			
Telefonica Serviços Empresariais do BRASIL, Ltda.	Brazil	99.99%	T. Gestión de Servicios Compartidos España, S.A. (99.99%)
Telefónica Gestión de Servicios Compartidos México, S.A. de C.V.	Mexico	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Telefónica Servicios Integrales de Distribución, S.A.U.	Spain	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Společnosti konsolidované jednořádkovou metodou			
Telefónica Factoring España, S.A.	Spain	50%	Telefónica, S.A. (50%)
Telefónica Factoring Do Brasil, Ltd.	Brazil	50%	Telefónica, S.A. (40%) Telefónica Factoring España, S.A. (10%)
Telefónica Factoring Mexico, S.A. de C.V. SOFOM ENR	Mexico	50%	Telefónica, S.A. (40.5%) Telefónica Factoring España, S.A. (9.5%)
Telefónica Factoring Perú, S.A.C.	Peru	50%	Telefónica, S.A. (40.5%) Telefónica Factoring España, S.A. (9.5%)
Telefónica Factoring Colombia, S.A.	Columbia	50%	Telefónica, S.A. (40.5%) Telefónica Factoring España, S.A. (9.5%)
Telco, S.p.A.	Italy	46.18%	Telefónica, S.A. (46.18%)
DTS Distribuidora de Televisión Digital, S.A.	Spain	22%	Telefónica de Contenidos, S.A.U. (22%)
Hispasat, S.A.	Spain	13.23%	Telefónica de Contenidos, S.A.U. (13.23%)
China Unicom (Hong Kong) Limited	China	9.57%	Telefónica Internacional, S.A.U. (9.57%)

[1] Consolidated using proportionate consolidation
[2] Fully consolidated with 100% of voting rights
Through these consolidated financial statements, Telefónica (Germany) GmbH & Co. OHG, complies with the provision of Art. 264b HGB ["Handelsgesetzbuch": Germany code of commerce], and is exempt in accordance with the stipulations of Art. 264b HGB.

Glossary of terms and acronyms

Glossary of terms and acronyms

A

ADSL 2+ (Asymmetric Digital Subscriber Line)
A more advanced and modern type of ADSL technology, which allows, among other things, to accelerate the data transmission speed to up to 24 Mbps. 6–16 Mbps is the optimum actual speed for the majority of households.

Android
An operating system by Google for smartphones.

Asymmetric transmission
Data transmission with different uplink and downlink speeds.

B

Base station
Base Transceiver Station (BTS) provides for radio connection with a mobile telephone. It typically supports several transceivers (TRX), each covering a specific area with radio signal.

BlackBerry
A technology for easy and safe access to email, calendar and data. Runs specifically on mobile devices by Research In Motion (RIM) from Canada.

Bluetooth
A technology of wireless device-to-device communication – e.g. mobile telephone and hands-free set, PDA and PC, etc. A mobile telephone with Bluetooth can communicate with other devices over a range of up to 100 metres, depending on the Bluetooth version used.

BPIN
Bank PIN (security code) is distributed together with the SIM card in the scratch field.

BTS (Base Transceiver Station)
BTS relays signal to mobile telephones.

Business Partner
A point of sale with a full range of mobile telephones and accessories, where a trained sales associate will help you with selection, activation and change requests.

C

Call redirection
A network function that allows for an incoming call to be redirected to any other receiving line, or to voice mail.

CAMEL (Customised Applications for Mobile networks Enhanced Logic)
A technology for direct communication between the roaming partner's and home network during the connecting of a call placed by a prepaid customer. The roaming partner's network can thus check the level of credit in the home network and connect the call accordingly.

CDMA (Code Division Multiple Access)
A digital transmission technology. Coded information is transmitted to several receivers at the same time within the same frequency band. Individual receivers use a dedicated decoding key to decode the data flow, and process only data meant for the receiver; other ('foreign') data is ignored.

Cell
A territory covered with a mobile telephone signal from a transceiver mounted on a BTS. One BTS can support several transceivers for several cells. In an open terrain, one cell may be 35 kilometres in diameter, however in an urban landscape, one cell may only cover one street.

Cellular network
A mobile network. An area covered with signal is split into smaller areas (cells) covered with individual BTS. A mobile telephone network typically consists of several thousands of cells.

CLIP (Calling Line Identification Presentation)
Caller identification.

CONEX
A direct connection of the O2 mobile telephone network centre with the local (company) PBX (Private Branch Exchange). This turns mobile telephones and the company telephone system into an integrated communication system that saves costs on calls between company branch lines and company mobile telephones.

Conference call
A mobile network service that allows a multi-party call.

CZK 100 discount on the postpaid tariff
If you subscribe to an O2 NEON tariff or O2 Business tariff and you activate O2 Internet, you get a discount of CZK 100 per month on your O2 NEON or O2 Business tariff. All you need to do is to enter your number associated with the O2 NEON tariff at the check-out in our e-shop. To take advantage of this offer, both services (O2 Internet and the mobile tariff) must be subscribed for the same duration of time.

D

DCS 1800 MHz

A standard for GSM mobile telephone networks. The main difference is that the network uses the 1,800 MHz frequency, which has a better quality signal compared to the normal 900 MHz. Both GSM standards are used in the Czech Republic (900 MHz and 1,800 MHz). Such networks are called 'dual'.

DECT (Digital Enhanced Cordless Telecommunication)

A wireless digital technology connecting a telephone receiver with the base. It allows unmitigated movement within the range of the radio signal (typically 300 metres in open spaces and 50 metres indoors). Another solution achieving a similar effect is to install a wireless Private Branch Exchange that can support more receivers from one base.

Device blocking

To increase security, some devices can be restricted for use with the help of a special security code; the code is selected on the device (unlike PIN and PUK codes that are stored on the SIM card). Please consult the manual of your device on the use of the security code in the model you have.

E

EDGE

A technology for fast mobile data transmission. EDGE deployed in combination with the packet service (GPRS) can give a speed of up to 384 kbps. The telephone or modem must be EDGE-enabled to take advantage of the technology.

EFR (Enhanced Full Rate)

An improved sound coding in the GSM network, with the quality of voice nearing that of a CD player. Good signal quality is required.

F

FUP (Fair User Policy)

A service that protects regular users from the consequences of network overuse by heavy users. FUP gradually slows down the transmission speed to those users who use too much bandwidth, especially by downloading large volumes of data for too long a time.

G

Gateway

A device which acts as an interface between two different networks
(e.g. mobile – internet; fixed access – mobile access, etc.)

GPRS (General Packet Radio Service)

A mobile data transmission technology. The transmitted data is divided into chunks, which are called packets. The destination address is attached to each such packet. Depending on the current network capacity, packets are transmitted to the terminal device, in which they are reassembled into the original data sequence. The terminal device (mobile telephone, modem) is connected permanently, but the transmission capacity of the network is used only when it receives or sends packets of data. The data transmission is charged based on the volume of data transmitted – not based on the duration of connection.

GPS
The GPS (Global Positioning System) allows for seeing the position of a device within a range of few metres. It is used mainly for satellite navigation and is now a standard feature of most smartphones.

GSM (Global System for Mobile Communication)
An acronym derived from the standard for mobile communication. GSM networks are often called second generation networks. They offer SMS, roaming, caller identification, call redirection, fax service, data, etc.

H

Hands-free
A device that allows hands-free calling from a mobile telephone.

HSCSD (High Speed Circuit Switched Data)
A technology used for data transmission in mobile GSM telephone networks which uses the so-called circuit switching. It uses multiple timeslots at the same time, which gives the mobile data transmission the much called-for speed. Available terminals use up to 4 timeslots and give a transmission speed of up to 43.2 kbps.

HSDPA (High-Speed Downlink Packet Access)
A technology in 3rd generation mobile networks (UMTS) that improves the data download speed to up to 14.4 Mbps. It is the most advanced technology of its kind used in the Czech Republic.

HSUPA (High-Speed Uplink Packet Access)
A technology in 3rd generation mobile networks (UMTS) that improves the data upload speed to up to 5.76 Mbps. It is the most advanced technology of its kind used in the Czech Republic.

I

IMEI
A fifteen-digit numerical sequence that carries coded information about the type and serial number of the device. IMEI is typically found on the back side of the telephone in the battery slot; alternately, it can be recalled to the device display by entering the code *#06#.

Intelligent Call Assistant (ICA)
Intelligent Call Assistant (ICA) allows calls from customers of other operators roaming our network to connect even if the number is dialled in the wrong format: common mistakes is dialling without an international dialling prefix, with one extra zero in the international dialling prefix (especially UK customers), using * instead of + in front of the international dialling prefix, etc. The system uses algorithms to correct the called number while respecting the numbering plan of the country. Calls that would not be connected otherwise due to an erroneous format (as before the service deployment) are redirected to ICA. Calls dialled connected are put through as usual and bypass ICA.

IPv6
A new generation of IP address which is 128 bits long. It is set to replace IPv4 which uses only 32 bits, which limits the number of available addresses; the available pool of unused addresses is almost exhausted. IPv6 will increase the number of addresses by several orders.

IrDA
A communication interface for mobile telephones and computers. Infrared radiation allows them to communicate with other devices within the range of direct visibility.

J

Java
A programming language. Applications (software, games…) in Java can be run on a mobile device (if the device supports Java script).

L

Li-Ion
A lithium-ion battery that is used to power wireless communication devices. Li-Ion batteries are lighter than older types of batteries, are relatively long-life and do not require full depletion – so they can be recharged any time.

Line
The basic technology for ADSL fixed internet access, O2 TV or calling from home via the O2 telephone network.

LTE
LTE (3GPP Long Term Evolution) is a fast mobile internet technology. It is formally classified as 3G, while its successor – LTE Advanced – will be a fully-fledged fourth-generation solution (4G). The theoretical downlink speed and uplink speed is 300 Mbps and 75 Mbps, respectively.

M

MMS
MMS (Multimedia Messaging Service) allows mobile telephones to send and receive not only text but also photographs and short videos. It is an improvement on SMS, which supports only text messages.

N

Network monitoring centre
A non-stop operation with a team of specialists that monitor the functions of all parts of the national data network. Any technical problems that may arise are dealt with remotely by the NMC team or engineers are despatched to the site. The O2 NMC centre is among the most modern in Europe.

NFC
NFC (Near Field Communication) is a technology for wireless communication between electronic devices over short distances; the standard specifies a maximum range of 20 cm, in reality it is more like 2–6 cm. The technology builds and improves on the standard ISO/IEC 14443 (contact-free cards, RFID), which combines the interface of the microchip Smartcards and of a wireless communication device. NFC is expected to propel the boom of mobile payments. Telefónica Czech Republic is a pioneer of NFC in the Czech Republic. Together with the City Transport Company in Pilsen (PMDP), Telefónica Czech Republic came out with 'Pilsen Card', an NFC application for mobile phones already in 2009.

NiCd
A nickel-cadmium battery is a long-life rechargeable battery that typically lasts up to 700 charging cycles (charge and deplete). If the battery is not fully depleted before recharging, the so-called memory effect can reduce its useful life.

NiMH
A nickel-metal hydride is an accumulator battery that holds more energy than NiCd batteries and has less of the memory effect (the need to fully deplete the battery to prevent the shortening of its life). It is typically more expensive than Ni-Cd batteries.

Node B
A UMTS base station – similar to BTS in the GSM network – provides for communication between the mobile network and a mobile telephone or another device using radio frequencies.

O

OLED (Organic Light-emitting Diode) display
A new generation display with excellent technical parameters: more than 16 million colours, a wide viewing angle, the image is high clarity and high contrast with extremely sharp rendering. It is very energy efficient and requires low operating voltage.

OTA
OTA (Over the air) is used for service activation and changes to services without the need to connect the device to a computer. Hardware manufacturers can thus offer users remote updates of the operating software.

P

PAC ID
An identification number that precisely guides a number porting request between operators. The sequence has eleven characters.

PBX (Private Branch Exchange)
A solution of inter-company telecommunications. PBX supports a maximum of 100,000 subscriber units. Different PBX rely on different technology and also differ in the number of branch lines they support.

PDA (Personal Digital Assistant)
A pocket computer combining the functionality of a mobile telephone and a personal computer.

PIN (Personal Identification Number)
A numerical security code. It is used, for instance, to protect the SIM card from unauthorised use. In this case you were given it when you purchased your SIM card. If a wrong PIN is entered three times in a row, the SIM card is blocked and can be unblocked by using the PUK code.

PPPoA / PPPoE
PPPoA / PPPoE is a type of protocol that facilitates data transmission in the internet network. The older type of PPPoA does not support new trends and technologies and fast internet. PPPoE is the current standard in most European countries and supports faster internet and digital television broadcasting.

Prepaid services
A popular method of using telecommunications services; the customer does not commit to the operator in a written contract. Mobile services are paid for through prepaid credit. The credit is charged depending on the service used (calling, SMS, MMS, internet access, etc.). When the credit runs out, it must be topped up to ensure the continuation of service.

Pricing of O2 NEON tariffs
If you are subscribed to O2 NEON and choose O2 Internet for CZK 600 per month, you are eligible for a discount of CZK 100 per month on your O2 NEON subscription. All you need to do is to enter your number associated with the O2 NEON tariff at the check-out in our e-shop. To take advantage of this offer, both services (O2 Internet and O2 NEON) must be subscribed for the same duration of time.

PUK
An eight-digit numerical security code that will unblock a SIM card after previous repeated failed attempts to enter PIN. If PUK is entered incorrectly 10 times, the SIM card is blocked for good and its holder must seek professional assistance in the operator's brand store.

R

Roaming
A function in the GSM mobile network that allows for a mobile telephone to be used in GSM networks of other operators abroad. Roaming services are billed based on inter-operator roaming agreements.

S

Sales Office
A team of certified sales representatives who will see customers in their own offices or in your company.

SAR
SAR (Specific Absorption Rate) is the energy absorbed by a body exposed to the radiofrequency field. Its unit is W/kg, which is the absorption rate per 1 kilogram of weight. The limit in Europe is max. 2.0 W/kg for the head and the torso.

Set-top-box
A device that receives digital broadcasting signal and converts it into images on the connected television set. In addition to channel switching it supports many other functions.

SIM card
A card with a chip containing identification information – the operator's network, phone number, activated services, billing, credit, etc. Mobile telephones require a SIM card to be inserted before they can connect to the network. The SIM card is protected using the PIN security code. SIM cards have a built-in (very small) memory for storing telephone numbers or SMS received.

SIM card blocking
A SIM card can be blocked by the user or by the operator. A user can block a SIM card if they enter a wrong PIN code three times. Unblocking is possible only with the so-called PUK code.
If a wrong PUK code is entered, the SIM card is blocked for good. An operator will block a SIM card (access for the SIM card to the network) in the event of a breach of the contract or on request of the user (e.g. in the case of theft).

SLA
SLA (service level agreement) is an agreement to deliver in a certain quality; sanctions apply when it is breached.

SMS centre
An exchange for despatching short text messages. If the recipient's mobile device is off the network, the message is stored in the network's SMS centre for limited time.

Splitter
A device that splits data traffic from voice traffic in a single fixed telephone line.

Symbian
An open-source operating system by Nokia for mobile devices; it supports a wide range of smartphone applications.

T

Tablet
A portable computer with a touchscreen display, typically 7–10 inches in diameter. iPad from Apple became the first tablet to conquer the mass market; it was followed by a number of other devices, with the Android operating system from Google for the most part. Tablets can be equipped with a built-in 3G module to stay online also in areas without WiFi coverage.

TDMA (Time Division Multiple Access)
A technology used to carry multiple calls in the GSM network. One transmission frequency is shared by several calls based on time division. Each mobile telephone sharing the frequency is assigned a short window within which it receives or transmits on the frequency. The devices alternated in sending/receiving very fast. The sequence of those short windows creates a timeslot during which the mobile telephone communicates with the mobile network's base station and vice versa.

Telematics
Telematics allows for a mobile connection to be used to collect data to be processed later. It is used, among other things, to monitor the movement of vehicles.

TFT (Thin Film Transistor) display
A type of display made of great many small transistors, each controlling a single pixel. This construction gives a very good quality image as it prevents shadows caused by display movement, and has a contrast of up to 100:1, which is ideal for fast animation. Its energy efficiency and thinness compared to older model add to its advantages.

Timeslot
A transmission channel between a mobile device and a base station in the mobile network, which is made up of quickly alternating and sequenced time windows of receiving/transmitting on a given frequency. A GSM frequency can support 8 timeslots. Mobile data transmission technologies (HSCSD and GPRS) allow using several timeslots simultaneously.

U

UMTS (Universal Mobile Telephony Standard)
The so-called 3rd generation (3G) mobile telecommunication network, which allows data transmission at a speed of up to 42 Mbps.

USSD (Unstructured Supplementary Service Data)
This technology allows operators to provide specific services, such as seeing the amount of credit when calling from abroad, call redirection, etc. Special prefixes activate specific services in the network.

V

VDSL
VDSL (Very High Speed DSL) is a technology for faster data transmission in the existing telephone network. Customer who are within 1.3 km range from the exchange, i.e. approximately a half of all Czech households, can make use of the benefits the technology brings. The high transmission speeds that VDSL offers (up to 25 Mbps downlink and 2 Mbps uplink) are ideal for new applications and the simultaneous running of O2 TV digital television and multiple internet connections at home.

Video Library
The Video Library gives O2 TV customers the option to select and buy programmes via their television screen. Video Library is a virtual video rental directly in your television.

Voice-enabled searching
The search item does not need to be written into the search engine field – saying it is sufficient.

VOIP (Voice over IP)
A call of which a part is carried via the internet. The voice is converted into a data sequence and it is carried via broadband internet lines. Unlike a normal call when the call engages the whole line for its duration, internet telephony can run simultaneously with regular data transmission or other calls.

VPN (Virtual Private Network)
A Virtual Private Network allows for communication between remote devices as if they were in one local network. The service connects all mobile telephones of a company into one virtual network connected to a PBX. Calling between mobile telephones in the virtual network can be done with only short format numbers and user privileges can be configured, as in the case of PBX. The calls within VPN are also charged at very low rates.

W

WAP (Wireless Application Protocol)
A data format for viewing special versions of websites on mobile phone displays. WAP is not so widely used any more as smartphones can display websites in a similar structure and detail as we know from a PC.

WiFi
A wireless network technology that allows the device to be online in the vicinity of the access point. WiFi wireless networks are easy to set up at home, to benefit from your ADSL/VDSL connection on all your household devices – PCs, tablets and WiFi-enabled mobile phones. The network operates in an unlicensed band on the 802.11 standard. O2 offers the so-called HotSpots service for internet access for PCs and mobile phones (enabled for this service).

WiFi modem
A device that is needed to connect a computer (or a computer network) to the internet via the ADSL technology. The WiFi modem is connected to the telephone line and covers the near range with a wireless network, so that multiple computers or other devices can be online simultaneously.

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