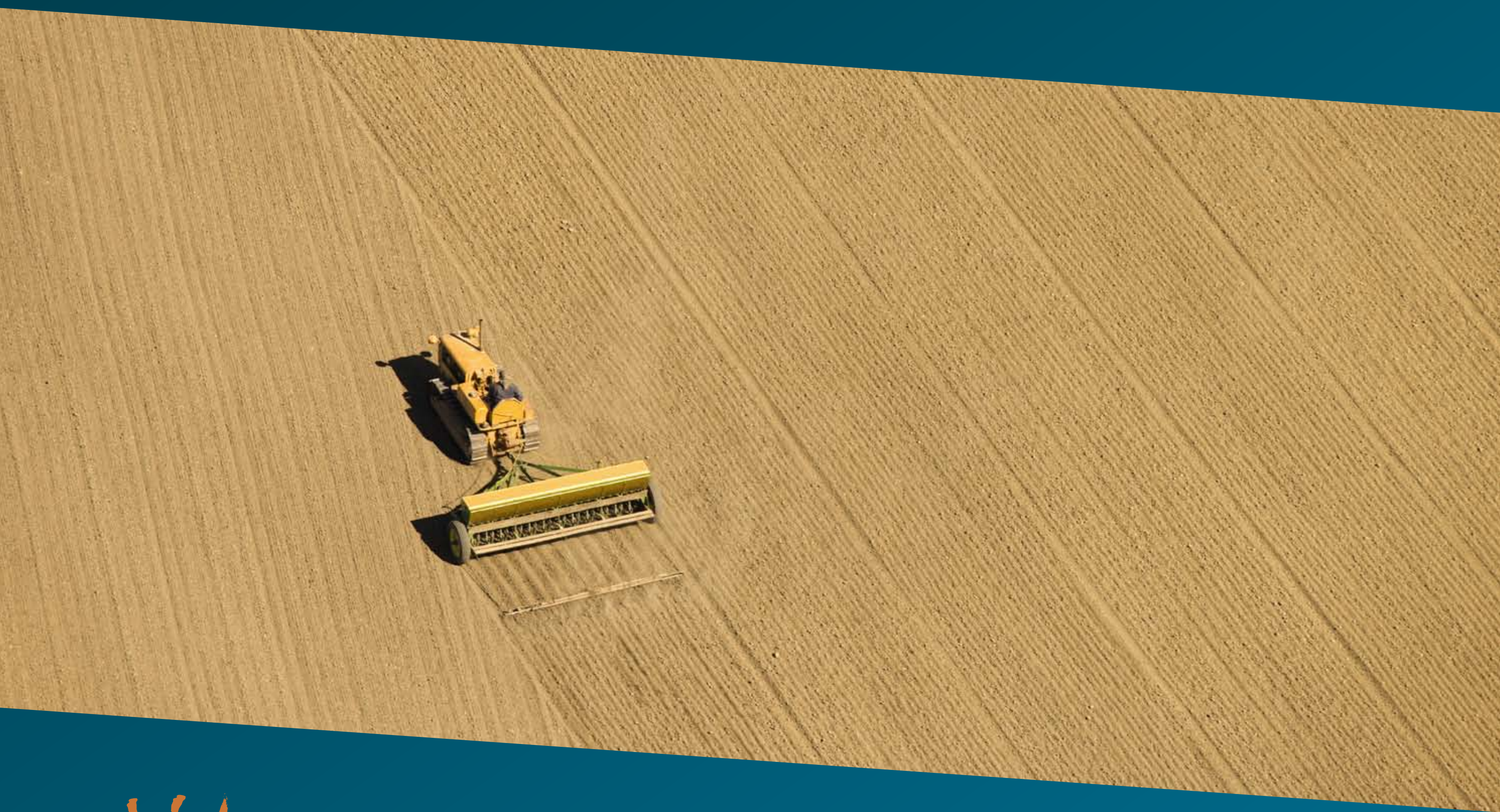
2010

Annual Report

Telefonica

Content

Introduction



Innovative approach

Independent auditor's report

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

I. We have audited the consolidated financial statements of Telefónica O2 Czech Republic, a.s. and its subsidiaries ("the Group") as at 31 December 2010 presented in the annual report of Telefónica O2 Czech Republic, a.s. ("the Company") on pages 85 – 140 on which we have issued an auditors' report dated 18 February 2011, presented in the annual report on pages 87–88. We have also audited the separate financial statements of the Company as at 31 December 2010, which are presented in the annual report of the Company on pages 141–195 on which we have issued an auditors' report dated 18 February 2011, presented in the annual report of the Company on pages 143–144 (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 O2 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 6–84 and 196–201 is consistent with that contained in the audited financial statements as at 31 December 2010. 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 O2 Czech Republic, a.s. for the year ended 31 December 2010 presented in the annual report of the Company on pages 202–210. The management of Telefónica O2 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 O2 Czech Republic, a.s. for the year ended 31 December 2010 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

25 March 2011
Prague, Czech Republic

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	**2010**	**2009**
Revenues	55 712	59 889
OIBDA – Operating income before finance costs, tax, depreciation and amortization[1]	27 380	27 076
Operating income	15 524	15 075
Income before taxes	15 318	14 877
Net income	12 280	11 666
Total assets	92 792	92 768
Property, plant and equipment	56 651	57 545
Total equity	73 176	73 879
Financial debts	3 024	3 131
Capital expenditure	5 663	6 489
Operations (end of period)		
Fixed accesses (x 1,000)	1 669	1 771
ADSL connections (x 1,000)	806	725
Pay TV – O2 TV (x 1,000)	129	138
Mobile registered customers in Czech Republic (x 1,000)	4 839	4 945
- of which contract	2 864	2 814
pre-paid	1 975	2 130
Active mobile customers in Slovakia (x 1,000)	880	553
Group headcount (end of period)	7 522	8 687
Ratios (in %)		
OIBDA margin (OIBDA/Revenues)	49,1	45,2
Net income/Revenues	22,0	19,5
Capital expenditure/Revenues	10,2	10,8
ROA (Net income/Total assets)	13,2	12,6
ROE (Net income/Equity)	16,8	15,8
Gross gearing (Financial debts/Total equity)	4,1	4,2

Macroeconomic indicators[2]	2010	2009
Population (in millions)	10,5	10,5
GDP growth (in %)[3]	2,2	-4,1
Inflation (in %)	1,5	1,0
Unemployment (end of period, in %)	9,6	9,2
CZK/USD exchange rate – average over the period	19,1	19,1
CZK/USD exchange rate – end of period	18,8	18,4
CZK/EUR exchange rate – average over the period	25,3	26,4
CZK/EUR exchange rate – end of period	25,1	26,5

[1] Including impairment reversal/loss and gains from sale of non-current assets. In 2009, the Group posted an impairment loss of CZK 23 million, while in 2010 it recorded impairment reversal of CZK 4,344 million attributable to the fixed line segment assets and impairment loss of CZK 18 mil.; gain from the sale of non-current assets reached CZK 422 million in 2009 compared to CZK 92 million in 2010.

[2] Sources: Czech Statistical Office, Czech National Bank, Ministry of Labour and Social Affairs.

[3] At constant 1995 prices.

Letter from the Chairman of the Board of Directors

To Our Shareholders

Let me use this opportunity to review the activities, development and the results of the Telefónica O2 Czech Republic Group in 2010. Our results of the past year were marked by the gradual economic recovery, continuing strict regulation and the highly competitive climate in all areas we do business in. Despite the challenges of the external environment, I can frankly say that I regard our results of the past year as satisfactory and our activities make a good springboard for further improvement in the year 2011.

Let me first make a brief summary of our goals we entered the year 2010 with. In line with our long-term strategy to maintain the leadership in the Czech telecommunications market, our goal was to keep up the customer adds in our key business areas, which are mobile contract customers and ADSL broadband internet. By actively promoting our ADSL-centric proposition in the fixed access segment, we aimed to slow down the rate of decline in the number of fixed lines. Growing demand from our customers for mobile broadband internet propelled our plans to improve our offer in this area, alongside the expansion of our mobile data network coverage. In Telefónica O2 Slovakia, our aim was to grow the customer base and improve financial performance. Last but not least, we wanted to deliver on all of the above while maintaining our high operating efficiency.

And now let me review, in more detail, the achievement of our goals for 2010.

I am proud to say that we succeeded, without accounting for the one-off reduction of inactive customers, in increasing the number of our mobile contract customers by 160 thousand, especially in the fiercely competitive atmosphere that prevailed in the market in 2010. This achievement was largely aided by our active strategy focused on the migration of customers from pre-paid services to contracts, the steady popularity of our O2 NEON tariffs, and, in the second half of the year, also the positive effect of the increased mobile broadband customer base. Despite the considerable competitive pressure felt throughout the whole year 2010 from the cable provider UPC, we accomplished a solid growth in our ADSL customer base. In 2010, their number grew more than 11% to 806 thousand. The steady growth in the number of customers using our internet connectivity service without a voice tariff, and the growth in business customers using the Voice-over-IP service, contributed to the fact that the number of fixed accesses'losses in 2010 declined 17% on the previous year, down to 101 thousand.

As I already mentioned above, our long-term aspiration is to keep our leadership in the mobile internet market in the Czech Republic. We gave this segment our focused attention in 2010, with some positive results to report. By the end of 2010, we have covered almost 43% of the population with our 3G network, and EDGE was within the reach of almost all Czech population. At the same time we considerably increased the transmission speed – without compromising on the quality of the voice and data traffic. Together with our high-speed networks expansion we also launched a portfolio of innovated mobile internet tariffs for our pre-paid and contract customers. The offer was successfully promoted by means of our Smart Network campaign, which delivered a promising growth in the number of mobile broadband customers and customers of internet in the mobile telephone in the second half of the year, followed by a positive effect on our mobile revenues.

Our offer of simple, transparent and clear O2 Fér tariffs in Slovakia, which, in the past two years, completely turned around the development in the Slovak mobile market, continued to attract customers and improve financial performance. In the past year alone, the number of customers went up by 328 thousand, closing the year 2010 with 880 thousand customers in total, which represents a 15% share of the market. This, in turn, delivered a solid revenue growth and positive OIBDA in the third and fourth quarter.

In line with our long-term strategy to constantly drive for better operating efficiency, in order to keep us in a competitive position in today's challenging market environment and to continue to create value for our shareholders, we embarked on an ambitious programme of restructuring in 2010. Its aim was to implement a more efficient organisation structure by way of reducing the number of organisation levels in the Company. We also focused on improving the efficiency of processes and systems. Special significance was attached to the transformation of our network operation, which resulted in outsourcing of some network related activities and delivered a headcount reduction by more than a thousand employees, with a positive effect on the staff costs in the second half of the year.

In addition to the above-mentioned restructuring programme, we continued with other projects aimed at improving our operating efficiency while raising the quality of customer care and customer experience. Improvements in the quality of service delivery, sales in our brand stores and communication with our customers have produced a reduction in the number of complaints and claims in both main customer divisions. We also saw an improvement in our call centres; their level of production increased while the average number of calls per customer and the average duration of call went down. Overall level of customer satisfaction with the service of our call centres also improved across all segments. All the above-mentioned activities aimed at enhancing the customer experience delivered an improvement in our Customer Satisfaction Index and helped us with closing on our competition.

As I already mentioned at the beginning, our financial performance in 2010 was aided by the gradual economic recovery, which has led to the stabilisation of consumption during the year in question, especially as far as mobile customers were concerned. Our revenues were at the same time under the pressure of falling termination rates and lower-than-expected ICT revenues due to fewer projects commissioned by the public sector. The total consolidated revenues reached CZK 55.7 billion in 2010, which is a 7% decline on the previous year. Projects and measures aimed at operating cost efficiency succeeded with reducing the operating costs (not accounting for the impact of the settlement agreement with T-Mobile from 2009) by 4.7% year on year, down to CZK 33.4 billion. The consolidated operating income before depreciation and amortisation (OIBDA) improved 1.1% year on year and reached CZK 27.4 billion, mainly due to the reversal of the impairment charge. Not accounting for this accounting operation, OIBDA would decline 14.9%, namely as a result of the lower revenues and one-off items posted in 2009 and 2010; the OIBDA margin would be 41.3%. This helped us maintain an above-average operating profitability compared to other operators in Central and Eastern Europe. I already mentioned that the year 2010 saw our investments going mainly into the roll-out of our mobile broadband networks and into projects to improve the quality of these networks. We also continued our selective investments in pro-growth areas, including namely various ADSL developments. We pursued focused investments in our information systems and technologies, to make their processes more efficient in the interest of greater operating efficiency and a better customer experience. The total investment costs were down 12.7% year on year to CZK 5.7 billion in 2010. Finally, in my review of our financial performance in 2010, I would like to highlight the 21.2% increase in free cash flows, which reached the total of CZK 16.4 billion and translates into CZK 51 per share.

The year 2011 will see us persevering with our dedication to improvement and enhancement of our relationship with customers by means of raising the quality of service and offering new products to meet the customers' needs. The priority for these initiatives and other projects is to achieve the ultimate customer experience and satisfaction. We will also continue with introducing further improvements to our portfolio of broadband services, where we plan to launch a host of VDSL-based services, in order to stabilise the number of fixed accesses and remain competitive. In line with our plans for further roll-out of the 3G network, and with the help of the recently signed agreement on 3G network sharing with T-Mobile, we will focus on offering innovated mobile broadband and data services. To this end, we plan to take advantage of our competitive position of having the largest and the best 3G network to attract more mobile broadband and mobile data customers, which will drive the share of these services in the total mobile revenues.

In Slovakia, we plan to continue with the active marketing of our transparent, simple and value-based services. We are confident that this strategy will impart a positive reflection on our financial performance and profitability, and help us maintain a solid growth in our customer base.

As there are several factors with an uncertain outcome at play, which will nonetheless have a bearing on our revenues, we present only a general outline of the expected developments in 2011. We anticipate that the revenues from ICT services may continue to be under the influence of the restrictions in the public sector, which will result in a lower number of projects. Additionally, mobile revenues will continue to be under pressure due to further cuts in mobile termination rates (by 35% in 2011). At any case, we will stay loyal to our drive for efficient operating and investment expenditure while continuing with investments that generate value for our customers and enhance their experience. And finally, cash flow generation and its maximisation remains one of our key strategic priorities for the future.

Luis Malvido

Luis Antonio Malvido
Chairman of the Board of Directors

Calendar of key events in 2010

January

Telefónica O2 launched a new network documentation portal which distributes digital maps detailing the situation of telecommunication networks on land to investors.

February

Telefónica O2 published its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2009. Consolidated revenues reached CZK 59.9 billion and the net profit grew to CZK 11.7 billion.

The Board of Directors elected Louis Antonio Malvido its Chairman and appointed him Chief Executive Officer of Telefónica O2.

Jiří Dvorjančanský was appointed Executive Director for Residential Marketing at Telefónica O2.

Telefónica O2 became general partner to the Open Air Festival, a new multicultural project for the whole family.

March

Telefónica O2 introduced new tariffs O2 Business – the first tariffs in the Czech market that offered unlimited calling within business hours for a flat monthly fee.

The number of people participating in Reward for Top-up programme for the customers of pre-paid services exceeded a one million mark.

April

Telefónica O2 started marketing O2 Clean Internet, a service giving a professional standard of protection against malware and viruses in local networks, to business customers.

By purchasing goods at the traditional Easter markets, employees raised almost CZK 240,000 to benefit sheltered workshops.

The number of messages delivered via Data Box, a system for the official communication between the authorities on the one hand, and legal and natural persons on the other, exceeded a ten million mark.

May

An Ordinary General Meeting of shareholders of Telefónica O2 Czech Republic 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. María Eva Castillo Sanz, an independent member of the Board of Directors of Telefónica, S.A., became a new member of the Supervisory Board and the Audit Committee.

The Board of Directors of Telefónica O2 approved an increase of the registered capital of Telefónica O2 Slovakia by means of a pecuniary contribution in the amount of EUR 40 million, to reach the total of EUR 240 million.

Telefónica O2 implemented changes in the organisation structure of the Company. A Marketing division and Strategy and Business Development division were created.

Telefónica O2 expanded the portfolio of its mobile data services with a new service O2 Pre-paid Mobile Internet, intended mainly for customers who are occasional users or are only just taking their first steps online; the pre-paid credit allows for being online anywhere, simply and anytime, without commitment.

June

Telefónica O2 took part in the global mobile campaign 1GOAL in support of children's education.

Telefónica O2 designed a special training in communication with people with a partial or total loss of hearing. The participants have become local ambassadors for the deaf or partially deaf in their regions.

July

Employees raised CZK 420,000 for the project called 'Let's Help Change the Story of One Life'.

Telefónica O2 matched the proceeds from each duck sold in the O2 Foundation's campaign Reward for Top-up between 27 July and 2 October; the proceeds from the fundraising campaign benefit a helpline for children (Linka Bezpečí) and for senior citizens (Linka seniorů).

August

Telefónica O2 acquires the domain www.o2.cz.

David Šita, Director, Strategic Account Division, left his post at Telefónica O2.

Telefónica O2 promulgated the date 2 August as the Day to Celebrate Coverage and, together with its customers, celebrated the six year anniversary of mobile internet in the Czech Republic by launching a special edition O2 Mobile Internet set.

Telefónica O2 matched the whole amount raised by employees to benefit the victims of floods, and prepared special programmes and services for those in need. All funds raised were donated to People in Need, a relief organisation which used them to alleviate the impact of floods in the stricken areas.

September

An Extraordinary General Meeting of shareholders of Telefónica O2 was held. The shareholders approved, among other things, a change in the form of all Company common shares in the nominal value of CZK 100 from bearer share to registered share. The reason for this change was the adoption of an amendment to the Public Procurement Act.

Jose Perdomo, Director, Consumer Division at Telefónica O2, left his post to join the newly established division Global New Services in the Telefónica Group, to helm its eHealth activities.

Telefónica O2 merged two divisions Strategic Accounts and Corporate and Business into a new Business division under the leadership of František Schneider.

Telefónica O2 introduced a new pre-paid card O2 Da, an economically priced option for Russian speaking and Vietnamese speaking customers in the Czech Republic call and send SMS to sixteen countries at local rates.

O2 Foundation donated CZK 10 million to help disadvantaged children and youth already for the ninth time.

October

A total of 270 employees helped out in fifteen charitable organisations in all corners of the Czech Republic as part of the Telefónica O2 Volunteer Day.

Telefónica O2 launched an innovated concept of its O2 TV service.

Two Telefónica O2's websites of O2 TV and the campaign Reward for Top-up, topped the WebTop100 of the most accomplished web presentation.

Telefónica O2 launched a new service, O2 Emergency Care, which expands the portfolio of telemedicine and telecare services supported by modern eHealth technologies.

November

The Supervisory Board of Telefónica O2 elected Alfonso Alonso Durána its Chairman and María Eva Castillo Sanz as the 1st Vice-Chairman. Anselmo Enriques Linares was co-opted a member of the Supervisory Board (the position had been vacant after Enrique Used Aznar's death in September 2010). The Supervisory Board elected František Schneider to succeed Jose Perdomo as member of the Board of Directors; František Schneider was formally made member of the Board of Directors after the resignation of Jose Severino Perdomo Lorenzo in September 2010.

Michal Urválek left Telefónica O2 and Steven Tree was made acting Director of the Human Resources division.

Telefónica O2 covered more than 40% of the Czech population with its 3G mobile data network; EDGE was available to 98% of the population.

Telefónica O2, in collaboration with the Czech Police, prepared a campaign to protect senior citizens against fraudsters and thieves.

Telefónica O2 received the prestigious 2010 Top Corporate Philanthropist award for the Most Responsible Partnership for its environmentally-friendly project of the Open Air Festival.

December

Tony Hanway is named the new Director of the Consumer Division at Telefónica O2.

As has become the tradition, employees raised CZK 317,000 to benefit disadvantaged fellow citizens through their purchases of Christmas gifts handmade in sheltered workshops.

01

About Telefónica Group

The customer
always comes first

01

About Telefónica Group

About Telefónica Group – introduction

Telefónica is one of the world's leading integrated operators in the telecommunications sector, providing communication, information and entertainment solutions, with presence in Europe, Africa and Latin America. The group operates in 25 countries. As of December 2010, Telefónica's total number of customers was 288 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 fourth position in the Telco sector worldwide in terms of market capitalisation, in first among European integrated operators and in third position in the Eurostoxx 50 rankings, composed of Europe's blue chip companies (March 2010).

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 close to 70% 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 183 million customers as of the end of 2010, thus becoming the leading operator in Brazil, Argentina, Chile and Peru. The group also has substantial operations in Colombia, 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 104 million customers as of the end of 2010.

Telefónica in figures

— 287.6 million accesses (103.9 million Europe; 183.7 million Latin America) (December 2010)
— Presence in 26 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])
— 270,000 employees (30% in Europe; 69% in Latin America; 1 % in other countries) (December 2010)
— Revenues: 60,737 mil. euro (2010)
— OIBDA: 25,777 mil. euro (2010)
— Net profit: 10,167 mil. euro (2010)

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

— The world's largest integrated telecommunications operator measured by number of accessed
— The largest integrated operator in Europe measured by market capitalisation
— First on the Dow Jones Sustainability Index
— Among the world's 50 largest companies measured by market capitalisation
— Among the world's 75 largest companies measured by revenues (Fortune Global 500)

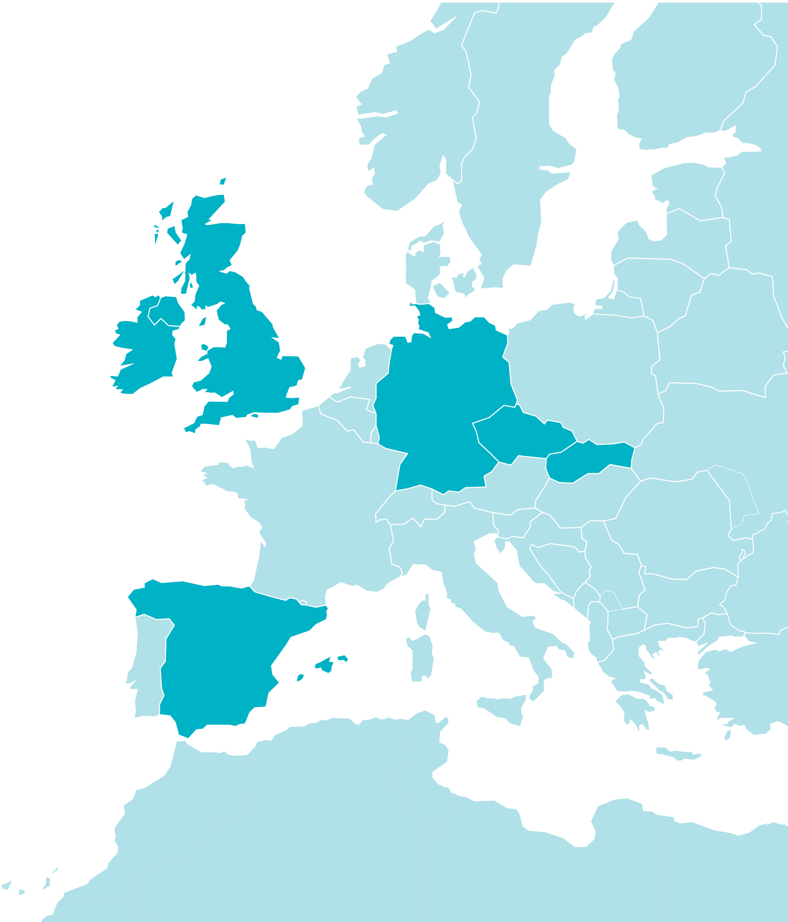
Telefónica – leader in the telecommunications market in Latin America

Argentina	
Number of accesses	22.3 mil.
Fixed line market	1.
Mobile market	2.
Brazil	
Number of accesses	76.0 mil.
Fixed line market	2.
Mobile market	1.
Central America	
Number of accesses	6.9 mil.
Fixed line market	–
Mobile market	3.

Colombia	
Number of accesses	12.4 mil.
Fixed line market	2.
Mobile market	2.
Chile	
Number of accesses	11.9 mil.
Fixed line market	1.
Mobile market	1.
Ecuador	
Number of accesses	4.3 mil.
Fixed line market	–
Mobile market	2.
Mexico	
Number of accesses	20.2 mil.
Fixed line market	–
Mobile market	2.
Peru	
Number of accesses	17.0 mil.
Fixed line market	1.
Mobile market	1.
Uruguay	
Number of accesses	1.7 mil.
Fixed line market	–
Mobile market	2.
Venezuela	
Number of accesses	10.6 mil.
Fixed line market	–
Mobile market	2.
Total number of accesses	**183.7 mil.**

* Data from December 2010
Note: Central America includes Guatemala, Panama, El Salvador, Nicaragua and Costa Rica.
The number of accesses includes narrowband service provided by Terra Brasil and Terra Colombia and broadband service provided byTerra Brasil, Telefónica de Argentina, Terra Guatemala and Terra México.

Telefónica – a strong player on the European market



* Data from December 2010

Spain	
Number of accesses	47.4 mil.
Fixed line market	1.
Mobile market	1.
United Kingdom	
Number of accesses	22.9 mil.
Fixed line market	–
Mobile market	2.

Germany	
Number of accesses	23.1 mil.
Fixed line market	4.
Mobile market	4.
Ireland	
Number of accesses	1.7 mil.
Fixed line market	–
Mobile market	2.
Czech Republic	
Number of accesses	7.7 mil.
Fixed line market	1.
Mobile market	2.
Slovakia	
Number of accesses	0.9 mil.
Fixed line market	–
Mobile market	3.
Total number of accesses	**103.9 mil.**

Corporate Centre

The Corporate Centre is responsible for the global and organisational strategy, corporate policies, management of joint activities and coordination of business unit operations. In 2008, the Corporate Centre reinforced its relationships with the organisation units by way of a reorganisation project, which gave rise to two organisation units dedicated to innovation and transformation, respectively; the units were established to give a stronger impetus to the drive for revenues and performance.

Telefónica España

Telefónica was founded in 1924 in Spain, however (since 2008), the home country is no longer the main market of the company. The company's main operations are in Latin America. Telefónica España is well appointed in all main market segments; it provides fixed telephony services (including pay TV), mobile and data services, broadband internet access, and has – via its subsidiary Meditel – investments in Morocco.

Telefónica Latinoamérica

Telefónica Latinoamérica has operations in 13 countries of Latin America – Argentina, Brazil, Chile, Ecuador, El Salvador, Guatemala, Colombia, Mexico, Nicaragua, Panama, Peru, Uruguay and Venezuela, where it provides the services of mobile and fixed telecommunications, internet access and pay TV. Additionally, Telefónica International Wholesale Services provides wholesale telecommunications services to a global standard. Its portfolio spans voice, data, IP, satellite, corporate and mobile services, and its optical network connects Latin America, United States and Europe. Telefónica is also actively pursuing ancillary business in Puerto Rico and in the United States.

Telefónica Europe

Telefónica O2 Europe plc changed its name to Telefónica Europe plc on 1 June 2008. The change came as an organic part of the integration process, two years after the company's integration in the group. The new corporate name structure follows the same pattern as in all the other regions – Telefónica España, Telefónica Latinoamérica and Telefónica Europe. With operations in the United Kingdom, Ireland, Germany, Czech Republic and Slovakia, Telefónica Europe provides the services of mobile and fixed telecommunications and broadband internet access.

On December 3, 2009, Telefónica's subsidiary in Germany, Telefónica Deutschland GmbH ("Telefónica Deutschland"), signed an agreement to acquire all of the shares of German company HanseNet Telekommunikation GmbH ("HanseNet"). On February 16, 2010, the Telefónica Group completed the acquisition of 100% of the shares of HanseNet.

Partnerships and other shareholding

Telefónica is present in China, Italy and Portugal, by means of shareholdings in China Unicom and Telecom Italia, respectively.

Other companies in the group

Atento offers the services of Customer Relationship Management via its network of contact centres. It has operating platforms in Spain, Argentina, Brazil, Chile, Colombia, United States, Morocco, Mexico, Peru, Puerto Rico, Czech Republic, Uruguay and Venezuela.

T-gestiona provides comprehensive administrative and financial support in the area of human resources, real property, logistics and distribution, consulting in the area of ERP processes and systems, and the services of a comprehensive back office. It operates in Spain, Argentina, Brazil, Chile and Peru.

Telefónica I+D is a research and innovation company in the field of technology. The volume of funds invested in innovation and development has made it the largest private research and development centre in Spain, and it is also the European leader in terms of participation in ICT research projects. It has operations in Spain, Brazil and Mexico.

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 — Indegrated 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 [1]	100 %
Telefónica Móviles España [1]	100 %
Telyco	100 %
Telefónica Telecomunic, Públicas	100 %
T, Soluciones de Informatica y Comunicaciones de España	100 %
Telefónica Remesas [2]	100 %
Tuenti [3]	91,4 %
Iberbanda	58,9 %

[1] Company owned through Telefónica S.A.
[2] Company owned through Telefónica Telecomunicaciones Públicas, S.A.
[3] Company owned through Telefónica Móviles España, S.A.U.

Telefónica Latinoamérica	
Telesp [1]	88,0 %
Telefónica del Peru [2]	98,3 %
Telefónica de Argentina	100 %
TLD Puerto Rico	100 %
Telefónica Chile [3]	97,9 %
Telefónica Telecom	52,0 %
T, Intern, Wholesale Serv, (TIWS) [4]	100 %
Vivo Participaçoes [5]	59,4 %
Vivo [6]	100 %
T, Móviles Argentina	100 %
T, Móviles Peru	100 %
T, Móviles Mexico [5]	100 %
Telefónica Móviles Chile	100 %
T, Móviles El Salvador	99,1 %
T, Móviles Guatemala	100 %
Telcel (Venezuela)	100 %
T, Móviles Colombia	100 %
Otecel (Ecuador)	100 %
T, Móviles Panama	100 %
T, Móviles Uruguay	100 %
Telefonía Celular Nicaragua	100 %
T, Móviles Soluciones y Aplicac, (Chile) [5]	100 %

[1] Effective stake 88.01%.
[2] Latin American Cellular Holdings, B.V. owns 48.28%, Telefónica Internacional S.A. owns 49.9% and Telefónica S.A. owns 0.16%.
[3] Telefónica Internacional de Chile Ltda. owns 44.89% and Inversiones Telefónica Internacional Holding Ltda. owns 53%.
[4] Telefónica, S.A. owns 80.56% and T. Int. Wholesale Services, S.L. owns 19.44%.
[5] Company owned through Telefónica S.A.
[6] Company owned through Vivo Participaçoes, S.A.

Telefónica Europe	
Telefónica O2 UK	100 %
Telefónica O2 Germany [1]	100 %
Telefónica O2 Ireland	100 %
Be	100 %
HanseNet (Germany) [2]	100 %
Jajah (US)	100 %
Tesco Mobile	50 %
Telefónica O2 Czech Republic [1]	69,4 %
Telefónica O2 Slovakia [3]	100 %

[1] Company owned through Telefónica S.A.
[2] Company owned through T. O2 Germany.
[3] Company owned through T. O2 Czech Republic.

Other stakes	
Atento Group	100 %
Telefónica de Contenidos (Spain)	100 %
Telco SpA (Italy) [1]	46,2 %
IPSE 2000 (Italy)	39,9 %
DTS, Distribuidora de Televisión Digital	22,0 %
Hispasat	13,2 %
Portugal Telecom [2]	2,0 %
China Unicom (Hong Kong) Limited (China)	8,4 %
ZON Multimedia [3]	5,4 %
BBVA	1,0 %
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.

02

Board of Directors' Report on Business Activity

We strive to improve

02

Board of Directors' Report on Business Activity

Telefónica O2 Czech Republic Group

Overview of the Group and the main changes in 2010

The group of Telefónica O2 Czech Republic (hereinafter Telefónica O2 Group) comprises Telefónica O2 Czech Republic, a.s. (hereinafter Telefónica O2 or Company) and several other subsidiaries. In 2010, the Group's services were provided mostly on the territory of the Czech Republic and in Slovakia. Through a wholly-owned subsidiary Telefónica O2 Slovakia, the Group has been operating in Slovakia since 2007. In 2007, Telefónica O2 acquired 100% of DELTAX Systems a.s. (hereinafter DELTAX Systems). During 2009, DELTAX Systems liquidated as a legal entity and merged in the successor company Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o.). In line with its strategy to add new services to the traditional voice and data, Telefónica O2 partnered with other companies and started MOPET CZ a.s., a venture to launch mobile payment services. Telefónica O2 holds a 14% share of the new company.

Telefónica O2 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 O2 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 2010, Telefónica O2 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 %
Companies incorporated in the Czech Republic					
Telefónica O2 Business Solutions, spol. s r.o.	Praha 4–Michle, Za Brumlovkou 266/2, postal code 140 00	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 O2 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 %
Affiliate companies					
AUGUSTUS spol. s r.o.	Praha 10–Vinohrady, Na Zájezdu 1935/5, postal code 101 00	Consultancy and agency in the field of non-telecommunications	49356160	CZK 166,000	39.76%
První certifikační autorita, a.s.	Praha 9–Libeň, Podvinný mlýn 2178/6, postal code 190 00	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	Real-time mobile payment services	24759023	CZK 91,000,000	14.29%

In June 2009, the Board of Directors of Telefónica O2 approved an increase of the registered capital of Telefónica O2 Slovakia by way of a pecuniary contribution of EUR 150,209,121.69. The company's registered capital of EUR 49,790,878.31 thus increased to EUR 200,000,000.00. The increase became effective on 19 August 2009.

In May 2010, the Board of Directors of Telefónica O2 approved an increase of the registered capital of Telefónica O2 Slovakia by way of a pecuniary contribution of EUR 40,000,000.00. The company's registered capital of EUR 200,000,000.00 thus increased to EUR 240,000,000.00 EUR. The increase became effective 6 May 2010.

Restructuring programme

In line with its long-term strategy focused on improving its operating efficiency, in 2010 Telefónica O2 implemented an ambitious restructuring programme; its aim was to implement a more effective organisational structure with fewer levels of organisation. The Company also focused on improving the efficiency of the processes through the continuing integration of fixed and mobile platforms and systems, with a particular attention on network operation; the outsourcing option was considered for some activities. The programme led to optimisation of the network operation, where some activities associated with certain technologies and locations were outsourced to a strategic partner, together with maintenance and repair of supporting technology. More than 1,000 employees were let go in connection with the restructuring, of which approximately 50% as a direct result of outsourcing in the area of network operation.

Number of employees of the Telefónica O2 Group by region:

	As at 31 December 2009	As at 31 December 2010
Telefónica O2 Czech Republic, a.s.	8,011	6,936
Telefónica O2 Business Solutions, spol. s r.o.	272	178
Employees in the Czech Republic	**8,283**	**7,114**
Telefónica O2 Slovakia, s.r.o.	404	408
Employees in Slovakia	**404**	**408**
Group employees – total	**8,687**	**7,522**

Projects to improve operating efficiency and customer experience

In addition to the above-mentioned restructuring programme, the Company continued to implement other projects, which sought to improve operating efficiency at the same time as raising the quality of service and, by extension, enhancing customer experience. Telefónica O2, as technology innovator, embarked on a project to develop tools and processes that would allow bringing all key instruments and customer relationships online. As part of the project of internal efficiency improvement and in connection with the headcount reduction, the area of leased properties was reduced. Reconfiguration of power supply schemes in offices, call centres and at selected base stations has led to significant savings on electricity consumption. The Company's fleet was downsized by 25%, which has led to fuel savings. Likewise, the process of customer documentation flow was improved through the implementation of a central point of entry.

Projects aimed at the building of customer trust and satisfaction started to deliver their first tangible results already in 2010. Quality improvements in service delivery, sales in brand stores and the Company's drive for active, credible and transparent communication with customers have led to a reduction in the number of complaints and claims by 25–30%, depending on the segment. Improvements could be seen also in call centres – the rate of their utilisation increased, with the number of calls answered within twenty seconds hovering steadily around 85% at the end of the year. The average number of calls per customer was down approximately 15% and the average duration of call shortened by approximately 8%. An ongoing independent customer satisfaction survey of call centres revealed that, during 2010, the level of customer satisfaction improved across all segments; approximately 64% of all requests registered by call centres were resolved during the first call.

Telefónica O2, pursuing the strategy to retain its leadership in the mobile internet market, significantly expanded the coverage of its high-speed mobile networks (EDGE and 3G), without compromising on the quality of service, and boosted the transmission speeds. The Company covered 72 towns and their greater areas with signal, and improved the coverage of ten other towns. At the end of 2010, 84 towns, which represent 42.5% of the population, were covered with the service. The average downlink speed reached 1.8 MB/s; in locations where new network had been built, the average speed could be as high as 4 MB/s. The technology coverage was up 81 percentage points and reached 98% of the population, which brought it to the level of the other two operators. The expansion of the mobile broadband network went hand in hand with a new portfolio of mobile internet tariffs for both pre-paid and contract customers. This in turn reflected in higher level of customer satisfaction across all customer segments.

All the above has led to a 1.3 percentage point increase on the scale of the Customer Satisfaction Index, which helped the Company with closing the gap to its competitors.

Telefónica O2 Slovakia

As at 31 December 2010, Telefónica O2 Slovakia registered 880 thousand customers, of which 334 thousand were contract customers. The number of customers increased 59% year on year. The revenues reached EUR 112 million, which is 51% more than in 2009. In the third and fourth quarter of 2010, Telefónica O2 Slovakia showed a positive operating income before depreciation and amortisation (OIBDA).

The company continued marketing its O2 Fér product with the same slogan – 'simplicity, transparency and flexibility'. In September 2010, a new product, O2 Moje Firma, was introduced in the SME segment. In 2010, Telefónica O2 Slovakia focused mainly on customer acquisition and on improving the quality of its customer base through Mobile Number Portability. To make the porting option more attractive, the company offered bonuses for every number ported to the O2 network. As a result of this campaign, in 2010 almost 142 thousand customers ported their already existing number to the O2 network.

At the end of September, the company announced its plan to roll out a proprietary 3G network in Slovakia. The launch of commercial service in the expanded 3G network is scheduled for June 2011. By July 2011, the O2 3G network should cover already 33% of the Slovak population in 24 towns.

At the end of December 2010, the network of Telefónica O2 Slovakia was available already to 94.9% of the population in Slovakia. The span of the network allowed carrying of almost 89% of calls 'on net'. The remaining 11% of calls were connected using national roaming. The share of on-net calls went up by almost 4 percentage points compared to the end of 2009.

A survey carried out by the independent market research agency Ipsos Tambor jointly with Telefónica O2 Slovakia revealed that O2 ranked at the top of all mobile operators in Slovakia in terms of customer satisfaction. The Customer Satisfaction Index (CSI) of O2 reached a record level, as did the company's gap on its competitors.

Telefónica O2 Slovakia also fared the best in the fifth year of the only independent awards of mobile operators in Slovakia. More than two thirds of votes secured the title 'Mobile Operator of the Year' for O2 – already in the second consecutive year.

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 2010, 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, in particular in connection with the adoption of the new regulatory framework.

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. The number of defaulting partners may increase in conjunction with the continuing economic recession.

Operating risks

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

The telecommunications market in the Czech Republic

In 2010, the Czech telecommunications market saw the first signs of the gradual economic recovery, which brought an approximately 2% growth of the economy measured by the Gross Domestic Product (GDP). Despite the positive developments, especially in early 2010 customers continued to drive prices down as they optimised their spending for all products and services, including telecommunication services, and the competitive pressure further intensified. During the year, the customer spend on mobile services gradually increased, slowing down the rate of ARPU dilution. The mobile market was also influenced by regulation in the area of mobile termination rates and international roaming; the number of customer additions slowed down followed by revenues decline. According to Telefónica O2's estimates, revenues from the Czech telecommunications market were down approximately 7% in 2010.

Revenues from the fixed line segment declined approximately 8% year on year, while mobile revenues saw a drop of 6% approximately, basically matching the rate of decline from 2009. The fixed line penetration reached 30% at the end of 2010, continuing the downward trend of previous years. Mobile penetration (measured by the number of registered SIM cards with a 13 month activity criterion), on the other hand, exceeded 134% (an accurate figure cannot be determined due to differences in the Czech operators' methodologies of accounting for mobile customers), which is among the highest penetration rates in Europe.

Among European Union member states, the Czech Republic has for a long time been in the upper echelon of countries with the highest volumes of voice traffic in mobile networks. This, however, did not stop the fixed-to-mobile substitution and the proportion of mobile voice traffic continued to grow also in 2010. According to Company's estimates, 86% of all voice traffic generated in 2010 was in the mobile networks, which translates into a 2 p.p. year-on-year growth.

The year 2010 saw a massive growth in the demand for data services – and the operators moved quickly to respond by expanding the coverage of their 3G networks and coming out with new products in this area.

Trends in the fixed line market

In 2010, the revenues from fixed lines reached approximately CZK 45 billion, which represents a year-on-year decline of approximately 8%. The fall of the voice revenues was partly offset by the growing revenues from broadband internet, IT services and business solutions.

Below we bring a round-up of the most important events in the fixed line market in 2010.

The acquisition of the retail business of České Radiokomunikace a.s. at the end of 2009 allowed T-Mobile Czech Republic a.s. (hereinafter T-Mobile) to offer its own fixed telecommunication service. At the beginning of 2010 T-Mobile introduced its '2in1' bundle combining an ADSL Internet data tariff and a choice of mobile voice tariffs; the products in the bundle were more economically priced than when purchased separately.

During 2010, České Radiokomunikace a.s. continued to deploy the WiMAX technology in other towns in the Czech Republic. České Radiokomunikace a.s. announced a change of ownership at the end of the year; Macquarie, a fund management company from Australia, became the new owner.

In September, Dial Telecom a.s. took over the corporate and wholesale businesses of Volný and strengthened its position in the Czech telecommunications market. Together with the business and wholesale customer base, Dial Telecom a.s. took over also a part of the sales and technical department. Dial Telecom a.s. also announced plans to continue investing in the expansion of its proprietary optical infrastructure, as per its strategy.

At the beginning of April, UPC Česká republika, a.s. (hereinafter UPC) added UPC Fiber Power 25 to its broadband internet portfolio and at the same time permanently slashed the prices of its two fastest internet services (UPC Fiber Power 50 and UPC Fiber Power 100) by 40%.

In the pay TV market, Telefónica O2 came out with an innovated O2 TV concept branded O2 TV Flexi in the autumn, in which it heeded the wishes of customers who wanted to make up their own programme menu and did not want to pay for channels they do not watch. Now they can combine their own menu of programmes in the basic package and select two optional programme packages of different varieties.

T-Mobile entered the pay TV market in November with its T-Mobile TV. Under this brand, T-Mobile began to market an already existing satellite platform by Skylink, one of the big four satellite TV providers in the Czech Republic.

The number of satellite television and IPTV users continued to grow in 2010. UPC began to broadcast in 3D on its HD+ channel.

Providers of WiFi internet connectivity (including various mutations of FTTx technology) retained, with approximately 835 thousand users, their strong position in the fixed broadband market. Despite the relatively high number of these providers, the quality of service varied greatly between them. During the course of 2010, WiFi providers intensified investments in FTTx infrastructure.

Trends on the mobile market

The mobile market in the Czech Republic in 2010 yielded revenues in the range of CZK 76 billion, which translates into a year-on-year drop of approximately 7%.

In the conditions of the gradually recovering economy and high penetration, all mobile operators saw their customer base increase in 2010. The net additions of active customers of Telefónica O2 and the registered customers of T-Mobile and Vodafone Czech Republic a.s. (hereinafter Vodafone) reached 108 thousand in 2010, compared to 249 thousand in 2009. The net additions recorded a 70% slump year on year.

In 2010, Telefónica O2 recorded a 2.1% year-on-year drop in the number of active customers down to 4,839 thousand, which is attributed mainly to the one-off disconnection of 111 thousand inactive customers. Without the effect of the one-off disconnection, the total number of customers would rise 0.1% year on year, which, given the highly competitive and penetrated mobile market in the Czech Republic, is a good result. The exact share of active customers of the Company in the total market cannot be determined due to differences in the methodologies used by T-Mobile and Vodafone; the two companies publish only figures of registered customers. The ongoing migration of customers from the pre-paid to post-paid service produced a year-on-year increase of 5.7% in the number of contract customers of Telefónica O2 (disregarding the effect of the one-off reduction due to disconnection of inactive customers), up to 2,975 thousand, in 2010.

Mobile operators responded to the needs voiced by their customers and innovated their voice and data tariff portfolios, shifting their focus to mobile internet and internet in mobile devices. As to voice tariffs, the offer of the so-called 'flat-rate' tariffs with unlimited calls included in the monthly fee was substantially expanded. Vodafone introduced a wholly new 'Tailor Made' tariff concept.

In the spring, Telefónica O2 expanded its offer of flat-rate mobile tariffs; SME customers could choose from O2 Business, tariffs with unlimited calling within business hours. Another innovation came in the form of the innovated tariffs for SMEs O2 Business with the new O2 Business Unlimited with unlimited calls, SMS and data. In January, T-Mobile launched Grand and Grand Plus, the first flat-rate tariffs in its portfolio, with unlimited calls for non-business customers. Shortly after, T-Mobile introduced Profi tariffs, offering the same service to business customers. The SME proposition was later expanded by community-based tariffs under the Team brand. Also in 2010, T-Mobile launched pre-paid Twist tariffs, which came with free on-net calls and SMS for the rest of the day after the first five calls or SMS paid for.

In the second quarter of 2010, Telefónica O2 added a pre-paid service to its mobile internet offer, and in early June it introduced a new portfolio of post-paid mobile data tariffs. Also in the second quarter, T-Mobile came out with a pre-paid mobile internet tariff.

In March, Vodafone announced an innovative concept of 'Tailor Made' tariffs, which let customers combine voice and data services of their choice, from zero monthly fee to unlimited calls, SMS and data.

Throughout the year, all operators introduced the improved offers of internet in a mobile device, together with a choice of smartphones.

At the end of the first half of the year, a regulatory intervention by the European Commission cut the prices of voice calls and SMS sent from abroad. The European Commission required that all operators implement a so-called 'data roaming limit', to protect customers from unexpectedly high bills for internet usage during their travels abroad. The data roaming limit of CZK 1,500 including VAT was implemented with effect from 1 June; it concerned all users who use mobile internet when visiting European Union and European Economic Area countries.

During the course of 2010, all mobile operators continued with their efforts to modernize and expand their 3G networks. As at the end of the year, Telefónica O2's 'smart network' had the widest coverage of 43%; its mobile 3G network was, at the end of December, available in 84 towns and cities. At the beginning of 2010, T-Mobile started the commercial operation of its 3G network in selected districts of Prague, and at the end of the first half year it completed the project of GSM network modernisation. By the end of the year, T-Mobile's 3G network covered already 37% of the Czech population. Vodafone signed an agreement with MobilKom a.s., the operator of the U:fon network, for CDMA mobile data network sharing. Vodafone also continued with the expansion of its own 3G network, which covered 38% of the population by the end of 2010.

At the end of 2009, MobilKom a.s. announced a turnaround in its business strategy and market positioning and declared its intention to become the first low cost operator in the Czech Republic. It plans to offer voice and data services on a retail and wholesale basis. At the end of June 2010, MobilKom a.s. announced that it would open its network to other operators wishing to offer broadband mobile internet or voice under their respective brands; MobilKom thus opened the door to virtual operators. WIA, OpenCall or MujOperator were some of the virtual operators using the U:fon network at the end of the year.

Regulation

Several changes occurred in 2010 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 we bring an overview of the most important changes in the legislation which governs the area of electronic communications:

— Enactment of the Act No. 132/2010 Coll., on audio-visual media services on demand and on the amendment to some other laws (Act on Audio-visual Media Services On-demand);
— Enactment of the Act No. 153/2010 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 Regulation No. 318/2010 Coll., laying down the form of traffic and location data records and the method of its provision to the Czech Telecommunication Office;
— promulgation of the Regulation No. 360/2010 Coll., laying down the format for electronic form of "the proposal for the decision of the dispute on obligation to payments" and technical requirements for its usage;
— Commencement of the implementation of the revised regulatory framework for electronic communications networks in the Czech law:
    I. 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;
    II. 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;
    III. Directive 2009/140/EC of the European Parliament and of the Council amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services;
    IV. Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and 2002/20/EC on the authorisation of electronic communications networks and services;
    V. 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 Councilestablishing the Body of European Regulators for Electronic Communications (BEREC) and the Office.

Telefónica O2 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.

The passing of the new Payment Services Act also directly concerned the Company. The provision of these services – previously known as "third party services", of Telefónica O2, which allowed the customers to order and buy goods and services of third parties, was concerned primarily by the following laws:

— Act No. 284/2009 Coll., on the Payment System, which incorporates in particular the European Parliament and Council Directive 2007/64/EC on payment services in the internal market, European Parliament and Council Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, to be amended by the European Parliament and Council Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions,
— Act No. 285/2008 Coll., on selected measures against the legalisation of the proceeds from crime and terrorist financing.

The Company also contributed to the preparation of the above legislative amendments through its involvement in the process of expert or public consultations, either directly – through industry associations of telecommunications operators, or through the parent company.

Relevant markets analysis and product regulation
Telefónica O2 continued to meet its duties with which it was tasked based on the relevant markets analysis undertaken by the Czech Telecommunication Office (hereinafter CTO) in previous periods.

In April 2010, the CTO published new regulated wholesale mobile termination rates. The price per one minute of call went down to CZK 1.96 with effect from 1 January 2010, and further down to CZK 1.66 with effect from 1 July 2010. Based on the same CTO decision, the maximum regulated wholesale mobile termination rates will continue to go down also in 2011: from 1 January 2011 to CZK 1.37 and from 1 July 2011 to CZK 1.08.

In February 2010, the CTO published the analysis of market no. 1 – access to the public telephone network in a fixed point, and subsequently decided on the determination of an undertaking with a significant market power and on the imposition of remedies.

In May 2010, the CTO published the analysis of the wholesale physical access to infrastructure in a fixed point, and subsequently decided on the determination of an undertaking with a significant market power on the imposition of remedies and price regulation.

In December 2010, the CTO published the relevant market analysis for market no. 6 – wholesale terminating segments of leased lines irrespective of the technology used for the provision of leased or reserved capacity.

The CTO promulgated decisions for relevant markets no. 2, 3 and 7, identifying an undertaking with a significant market power and imposing remedies and price regulation.

The CTO proceeded with the consultation on the regulation strategy in the area of Next Generation Access (NGA), and on 27 September 2010 it published a document 'Proposals for Regulation of Next Generation Optical Access Networks according to Individual Network Construction Scenarios'. This paper is based on a document published by the European Commission 'Recommendation on regulated access to Next Generation Access Networks [C(2010)6223]' on 20 September 2010.

Regulation of international roaming

Retail prices of incoming calls went down to EUR 0.5 per minute with effect from 1 July 2010; the prices of outgoing calls were down to EUR 0.39 per minute. The prices in Czech crowns were set based on the applicable exchange rate.

In March 2010, Telefónica O2 introduced a safeguard mechanism for data services provided to end customers. Customers are automatically protected against too high bills for data roaming services over EUR 50 per month.

Imposition of duties related to the provision of the Universal Service

Telefónica O2 provided the following services during 2010 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 services 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 2010.

Universal Service

The CTO published its final decision determining the amount of loss incurred as a result of Universal Service provision in 2007 and 2008.

Telefónica O2 submitted a request for reimbursement of loss incurred as a result of Universal Service provision in 2009. The CTO commenced a process of verification of the claim against the document supplied.

The CTO published a final decision determining the amount of loss from the provision special price plans for people with physical or health-related disabilities in 2009.

State policy and support in the area of broadband internet

The Ministry of Industry and Trade of the Czech Republic completed a policy paper titled 'Digitální Česko' (Czech Republic Goes Digital), which was put for public consultation in December 2010. The policy paper deals with the development of ICT, with an emphasis on levelling out the disparities in broadband internet availability between urban and rural areas. The policy paper also includes a plan for the development of optical and wireless access networks in the Czech Republic.

EU structural funding continued to be available for projects to implement ICT in public and private sector organisations.

Telefónica O2, as a member of industry associations (Association for Information Technologies and Telecommunications, Association of Mobile Network Operators and the Czech Telecommunications Association), sent its comments on the draft of Digitální Česko policy paper. 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.

Networks and technology

In 2010, Telefónica O2 continued to expand and modernize its network infrastructure, which consists of the largest fixed line and mobile telecommunication network in the Czech Republic.

As far as mobile networks are concerned, investments were directed mainly at an extensive expansion of the Company's 3G network based on the UMTS/HSPA technologies, increasing data transmission speeds, upgrading the GSM network technology and at providing for sufficient capacities now when the traffic is growing.

Compared to the situation in early 2010, when the 3G network covered only main regional cities, the network has been significantly expanded to other locations throughout the year. The number of UMTS/HSPA base stations at the end of 2010 stood at 1,835, compared to 1,364 at the end of 2009. The coverage of the population with the 3G signal increased from 26.6% at the end of 2009 to 42.5% at the end of 2010. The year 2010 also saw the completion of a massive upgrade of the 2nd generation mobile network which had been commenced in the previous year; this effectively increased the coverage of the EDGE technology, which allows for faster data transmission in network, to 97% of the territory and 98% of the population of the Czech Republic. Thanks to this, combined with the CDMA network, which covers 90.4% of the population, Telefónica O2 had, at the end of 2010, the best mobile data infrastructure in the Czech Republic.

Data traffic in mobile networks increased dynamically in 2010. In peak hours, it reached on average more than double that of 2009. Investments in network transmission capacities followed suit. Further increases in the volume of voice traffic and additional demand from new developments (residential, commercial and industrial) have led to 65 new base stations and 147 smaller transmitters, namely to improve coverage in buildings, being installed in the GSM network in 2010. At the end of 2010, the total number of GSM transmitters reached 4,995, and the coverage of the population stood at 99.6%.

In the fixed line area, a significant share of investments went into broadband and IPTV projects. To satisfy the demand from customers, Telefónica O2 expanded the capacity of access pints and strengthened the capacities of transmission lines in the IP/MPLS backbone network. The number of ADSL access points reached 2,415 at the end of 2010, compared to 2,402 in 2009. In 2010, 162 IP DSLAMs were put into operation, and O2 TV was available in 2,265 locations. The total installed capacity of ports went up to 1,050,700, which is a year-on-year increase of 7.6%. The share of O2 TV-enabled access ports installed in IP DSLAM equipment stood at 62% at the end of 2010, compared to 56% at the end of 2009. A total of 840,400 were occupied at the end of 2010 (up 11% on the previous year).

Telefónica O2 continued to roll out its access network, namely to satisfy the demand from customers in new residential, commercial and industrial developments. The access network consisted of metallic cables spanning the whole territory of the Czech Republic, supplemented with optical cables and radio relay systems. At the end of 2010, the total length of metallic cable was 305.1 thousand km (up 1.7 thousand km year on year). The optical network capacity continued to increase with the growing volume of traffic generated by broadband customers, connectivity orders from corporate customers and, in selected cases, the need to connect new residential developments. The total length of optical cable, including those laid in conduit systems, reached 31,529 km at the end of 2010, compared to 31,204 km in 2009. The total length of optical cable reached 998,691 km (a year-on-year increase by 22,889 km).

The Company also added to the capacity of two existing international telephone exchanges by building a new soft switch telephone exchange. The capacity of subscriber interfaces of HOST exchanges and Remote Subscriber Units (RSU) was optimised accordingly. At the end of 2010, the fixed line network comprised, in addition to the international exchanges, also six transit exchanges and 138 HOST exchanges. The network of RSUs was optimised by reducing their number by 10, down to 2,374.

Voice over IP services enjoyed a dynamic growth in 2010. During the year, the number of end users of the Company's IP Centrex service doubled and reached almost 40 thousand.

The GSM network operated by Telefónica O2 Slovakia consisted of 964 base stations at the end of 2010. Network-related investments in Slovakia focused mainly on the building of own transmission capacities.

As mentioned earlier in the Annual Report, in the course of 2010 Telefónica O2 increased the share of network operation and maintenance activities contracted out to external parties, which achieved a significant saving of operating costs and their greater variability.

Voice services

In the area of mobile voice services, in 2010 Telefónica O2 continued to build a strong awareness of the simplicity of its O2 NEON tariffs. At the same time, as part of the project to simplify its product portfolio, the Company actively supported the migration of customers from older tariffs to O2 NEON. Customers would benefit from more freedom that O2 NEON tariffs offer and could take full advantage of fixed broadband internet access in the form of discounts on other services, calls to a selected number and many others.

In March 2010, Telefónica O2 came out with a special proposition to new users of O2 NEON tariffs: customers (registered small business owners or entrepreneurs) who activated a new number with O2 NEON L, L+, XL or XXL during the period from 1 to 14 March 2010 were eligible for a 30% discount for the whole duration of the contract (2 or 3 years, depending).

From 1 June, Telefónica O2 started offering an add-on service O2 Navzájem, which came with unlimited calls within a group of up to seven friends, any time of day, for a flat fee. The service was offered to contract customers and the users of the O2 pre-paid card. Each person in the group paid the same monthly fee and the service offered more value for money as the number of 'friends' increased. The unlimited communication with selected contacts makes the service an ideal complement to O2 NEON tariffs.

New customers of the mobile pre-paid service from Telefónica O2 could enjoy a unique offer between 1 April and 30 June 2010. Users of O2 NA!PIŠTE and O2 NA!HLAS could sign up for a special promotion offering one minute of call for only CZK 1. Additional benefits that come with the pre-paid service also included a choice of four top-up packages: calling on weekend or in the evening for CZK 0.50 per minute, weekend SMS for CZK 0.50 or internet in a mobile device for CZK 20 per week. For every top up, pre-paid customers could claim one of the guaranteed rewards via www.odmenazadobiti.cz ('reward for top-up'). At the end of 2010, Telefónica O2 went live with its innovated Reward for Top-up loyalty programme for the customers of pre-paid services. The goal of the innovation was to bring the programme even closer to the target group of customers by offering them a range of rewards, which depended on the number of months the customer actively used the number for.

O2 DA was Telefónica O2's proposition to Russian- and Vietnamese-speaking customers. The tariff came with cheaper calls to sixteen countries: calls and SMS to Russia or Vietnam were, for instance, only CZK 5.50 per minute and CZK 2.60, respectively.

Having performed a detailed analysis of small business and entrepreneur customers' needs for mobile voice communication, from April 2010 Telefónica O2 expanded its offer of mobile tariffs designed for this important customer segment with the addition of the new O2 Podnikání tariffs which were the first in the Czech market to offer unlimited calls within business hours included in the monthly fee. This benefit did not come with any time limitation and could be enjoyed as long as the tariff was subscribed. The new O2 Podnikání tariffs came in four options: O2 Podnikání M, O2 Podnikání L, O2 Podnikání XL and O2 Podnikání XXL. The highest tariff offered, within the monthly subscription fee, unlimited calls between 9 am and 5 pm anywhere, without network restrictions. In the case of the other tariffs, the unlimited calls were tied to the same hours as above, and to more than 7 million numbers in the O2 network, including all fixed lines in the Czech Republic. Thanks to O2 Podnikání, customers no longer have to monitor their usage and costs and dedicate their time in full to their business.

From May, Telefónica O2 began to market O2 Business, innovated tariffs for SMEs. The new O2 Business Unlimited was offered as a truly unlimited option, giving its users unlimited calls, data and SMS to all networks in the Czech Republic for the new price of CZK 2,900 (exclusive of VAT). The other O2 Business also offered a lot of value – more free minutes, lower per-minute rates and lower monthly fees. To complement O2 Business, customers could choose one of the O2 Podnikatel add-on tariffs offering value on-net calls.

In the fixed line area, traffic continued to be gradually carried over from traditional fixed lines to Voice-over-IP (VoIP). Naturally, in 2010 Telefónica O2 focused on further development of this technology and introduced O2 Unlimited Line and O2 Virtual Exchange, two services offering a reasonably priced virtual PABX exchange included in the monthly fee. Telefónica O2 marketed its VoIP services as an additional option with its data services of guaranteed quality. The number of VoIP customers more than doubled during the course of 2010.

Customers in the lower segments, which do not require a virtual exchange functionality and use asymmetric internet access via ADSL, were the target group for Telefónica O2's new IP service (IP telefonní přípojka). For a monthly fee of CZK 230 exclusive of VAT, the customer had a guaranteed telephone service over ADSL, with unlimited calls to all fixed line networks in the Czech Republic and a rental of a high-quality VoIP telephone set. The service was open only to business customers.

On its quest to continuously develop and improve its VoIP service, Telefónica O2 introduced a guaranteed fax service (Faxová přípojka) for the customers of O2 Unlimited Line, O2 Virtual Exchange and the IP telephony service.

In December 2010, Telefónica O2 expanded its offer of calling from home options. All fixed access customers were offered calls to all mobile networks with prices starting already at CZK 2 per minute if they subscribed to O2 Calling Mobile 60 or O2 Calling Mobile 120. Telefónica O2 at the same time expanded its offer of international calling packages; customers could call 47 international destinations for prices starting at only CZK 2 per minute.

From February, deaf or hearing-impaired customers could use the free assistance service O2 Deaf Call. Telefónica O2 operated a 24/7 line where specially trained operators helped people with a complete or partial loss of hearing communicate with hearing persons. The service could previously be used via a text telephone or fax, and now communication via e-mail and SMS were introduced. The service works on a simple principle: the operator receives instructions from the non-hearing customer via e-mail, fax or SMS and conveys the message to the hearing recipient. Likewise, the operator can interpret information to the deaf or hearing impaired recipient, in which case the message is transcribed and despatched using the preferred means.

From 1 November 2010, Telefónica O2 has been offering O2 Emergency Care, a service which is a valuable addition to the portfolio of Telecare and eHealth services. Telefónica O2 was the first – and is as yet the only mobile operator in the Czech Republic – to offer a mobile emergency care service. The aim of O2 Emergency Care is to reduce the health and social risks for senior citizens or people with disabilities, allowing them to lead a quality life in their own social environment. The mobility of the solution is a particular benefit over the fixed-line based services on the market. Users of the service can call for help in emergencies not only from their home but from anywhere.

Internet, data and value added services

During the course of the year, Telefónica O2 continued to market its broadband proposition branded as O2 Internet. Customers activating the home variant O2 Internet Home got the service for CZK 600 per month for a period of one year – without a commitment and fixed access charges. New and existing customers also qualified for additional discounts if they combined their internet service with other services. From the middle of 2010, the Company focused on promoting its higher tariff with the speed of up to 16 MB/s for CZK 400 per month. A good balance of speed, price and reliability continued to be the primary attraction for getting ADSL from Telefónica O2.

During the course of 2010, Telefónica O2 strengthened its leadership in the mobile data market. Together with the expansion of its mobile broadband network, the Company launched the Smart Network campaign which spearheaded the offer of new services in the area of mobile internet and internet in a mobile device.

From 8 June, Telefónica O2 had a new post-paid mobile internet tariffs. Customers could choose from O2 Mobile Internet Standard for CZK 500 inclusive of VAT with FUP data limit of 2 GB, O2 Mobile Internet Pro for CZK 750 inclusive of VAT with FUP data limit of 10 GB, O2 Mobile Internet Unlimited for CZK 1,000 inclusive of VAT and no data limit. O2 Mobile Internet Start for CZK 300 inclusive of VAT with a monthly data limit (FUP) of 500 MB, which gave a good balance between the price and downloadable data, found its customers mainly among occasional users of mobile internet. The Company also introduced mirror range of mobile internet services in the form of add-ons to the fixed O2 Internet, and improved the proposition even further by offering a satisfaction guarantee – the service could be 'returned' without a sanction within two months of purchase.

Telefónica O2 was the only operator in the market to introduce, from 1 June, a concept of pre-paid mobile internet branded as O2 Pre-paid Mobile Internet, accompanied by a range of daily packages. The service gave customers unlimited access to the internet, without the need to commit to a contract and regular payments; it came in four options, tiered by price. The daily packages consisted of 24 hour blocks which could be used up anytime within two months from the activation. The user could go online and offline as often as they liked within one block, which was capped at 500 MB of data (FUP). The pricing structure was as follows: 1 day – CZK 50; 5 x 1 day – CZK 200; 10 x 1 day – CZK 350; 30 x 1 day – CZK 900. Customers could subscribe to pre-paid mobile internet in two ways - with the O2 Mobile Internet set or the O2 Mobile Internet card. The set consisted of a pre-paid SIM card with five weeks of free internet access and a Huawei E1750 USB modem, and it was priced at CZK 995. The O2 Mobile Internet card could be purchased separately for CZK 95; it came pre-loaded with a credit of CZK 50, which gave the customer one day of free access. Customers appreciated that they paid only for those days when they actually went online. The product was designed namely for customers who need mobile internet access only occasionally.

In June, Telefónica O2 expanded its portfolio of internet access via a mobile device for pre-paid customers. Smartphone owners wanting blithely access to the internet via their mobile device could subscribe to the new O2 Internet on Your Mobile Plus, which was priced at CZK 75 per week inclusive of VAT. The monthly data limit (FUP) was set at 500 MB.

SME customers could get, if they subscribed to selected mobile data tariffs, a Samsung N 150 netbook for the subsidised price of CZK 1,495, or the professional notebook HP 4520s for CZK 6,495, both with an integrated 3G modem, hence giving the customer access to the fastest mobile data network without the need to have any additional equipment.

Starting from June, the Company's customers were given the opportunity to use the BlackBerry Expres service without the initial acquisition cost of BlackBerry Enterprise server. A new tariff BlackBerry Modem also let customers use their BlackBerry devices as a modem for wireless internet access from a personal computer.

On 30 November 2010 Telefónica O2 started offering data tariffs for the iPad with WiFi and 3G capability. All the data tariffs came without a contract and commitment – they could be simply activated and deactivated as needed. The WiFi hotspots of Telefónica O2 in the Czech Republic were opened to customers free of charge.

As to internet connectivity and data services for the corporate segment, in 2010 Telefónica O2 focused namely on increasing its head start on the other providers, and on adding more value to these services for the customer to benefit from. In January 2010, the Company introduced a new concept of internet connectivity for corporate customers. The support of the PAM32 SDL protocol made it possible to offer symmetric access of up to 20 MB/s over the wide-reaching metallic cable network. The service O2 Internet Business also came with an unprecedented scope of value added services – from connection reliability guarantee, VoIP, anti-virus shield and user defined filters of internet communication to a mobile back-up. O2 Internet Business represented a solid foundation upon which the customer could build a reliable communication solution addressing the needs of their businesses and offering voice and data – safely. The introduction of the service helped the Company increase its share of the corporate internet access market.

In the area of fixed data services, at the beginning of the year the Company performed a thorough analysis of this segment, which included, among other things, individual interviews with customers. This exercise resulted in a proposal of modifications with the view to make the service a tight fit with the profiles of individual customers and their needs. The interviews focused namely on the technology, access capacities (speeds), optimal configuration of the service availability guarantee and the offer of add-on services. The retail giant Kaufland with almost one hundred outlets was one of the major new acquisitions in the second half of the year.

In April, Telefónica O2 started offering a new service branded as O2 Clean Internet, which gave a professional level of protection against malicious code to any computer network which was connected to the internet through the infrastructure of Telefónica O2. The service O2 Clean Internet could be installed on most types of internet connection offered by the Company (symmetric/asymmetric xDSL lines, IOL Ethernet, VPN Expres, etc.). The professional solution considerably reduced the occurrence of malicious code (malware, spyware) and viruses in local networks and at the same time gave the users all the necessary tools to monitor and manage the security of the online interface and filter out unwanted internet traffic. The solution did not require any modifications on the part of the customer's infrastructure as the whole service was operated from the O2 data centre and did not pose any capacity demands on the customer's network. The price was CZK 500 per internet connection.

Customers of O2 TV could enjoy two innovations from Telefónica O2 introduced on 1 October 2010. All users of the virtual Video on Demand home movie rental function could watch all films in the New Releases section at a discount of CZK 25, and films for children at a discount of 25%. Ten new channels were added to the programme offer of O2 TV, making the total of 81 digital channels. The channels were activated automatically and free of charge, depending on the customers' choice of package.

On 15 October, Telefónica O2 presented its innovated O2 TV concept. From that date onwards, all customers could pick and mix channels as per their preference and needs to make the basic package which is now called O2 TV Flexi. This package containing automatically 20 channels of choice could be supplemented with two add-on theme packages with up to 19 additional channels for the price starting from CZK 400 (if fixed internet access is subscribed simultaneously), or from 550 (concurrently with fixed voice) or CZK 650 (standalone price). Naturally, any number of add-on theme packages from the 'menu' could be on top of the basic O2 TV Flexi. The more packages were subscribed, the bigger the savings. Every second package cost CZK 50 less; the maximum discount was CZK 150. If the channel selection no longer suited the customer, they could re-configure it every 30 days free of charge.

Machine-to-Machine (M2M) communication was among the most dynamically growing business areas in 2010. During the second quarter of the year, Telefónica O2 started offering IP Connect M2M, a service supporting the communication between metering equipment and other technology with customer networks. It is a service relying on a low-capacity fixed data connection with a high degree of availability, especially when combined with mobile back-up. The transmission capacity requirement of this service is on the same par with ATM machines, metering and surveillance equipment. The Company developed its M2M proposition further by offering remote access to fixed networks. Telefónica O2 also came out with a special mobile tariff O2 Machine to meet the demand from customers for a capped cost of data transmission within mobile M2M solutions. It was the first service offering a comprehensive M2M solution and other standardised add-on services, including remote equipment control, self-activation of services or a complete range of Software as a Service applications. O2 Car Control was the first M2M service which spanned the whole value chain and naturally it was met with an enthusiastic market reception.

The portfolio of O2 Car Control services was expanded in the first quarter of the year. The new service, Personal Control, makes it possible to monitor employees working in the field for their greater safety and also to optimise the effectiveness and quality of their work. Leaflet distribution, working in hazardous or difficult conditions or community work were the typical areas in which the service was put to good use.

Convergent services

In 2010, Telefónica O2 innovated its successful concept of consumer services which had been launched in May 2009. It is based on fixed broadband ADSL access (O2 Internet, Internet Home). These tariffs let the customer choose freely and flexibly from a diverse portfolio of fixed and mobile services, and benefit for example from a combination of fixed broadband with O2 Mobile Internet, O2 TV digital television, O2 Calling or the mobile tariffs O2 NEON. Greater efficiency and the focus on the customers' needs were the mark of Telefónica O2's convergent market offer. During the course of the year, the combined services were gradually gaining popularity among the customers of Telefónica O2. The convergent concept also allowed for effective routing and managing data traffic from customers, which delivered additional efficiencies in the utilisation of fixed and mobile data networks.

From September 2010, corporate customers of Telefónica O2 were invited to take full advantage of what a truly convergent operator could offer. O2 Team Combi, a solution for company mobile communication, gave customers the ultimate availability through the redirection of fixed line calls to a mobile number or the other way round, and made it possible to implement corporate communication rules (call bans and restrictions, company numbering plans, tagging of private calls, etc.). O2 Team Combi could be installed with every voice service; prices started from CZK 1 per month.

Starting from the third quarter of the year, Telefónica O2 offered a mobile back-up solution to its fixed service, internet access and data VIP service customers; the new service ran on all mobile networks (UMTS, EDGE, CDMA, GPRS), and together with the widest fixed data network coverage, a number of technologies to choose from and the added benefit of the mobile network, Telefónica O2 offered to its corporate customers an unprecedented guarantee of quality of data communication, with higher availability and guaranteed access even when the network was experiencing problems. The offer of convergent services included also a fully mobile access to the corporate fixed data network, which has the benefit of integrating highly mobile, temporary sites or locations that are outside the reach of the fixed line network into the customer's ICT systems.

Payment services

Telefónica O2 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 2010, was opted for on average by 521 thousand customers per month. 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 754, up 19.9% year on year. The total of funds used to pay for goods and services, via the two aforementioned methods of payment, reached CZK 722 million in the Czech market in 2010. Customers could also opt for Datarif (a dial-up data transfer).

In autumn 2010, Telefónica O2, in collaboration with other mobile operators, members of the Association of Mobile Network Operators, launched a new campaign in the Czech market – '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. The service, O2 Payment, has been in Telefónica O2's portfolio since October 2010.

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.

ICT services, solutions for business and for the government

As in the other segments of its business, also in ICT and business and government solutions, Telefónica O2 began to see the first signs of recovery in the economy. Furthermore, after the parliamentary elections in the Czech Republic, the new cabinet commissioned a review of cost-effectiveness in the public sector, with the aim to close the state budget deficit by way of reducing government spending. This resulted in a lower number of ICT projects in which the Company participated. Despite challenges of the economic situation, Telefónica O2 confirmed its position as a reliable and efficient partner to the government's needs for telecommunications and comprehensive ICT solutions.

The Company successfully forged ahead with its systems integration project at the Ministry of Agriculture, participated in projects for supporting ICT operations at the State Agricultural and Intervention Fund, Ministry of Transport and the Office of the Government Representation in Property Affairs.

In 2009, Telefónica O2 engaged in partnership with the Czech Post to provide technology for the Data Box Information System (ISDS), the flagship project in the field of eGovernment. The data boxes are used as a data repository and to deliver official digital correspondence from the authorities and for making certain acts with regard to them. The volume of transactions carried by the system in the form of data messages in 2010 exceeded 27 million.

In line with its eHealth strategy, Telefónica O2 started a pilot operation of a new service O2 Emergency Care, which was implemented in partnership with the town district of Prague 10. The service is to benefit namely senior citizens who live with a constant risk to their life or health. After pressing a button on the handset, the user is automatically connected to a helpdesk staffed with operators who are qualified according to the relevant legislation in the area of social services.

The year 2010 also saw the live launch of Pilsen Card in a Handset, which is an equivalent to the plastic multifunctional smart card of the Pilsen Municipal Transport Company. The project relies on NFC (Near-Field-Communication), which allows for the integration of the Pilsen Card in selected mobile handsets. Telefónica O2 implemented this project in partnership with other external suppliers.

Interconnection

The year 2010 saw, in the area of network interconnection, a further wave of consolidation of the Czech telecommunications market. This trend was propelled also by the transfer of a significant portion of the activities of České Radiokomunikace to T-Mobile, which spurred the ADSL broadband internet market. T-Mobile used the metallic cables unbundled by Telefónica O2 to provide the service. On the other hand, another major service provider, VOLNÝ, a.s., commenced a retreat from the residential fixed broadband market.

In the area of fixed public electronic communication networks, particularly GTS Czech, T-Mobile, Dial Telecom and RIO Media pursued acquisitions which resulted in the strengthening of their respective market positions.

Mergers and acquisitions in the electronic communication markets raised the need for changes in the fixed network interconnection between Telefónica O2 and other licensed operators. No changes were implemented in the mobile network interconnection between Telefónica O2 and other mobile service providers.

At the end of 2010, the fixed network of Telefónica O2 was interconnected with sixteen networks operated by other licensed entities. Telefónica O2's mobile network in the Czech Republic was interconnected with the networks of three other mobile operators and with twelve fixed public electronic communication networks.

The share of customers using the services of other operators relying on the Wholesale Line Rental (WRL) service from Telefónica O2 saw an increase in 2010. Carrier Selection/Carrier Pre-selection (CS/CPS), on the other hand, gradually lost importance as the number of subscribers stabilised and no major fluctuations in the numbers of activations occurred.

National wholesale services

The trend, which in the area of national wholesale was evident already in the previous year, eventually culminated in 2010. The unfavourable macroeconomic climate accelerated the already ongoing consolidation of the telecommunications market.

Despite the fact that the economic reality called for more stringent cost control and a number of economizing measures, mobile operators followed the strategy of Telefónica O2 and innovated their service portfolios and continued to roll out their 3G networks in an effort to satisfy the growing demand for mobile internet and internet in handset.

These market developments spurred the demand for Telefónica O2's wholesale services, especially its backbone network capacity. In collaboration with T-Mobile, Telefónica O2 commenced the preparation for 3G network sharing, a project to save costs to both companies and accelerate the deployment of the network.

With a strong campaign of T-Mobile in the consumer fixed broadband market, Telefónica O2 recorded an increase of wholesale ADSL connections, whose number went up by 22,000 to the total 70,000.

The demand for Ethernet-based data services also continued to grow. The Company responded by increasing the coverage and innovating its product portfolio in favour of higher speeds. The interest in services with higher transmission capacities of 1Gbit/s and greater also increased.

International wholesale services

In the area of international data and internet services, Telefónica O2 responded to the growing demand for international transmission capacity by acquiring a sufficient capacity reserve. As in the previous year, also in 2010 the Company saw a rising demand for high capacity international leased lines (Lambda 2.5 and 10 Gbps), and the volume of sales increased accordingly. Likewise, international IP connectivity was up, as was the demand for Ethernet-based services.

In the area of international voice services, Telefónica O2 continued to strengthen its market position in Central and Eastern Europe. The Company forged ahead with interconnecting its networks directly with those of other European fixed and mobile operators in Europe and beyond, with a focus on Russia, Near and Middle East. The transit voice traffic recorded a 12% increase on 2009, and reached a record-breaking mark of close to 1.7 billion minutes.

Also in 2010, Telefónica O2 maintained a high quality of voice services. Vodafone Germany recognized the Company as the international operator with the best quality of service.

In the area of international services, the Company closely cooperated with the international operator TIWS (Telefónica International Wholesale Services), which is a part of the Telefónica Group.

Comments on the financial results

In this section we present and comment on the consolidated financial results of the Telefónica O2 Group prepared in accordance with International Financial Reporting Standards (IFRS).

Consolidated financial results

Revenues, Operating Costs and OIBDA

The consolidated revenues reached CZK 55.7 billion in 2010, down 7.0% year on year. Gains from the sale of non-current assets reached CZK 92 million in 2010, compared to CZK 422 million in 2009. As described in 2009 Annual Report, in 2009 the Company sold its former headquarters with a one-off gain of CZK 342 million. The total consolidated operating costs declined 1.8% year on year, reaching CZK 33.4 billion in 2010, as a result of strict financial discipline and the booking of several non-recurring items.

As a reaction to uncertain and potentially negative developments in the telecommunication market and the regulatory environment, in 2003 ČESKÝ TELECOM (predecessor of Telefónica O2 Czech Republic) booked an impairment loss of CZK 9,909 million from fixed line assets which constitute a cash generating unit (CGU). Since then the impairment tests were performed annually. The most recent impairment test performed as at 30 June 2010 took into account the Company's fixed broadband and data focused strategy, enhanced fixed network performance as well as the continuous synergies from integration with the mobile segment, and resulted into an impairment loss reversal of CZK 4,344 million, which amount was positively reflected in OIBDA.

Consequently, with the help of the above item, the consolidated operating income before depreciation and amortization (OIBDA) increased by 1.1% reaching CZK 27.4 billion in 2010. Without the impact of the impairment reversal, OIBDA would have declined 14.9% year on year in 2010 to CZK 23.0 billion; the decline was driven by the lower revenues and non-recurring items booked in 2009 and 2010. Comparable OIBDA[1] decreased 6.7% year on year to CZK 24.5 billion in 2010, while comparable OIBDA margin[2] reached 44.1% in 2010, which was basically a flat year on year trend (2009: 44.2%). OIBDA adjusted for guidance[3] decreased 8.4% year on year and reached CZK 24.1 billion in 2010, which was within the guidance range of -5% to -9%.

Depreciation and Amortization

The consolidated depreciation and amortization amounted to CZK 11.9 billion in 2010, resulting in a 1.2% decline year on year. The impairment reversal led to an increase in the depreciation and amortization by CZK 316 million in 2010.

Operating Income, Income before Tax and Net Income

The consolidated operating income and consolidated income before tax went up 3.0% year on year and reached CZK 15.5 billion and CZK 15.3 billion, respectively, in 2010, largely due to the above-mentioned impairment reversal. Without the item factored in, operating income and income before tax would have declined 23.7 % and 24.1% year on year, respectively, driven by the declining OIBDA and slightly higher net finance expenses, which were not fully compensated by the lower depreciation and amortisation charge. The consolidated net income amounted to CZK 12.3 billion in 2010, up 5.3% year on year, due to the combination of the above-mentioned factors. Excluding the impairment reversal, the net income would have declined 22.7% to reach CZK 9.0 billion.

Cash and Debt levels

On 31 December 2010, the Group's consolidated financial debts (long-term and short-term) amounted to CZK 3.0 billion, down 3.4% compared to the 2009 year-end. The amount of cash and cash equivalents reached CZK 4.8 billion as at the end of 2010, compared to CZK 1.3 billion the year before. The combination of cash and debt balances resulted in a net leverage[4] of -2.4% and a gross leverage[5] of 4.1% as at the end of 2010, compared to 2.5% and 4.2%, respectively, as at 31 December 2009.

Capital Expenditure

The total consolidated capital expenditure amounted to CZK 5.7 billion in 2010, down 12.7% year on year. As in the previous years, 2010 investments were selectively targeted at the growth areas of the business. The expansion of mobile broadband networks (EDGE and UMTS), enhancement of the fixed broadband network and upgrades to the information systems ranked among the key investment priorities in 2010.

---

[1] OIBDA excluding royalty fees and management fees (2009: CZK 754 million, 2010: CZK 1,057 million) and non-recurring items (2009: universal service, gain from real estate and settlement agreement with T-Mobile totalling CZK 1,548 million; 2010: universal service, restructuring costs and impairment reversal totalling CZK 3,915 million).

[2] Comparable OIBDA over Comparable business revenues (business revenues excluding universal service: 2009: CZK 367 million; 2010: CZK 47 million).

[3] In terms of 2010 guidance calculation, OIBDA royalty fees and management fees (2009: CZK 754 million, 2010: CZK 1,057 million). In addition, 2009 OIBDA base excludes non-recurring items (settlement with T-Mobile, universal service and gain from real estate sale) totalling CZK 1,548 million and 2010 OIBDA excludes non-recurring items (universal service and impairment reversal) totalling CZK 4,373 million; 2010 guidance assumes no changes in consolidation and constant FX rates of 2009.

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

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

Cash Flow

The total consolidated free cash flows[6] increased 21.2% year on year and reached CZK 16.4 billion in 2010, largely due to the lower amount of paid taxes (down 40.1% year on year) and the lower payments on investments in property, plant and equipment and intangible assets (down 34.9% year on year to CZK 5.5 billion).

Overview of consolidated revenues

The total consolidated revenues in 2010 reached CZK 55.7 billion, down 7.0% year on year, mainly due to further cuts in mobile termination rates, the slow economic recovery impacting on customers' spend patterns and the lower-than-expected revenues from IT and business solutions due to the lower number of projects in the public sector segment.

The total consolidated voice revenues (voice-outgoing, interconnection and other wholesale services, monthly and one-off charges from voice services and connection charges) amounted to CZK 34.4 billion in 2010, down 11.1 % year on year.

In the highly penetrated mobile market in the Czech Republic, the total active mobile customer base decreased 2.1% year on year down to 4,839 thousand at the end of 2010. This performance has been impacted to a large extent by one-off disconnection of 111 thousand inactive contract customers in the second quarter of 2010. Excluding the effect of the one-off disconnection, the customer base would have increased 0.1% year on year. The number of contract customers went up 1.7% year on year, reaching 2,864 thousand at the end of 2010 (+5.7% year on year, discounting the impact of the disconnection of inactive accounts). Consequently, contract customer net additions reached 160 thousand in the year (excluding the disconnections). The solid performance was driven by the continuous growth of O2 NEON tariffs, customer migration from the prepaid to the contract segment and a solid uptake of mobile broadband customers. At the end of 2010, contract customers represented 59.2% of the base (+2.3 percentage points year on year). The number of prepaid active customers reached 1,975 thousand at the end of 2010, down 7.3% year on year.

The blended monthly average churn rate reached 2.4% in 2010, posting a 0.3 percentage point year on year increase mainly due to the disconnection of inactive accounts the contract customer base. In the fourth quarter of 2010, however, the churn rate declined 0.2 percentage points down to 2.2%, which was facilitated by the improved churn of prepaid customers.

In terms of usage, mobile traffic[7] carried in the Czech Republic grew 6.8% year on year to 8,790 million minutes in 2010.

In 2010, blended ARPU[8] reached CZK 468.5, down 8.1% year on year, impacted largely by MTR cuts. However, the year-on-year decline of ARPU decelerated during 2010: from 11.2% year on year in the first quarter to 6.0% year on year in the fourth quarter 2010, which is attributed to the ongoing stabilization in the customer spend. Not including the impact of the MTR cuts, ARPU would go down 6.6% in the first quarter, 3.7% in the second quarter, 3.5% in the third quarter and 1.9% in the fourth quarter. Contract ARPU reached CZK 659.7 in 2010, down 11.4% year on year, while the rate of decline in the fourth quarter slowed down to 8.5% year on year and closed at CZK 643.5. Customer migration from prepaid to the contract tariffs and MTR cuts continued to drive contract ARPU dilution. The prepaid ARPU decreased 7.8% year on year down to CZK 206.0 in 2010 with just a 5.4% drop to CZK 212.3 in the fourth quarter. The data ARPU was down 4.1% year on year to CZK 120.1 in 2010, and in the fourth quarter saw a year-on-year improvement of 2.7% to CZK 123.1.

[6] Net cash from operating activities and net cash used in investing activities.
[7] Inbound and outbound, excluding inbound roaming and roaming abroad.
[8] Including inter segment revenues.

The total number of fixed accesses operated in the Czech Republic declined 5.7% year on year to 1,669 thousand as at the end of December 2010. Compared to 2009, the number of net losses decelerated 17.4% to 101 thousand in 2010 (2009: 123 thousand), a trend propelled by a healthy demand for naked access and the increasing number of VoIP lines installed for corporate customers.

Voice traffic generated in the fixed network went down 13.1% year on year in 2010 to 1,741 million minutes as a result of continued fixed telephony lines losses and fixed to mobile substitution.

The total number of active mobile customers in Slovakia reached 880 thousand at the end of December 2010, up 59.2% year on year, with 99 thousand net additions in the fourth quarter (+10.6% year on year). Additionally, in absolute terms, Telefónica O2 Slovakia considerably grew its customer base by the figure of 328 thousand in 2010, posting a 44.0% year-on-year growth. The number of contract customers was up 71.0% year on year, reaching 334 thousand at the end of 2010, while the number of prepaid active customers increased 52.8% year on year, closing the year at 546 thousand. Consequently, contract customers represented 38.0% of the total customer base at the end of 2010, up 2.6 p.p. year on year. Contract ARPU reached EUR 19.0 in 2010, while prepaid ARPU stood at EUR 8.5.

Consolidated revenues from monthly and one-off charges from voice services went down 11.8% year on year to reach CZK 13.6 billion in 2010. The decline was driven mainly by the lower number of fixed telephony accesses and the impact of the new concept of services for the consumer segment, which is based on a broadband proposition, including naked ADSL. The revenues from the mobile segment declined only slightly; the decline reflected the preference of contract customers for lower-priced voice tariffs.

Revenues from outgoing voice reached CZK 11.9 billion in 2010, down 9.8% year on year due to the lower volume of voice traffic generated in the fixed network, the higher proportion of mobile customers on semi- and flat-rate based tariffs and lower roaming revenues.

Revenues from interconnection and other wholesale services declined 10.4% year on year to CZK 8.9 billion in 2010 as a result of namely the 28.1% reduction in MTR and lower revenues from roaming visitors, which have not been fully offset by the marginal growth in international transit services in the fixed line segment.

Revenues from SMS & MMS & value added services were down 2.7% year on year to CZK 4.8 billion as a result of a higher proportion of SMS revenues being included in the monthly charges for O2 NEON tariffs and the higher number of customers subscribing to these tariffs. In 2010, O2 customers in the Czech Republic sent 2,477 million SMS in total, which represents a 2.5% year on year increase.

Revenues from leased lines and fixed data services went down 10.7% year on year to CZK 3.1 billion, mainly due to lower revenues from leased lines, which were not fully compensated by a growth in IP based data services.

Revenues from internet (including monthly and one-off charges), mobile data and IPTV grew 12.6% year on year in total and reached CZK 8.3 billion in 2010, largely as a result of the positive reception of the new broadband-centric (naked ADSL) proposition by the market and the growth of the O2 Internet customer base. The total number of ADSL accesses reached 806 thousand at the end of 2010, up 11.1% year on year, with 81 thousand net additions recorded in 2010. In the fourth quarter, the company reported 29 thousand ADSL net additions, helped also by the upswing in wholesale accesses. The total number of O2 TV customers reached 129 thousand at the end of 2010. Additionally, from the second half of 2010, this revenue stream has been positively impacted by a growing contribution of mobile internet revenues driven by the growing demand for mobile broadband. This was a result of our successful marketing campaign promoting the advantage of mobile broadband networks for customers.

Consolidated revenues from IT and business solutions went down 7.4% year on year to CZK 2.6 billion, largely due to a year-on-year decline in the number of public sector projects in the second half of the year. Revenues from equipment and activation fees declined 4.7% to CZK 1.5 billion due to lower sales of handsets and other equipment. Other telecommunication revenues went down 6.7% year on year to CZK 915 million, to which the lower revenues from Universal Service (2009: CZK 367; 2010: CZK 47 million) contributed.

Overview of consolidated operating expenses

The consolidated operating expenses of the Telefónica O2 Group declined 1.8% year on year and reached CZK 33.4 billion in 2010 as a result of our strict financial discipline implemented by the Company to offset, to the maximum degree possible, the declining revenues and the impact of several non-recurring items. While in 2009 the consolidated operating expenses have been positively impacted by the settlement agreement with T-Mobile (CZK 1,027 million), in 2010 the redundancy payments related to the Company's restructuring programme (CZK 458 million) became more prominent in the context of the operating expenses. Excluding these two items, the consolidated operating expenses would decline 6.0% to CZK 32.9 billion in 2010.

The interconnection and roaming expenses declined 10.3% year on year to CZK 10.2 billion in 2010, in line with the interconnection revenues; this was mainly due to the MTR cuts and lower roaming prices. The cost of goods sold fell 16.8% year on year to CZK 1.9 billion in 2010, as a result of the lower handset sales and the lower average cost of equipment. Other costs of sales, which comprise the costs of contents, sub-deliveries, the customer loyalty program, telecom services and other cost of sales, decreased 27.5% in total and reached CZK 1.8 billion in 2010. The costs associated with the Universal Service in 2010, together with the lower revenues and lower sub-deliveries for ICT projects, were the key drivers of this trend.

The total personnel costs including redundancy payments amounted to CZK 7.1 billion in 2010, which is 0.7% higher year on year compared to 2009. Not accounting for redundancy payments booked in relation to the restructuring programme (CZK 458 million), personnel costs would go down 7.1% year on year. The total number of Group employees reached 7,522 as at 31 December 2010, down 13.4% year on year. The headcount of Telefónica O2 was reduced 13.4% year on year, down to 6,936 as at the same date, of which some 50% related to the outsourcing in network area.

The marketing and sales expenses (marketing and commissions) declined 6.1% year on year in total, down to CZK 2.6 billion in 2010, as a result of the Company's continuous effort at efficient marketing expenditure. The network & IT repairs and maintenance expenses increased 3.9% year on year to CZK 2.5 billion, largely as a result of the outsourcing of network-related activities. Rental, buildings and vehicle costs reached CZK 2.2 billion, up 1.7% year on year, while the costs of utilities were down slightly (1.4% year on year) and reached CZK 1.1 billion in 2010. Other external expenses (billing and collection, call centres, consultancy and professional fees and other external expenses, including royalty and management fees), and other operating expenses, reached CZK 2.8 billion in 2010, 1.3 times higher year on year, largely due to the settlement agreement with T-Mobile reached in 2009. Excluding this item, this expenditure category would increase 25.5% year on year, driven by the higher cost of call centre operation, as a result of the Company's campaign to improve the quality of customer experience.

Taxes (other than income tax) and provisions for bad and doubtful debts and inventories increased 16.1% year on year in total and reached CZK 1.1 billion in 2010, and were impacted by a review and adjustment of the bad debts provision policy in 2009 based on the success rate of collection on accounts receivables.

The outlook for 2011

In 2011, Telefónica O2 Group will continue to focus closely on its customers - by further improving and strengthening its relationship with the customers through better quality of service and offering new products to meet the customers' needs. The primary goal of these initiatives is to offer a best-in-class customer experience and level of satisfaction. In particular, the Company will continue with its innovations to the fixed broadband value proposition; by introducing VDSL-based services it plans to stabilize fixed access losses and maintain competitiveness. In line with its 3G coverage expansion strategy, and thanks to its recently signed 3G network sharing agreement with T-Mobile, the Company intends to introduce an innovated proposition of mobile broadband and data services to the market. In 2010, Telefónica O2 built up a competitive advantage of having the widest quality 3G network coverage. In 2011, the Company will aim to retain this advantage and increase the number of mobile broadband and data customers, hence improving the respective share of this segment in the total mobile revenues.

Telefónica O2 Slovakia will continue in the active marketing of its 'transparency, value and simplicity' customer proposition. By doing this, it plans to further improve its financial performance and profitability while maintaining a solid rate of growth of its customer base.

The group does not have a full visibility of its revenues performance in 2011. It expects that ICT revenues could continue to be under pressure of the lower-than-expected number of projects in the public sector. In addition, mobile revenues will be hit by additional MTR cuts (-35% in 2011). The Company will persevere with its effort to tap into efficiency reserves in the area of operating and investment expenditure, while investing prudently in areas where investment generates value for the customer and maximizes cash flow generation, which remains one of the primary goals for 2011.

In 2011[9], the Group expects OIBDA[10] to decline within the range of 1% and 5% and CAPEX to be around CZK 5.7 billion.

[9] 2011 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2010.

[10] In terms of 2011 guidance calculation, OIBDA excludes royalty and management fees (2010: CZK 1,057 million). In addition, 2010 OIBDA base excludes reversal of the impairment loss of CZK 4,344 million.

03

Corporate Social Responsibility (CSR)

A great place to work

03

Corporate Social Responsibility (CSR)

Also in 2010, Corporate Social Responsibility and Sustainability continued to form an integral part of the corporate structure and strategy of Telefónica O2. During the whole course of 2010, the Company considered the impact of its activities on the external environment, strived to involve all stakeholders and satisfy all Company's needs which have arisen from the developments in the marketplace. Telefónica O2, as the leading provider of telecommunications services in the Czech Republic, tried to leverage its market position of the benefit of the needy. Building of trust, win-win partnerships and a dialogue with all stakeholders were the pillars of the Company's CSR policy. By joining all these pillars in its CSR policy, the Company tried to achieve maximum effectiveness, help and support.

Ernst & Young performed an audit across the Telefónica Group, which examined key CSR areas (environment, ethics, employee relations, customer relations, supplier relations and community relations). The audit conclusions were used in the planning of goals and action plans for the year ahead. CSR objectives were presented to the Company's Board of Directors and Ethics and Corporate Social Responsibility Committee, which supervises the process of execution of CSR activities.

A group-wide survey focused on the perception of Telefónica O2 in the eyes of the public, the so-called RepTrak, was carried out on an ongoing basis during the whole year. The survey helped to define CSR priorities and manage the Company's reputation.

Business Principles

Corporate culture and reputation are among the priorities of the Telefónica Group, and in 2010, too, Telefónica O2 paid a lot of attention to the development of an ethical environment and of its good reputation in this area. An online course on Business Principles, which was opened for the whole year, formed a part of the employee's curriculum; as at 31 December 2010, 89% of all employees, including a number of third-party personnel, have completed the course.

Employees have the duty to report unethical conduct which they may come across; the Company guarantees anonymity for the whistleblower. Telefónica O2 prepared an awareness raising campaign to promote available confidential help tools. Employees can report unethical conduct in several ways: they can choose between an online application, e-mail, letter, or make their report by calling (alternately, outside working hours, leaving a voice message) or a personal filing with the Corporate Governance Office. Employees have also the option to approach consultants, professionals from Human Resources, Security and Legal Affairs. The reports are investigated by Security or Internal Audit. 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 O2 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 Rules and employees are required to comply. The brochure Business Principles is given to every new employee upon their commencement of employment and it can also be downloaded from the Company's intranet and website.

The Business Principles assert that Telefónica O2 is a company that is equally open, trustworthy and transparent towards its people and the customers. A natural move for the Company was therefore to join the Coalition for Transparent Business; by joining, Telefónica O2 publicly espoused its ethical values. In 2010, the Company was one of more than twenty founding members of the Coalition for Transparent business. By the end of 2010, the Coalition had more than thirty members from the ranks of Czech and multinational companies from all sectors. The Coalition will continue its close cooperation with the Platform for Transparent Public Procurement, which is an association of political parties, industry associations and public institutions, and is involved in the drafting of the amendment to the Public Procurement Act. This is yet another way in which Telefónica O2 wants to make a contribution, alongside other major businesses and institutions, towards the development of an environment built on ethical principles in the Czech Republic.

Market conduct and customer care

Customer Experience

In 2010, Customer Experience became the key pillar of the Bravo! Programme. In Telefónica O2, customer experience translates into four customer promises:

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.

In 2010, the above became a yardstick by which new and existing products and services were measured; existing products and services were modified to reflect our philosophy. Its execution, and the overall quality of customer experience, was monitored by the Company using a number of regular or one-off surveys. The main one, Customer Satisfaction Index (CSI), showed a positive trend in all segments.

The consumer segment showed a marked improvement in the quality of customer care at call centres. The priority was to ensure a high availability of the call centre and that the customer's request is adequately resolved at the first call. Customers who could not reach the call centre during the time when the call centre was handling an increased volume of traffic could opt for a call-back. To improve the quality of care for small business customers, Telefónica O2 implemented the so-called 'virtual agent', to accelerate targeted referral to qualified operators. During the year, SOHO and medium business segments were merged, and the corresponding service model was modified, which occurred without any negative impact on customer experience. The medium business segment enjoyed an innovation of the so-called 'business partners', personal account managers giving medium businesses individual care.

The Company also focused on reducing the wait times in its brand stores. The installation of Queue Management Systems and the scaling of capacities to the traffic and other operating considerations delivered a reduction in the number of people leaving without service. At the beginning of the year, a system to measure feedback from customers served by our retail network was implemented, and the results were used to improve the quality of care and the effectiveness of customer care, and to eliminate the causes of dissatisfaction of customer, which related, for example, to the accuracy of order taking. The Company also introduced a concept of the so-called 'in-store SME specialists' who gave this customer segment specialised care.

With regard to fixed service delivery and repair, the Company focused on keeping the promised installation dates and on active communication with the customer during the process of handling of the request. Telefónica O2 implemented a new process of fixed service delivery, which included a specialised back office team which took over the responsibility for the end-to-end handling of the request, while the sales channels now focus mainly on the taking of the order. Telefónica O2 also implemented a new simplified claims handling process at the front office level. At the same time, the year 2010 saw the elimination of some of the causes of frequent complaints, which produced a reduction in the number of unwanted calls to the call centre and a drop of approximately 30% in the number of claims. In the area of online services, the Company debuted its new website www.o2.cz and held an active presence in social networks (Facebook, Twitter).

In the corporate segment, the Company phased out its IVR system and the live operators were able to answer more than 95% of calls within 15 seconds.
The lead time of service delivery, especially of mobile services, was shortened to 'next-day delivery' based on the feedback from corporate customers.

The POTR project, a part of the BRAVO programme, reviewed the causes of the frequent errors in invoices. The result was a change in the work procedures, modifications of systems, reduction of claim handling lead times, implementation of quality assurance processes and more information for the customer. At the same time, the product portfolio was simplified and many customers were migrated from old tariffs to the new ones.

The satisfaction of corporate customers has been rising steadily every month since the beginning of the year; the biggest improvement could be seen in claims handling and service delivery. The customers were also much more satisfied with the quality of commercial relations and the quality of contact with the call centre.

Products and services for people with special needs

In 2010, Telefónica O2 focused on helping and supporting people with special needs, especially senior citizens and people with disabilities, by making their communication easier.

The Company launched Aligator, a new version of special handset for senior citizens. Aligator is exceedingly simple to operate, especially for senior citizens and people with disabilities who find it challenging to operate regular mobile devices. The handset had side buttons to facilitate access to the main functions of the telephone, and the control keys were robust, big, and the display of a considerable size is well lit for better recognition of characters and digits. The price, too, was lower compared to the predecessor product.

Telefónica O2 improved its offer and marketed this device to customers at a special promotional price. The pre-paid offer contained the handset Aligator A400 and a SIM card with a credit of CZK 100. Every such set also came with a gift – the brochure The Internet School for Senior Citizens. The post-paid option offered the handset for the symbolic price of CZK 1 together with the purchase of O2 Neon Senior tariff.

Deaf Call

Also in 2010, Telefónica O2 continued to operate Deaf Call, a service which lets deaf or partially-deaf customers really communicate in the case of emergency or in various life situations – when making a medical appointment, ordering a repairman or consulting directory services. The service helps people who are deaf or hard of hearing communicate with the hearing and the vice versa. Specially trained operators are available 24/7. The Company has been offering this service free of any charge from the beginning of 2010. During the course of the year, the operators handled 13,438 calls; fax, e-mail, ICQ, SMS and the fixed line were the most popular options for communication.

Discounts

In 2010, Telefónica O2 continued to provide a discount on O2 fixed line service to people with a dependency of the 1st degree – in spite of the fact that the Czech government no longer subsidises the discount. The Company also preserved the option for people with disabilities to rent a special telephone set.

INSPO 2010 conference and the competition Internet and My Handicap

In 2010, Telefónica O2 was became the general partner of the 10th INSPO conference 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 Internet and My Handicap, whose results were announced at the INSPO conference.

Floods in 2010 – emergency response

In the summer of 2010, Telefónica O2 responded to the emergency brought on by floods and, again, decided to provide relief to people stricken by the disaster. The Company prepared special programmes and services to help them address the situation: a free-of-charge issue of a new SIM card with the same telephone number; a discount of up to CZK 1,000 against the purchase of a new mobile handset or fixed line telephone set, ADSL or ISDN modem or a set-top box for O2 TV. Furthermore, customers could arrange for a postponement of the due date for their bills for contract mobile and fixed-line services, by up to a quarter of a year. The collection of receivables, which existed prior to the floods, was also suspended, and the numbers with restrictions on service due to non-payment were restored to full service.

Telefónica O2 also offered a 50% discount on mobile calls within the Czech Republic for the duration of two billing cycles. Pre-paid customers could claim an extra CZK 100 credit for a period of 6 months. Telefónica O2 at the same time organised an employee fundraiser to help the victims of floods, and match the total amount of employee donations with an equal amount from its own pocket. The O2 Foundation presented the total donation of CZK 1,423,706 to the People in Need Foundation, which is its longstanding partner in emergency relief operations in the event of natural disasters, etc.

We help to guide children through the world of communication technology

As a provider of communications services, Telefónica O2 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.

Telefónica O2 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. In 2010, the Company also started blocking websites with child pornographic content. All websites that were made illegal in all EU countries were blocked in the O2 network.

Supporting campaigns to benefit children

In February 2010, 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 identity protection in online environments and which was called 'Think B4 U Post'. Telefónica O2 was also member of an advisory committee of the Saferinternet project.

In June 2010, Telefónica O2 gave its support to an expert conference organised in the seat of the Senate of the Czech Parliament by the National Centre for Safer Internet. The conference focused on the issues of cybercrime prevention, especially with regard to children. The event was organised under the auspices of the 1st Vice-chair of the Senate PaedDr. Alena Gajdůšková, JUDr. Miroslav Antl, Vice-chair of the Constitutional Law Committee of the Senate and RNDr. Igor Němec, President of the Personal Data Protection Office.

In September 2010, the Company prepared and had printed, on recycled paper, a brochure to inform and warn parents '(Teach Your Children) Surf Safely', which explained the risks of children surfing online and gave tips to parents how to effectively mitigate those risks. The brochure was distributed via the network of O2 brand stores and as a supplement to the employee bulletin O.pen; it was also available from the Safety Line.

In November 2010, Telefónica O2 gave its support to the International Safer Internet Conference, this time headlined 'Safer Cyberspace: European Inspiration and Czech Experience'. Fourteen speakers (including a representative from Telefónica O2), of which five were international guests, spoke at the conference. The conference provided a common platform for the public sector and business to discuss the issues of computer security and online safety.

The end of 2010 saw already the 8th 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 O2 was the general partner of the event.

Caring for employees and the workplace environment

It is the Company's long-term strategy in the area of human resources to make O2 'a place which is a pleasure to work at'. In autumn 2010, a new 'charter' between the Company and its employees was agreed, 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.

Employee structure

	As at 31 December 2010
Employees total	6,936
of which women	36.2%
of which men	63.8%
of which employees with physical handicap or disability	1%

Employees by division

Organisation unit	As at 31 December 2010
Business Division	957
Consumer Division	2,028
Operations Division	2,647
Corporate Affairs	13
Strategy and product development	301
Human Resources	73
Support Units	312
Finance Division	297
Legal and Regulatory Affairs	42
Internal Audit & Risk Management	15
Marketing Division	201
Office of the CEO	4
DHL	46
Total	**6,936**

Employee engagement

Reflect

The interest and motivation of employees to participate in the employee satisfaction survey stayed at 90%, as was the case in the previous year. The overall Reflect index stayed at the level of the year 2009. The management considered the outcome as good, especially with regard to the fact that many important changes occurred during the year. Several surveyed areas showed a positive trend, including the Top Management index, which however remains an area with the biggest room for improvement, especially in terms of effectiveness. My Manager, My Work and Atmosphere indices remain among the strong points of Telefónica O2.

Getting closer to the customer

In 2010, the Company introduced a new 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 240 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

The Company wants its 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. This feedback channel was piloted in several divisions during 2010, and the roll-out to all units will continue in 2011.

Spirit of O2 Awards

As every year, also in 2010 Telefónica O2 recognised the best employees at its annual Spirit of O2 Awards. Employees could either nominate themselves or their colleagues whose accomplishments distinguished them from the rest and who helped keep Telefónica O2 at the forefront of the telecommunications market. A new category Employees' Choice, was introduced in 2010; employees voted for the best one from their midst.

Global Bravo Awards

Telefónica's global Bravo strategy introduced Bravo Awards, a model of non-financial reward for employees' contribution towards the achievement of corporate goals.

Work-life balance programmes

Telefónica O2 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. The communication tools (fixed and mobile internet connection and a company mobile telephone) meant that not all activities had to be done from the office. 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.

Education and personal development

Orientation training for new employees

In 2010, 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 84 participants in 2010.

Leadership

Also in 2010, the long-term programme Leading to Excellence continued to build leadership skills of middle and higher managers. The course participants (more than 500 in the four years of the programme's existence) could opt to continue with an additional module, Feedback – the Pathway to Success, which was launched participating managers in 2010 and already had 24. Top managers had a choice of courses at Telefónica Corporate University.

Job Model

A new Job Model, which was the product of several years of intensive work, was implemented by Telefónica O2 in 2010. The Job Model introduced consistency and presented a solid platform for the base salaries in the Company – employees, depending on their job, were assigned to one of six groups and the corresponding salary class, which is tied with a particular rate of bonus, and may have other consequences for the remuneration. The content of the job, i.e. the work that the employee is expected to perform and their job-related responsibilities, is the principal factor for the classification.

Employee shares

In 2010, Telefónica O2 launched a scheme that offers a unique opportunity to invest in the Company's shares and qualify for a bonus if the employees hold the shares for a specified period of time and meet other conditions of the scheme.

Employees may purchase the shares of Telefónica, S. A., every month throughout the year up to the annual limit of EUR 1,200. 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.

Motivation programmes and benefits

Despite the challenging economic reality in the marketplace, Telefónica O2 continued the tradition of offering its employees a wide choice of employee benefits – for example financial products, O2 products and services, benefits promoting health, education and the work-life balance of employees. Employees with reduced work capacity also received a voucher for restorative physiotherapy holiday in the value of CZK 10,000 per year.

Employer of the Year

The Company came fifth in the main category of the 2010 Employee of the Year Awards, and the achieved the highest placement of all IT/Telco companies.

Caring for the environment

Environmental policy

The commitment of Telefónica O2 to keep the footprint of its operations on the environment minimal in 2010 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 O2's fundamental principles of environmental protection were coordinated across the Telefónica Group and helped to deliver on both the group and local objectives and meet the statutory and other conditions.

Green Company

Telefónica O2 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 2010 - its Green Company programme involved employees in protecting the environment

Reducing our environmental footprint

The Company continued in its successful campaign to reduce its negative footprint on the environment. In providing for its operations, Telefónica O2 in 2010 consumed more than 2.5% less electricity, and 7% and 50% less natural gas and water, respectively compared to 2009. Also compared to 2009, the total volume of polluting emissions released into air from heat and power generating sources and from vehicles was also reduced; for instance the consumption of fuel was down more than 20% year on year. The Company also successfully managed its waste generation and again achieved a year-on-year reduction in the volume of generated waste.

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 standard. Telefónica O2 was the only telecommunications operator in the Czech Republic to have this certificate.

Supporting sustainability events

Also in 2010, Telefónica O2 worked to promote principles of active care for the environment within the social area. One of the major campaigns in this respect was the social project Let Your Old Cell Phone Help, the proceeds of which went for the benefit of the Safety Line.

In 2010 Telefónica O2 became the general partner of Open Air Festival, a new all family multicultural project. The organizer Abaton Production and the sustainability partner Bioplaneta organised, together with the Company, the first year of the event. The all-encompassing environmental concept of the festival also meant that 90% of all waste was recycled after the event, and the waste was collected throughout the event, not after it ended as usual.

The festival was entered for the Greener Festival Awards and received the mark 'Commended' (2nd best). Telefónica O2 also received an award for Best Partnership of 2010 in the Top Corporate Philanthropist Awards organised by the Donors' Forum in collaboration with Czech Top 100.

Supporting communities

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

In 2010, the Company took part in the 7th edition of TOP Corporate Philanthropist, awards given by the Donors' Forum to businesses excelling in the field of CSR. Telefónica O2 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 sixth position. Philanthropic activities are measured using the LBG (London Benchmarking Group) Standard Responsible Company, which is a comprehensive and standardised system for the assessment of corporate philanthropy. The Personality of the Year sponsored by O2 was presented on the same occasion, already for the second year running. The award recognises individuals who had made an outstanding contribution to the development and promotion of Corporate Social Responsibility, for personal engagement in the non-profit or philanthropy sector in the Czech Republic.

The total value of donations, gifts and telecommunications services provided by Telefónica O2 to or for the benefit of community projects in 2010 exceeded the mark of CZK 33 million.

Regional grants and the O2 Foundation Award

In the 9th year of its regional grant programme, the O2 Foundation continued the tradition and distributed more than CZK 10 million among 54 NGO projects, from which more than 7 thousand children and young people benefited. The grants for amounts ranging from CZK 50,000-400,000 were awarded to projects in aid of socially and physically disadvantaged children and youth, their leisure activities, education and to projects aimed improving mobility and reducing barriers in communication. The 2010 O2 Foundation Award went to APLA (Association in Aid of People with Autism), specifically to its Prague, Central Bohemia, South Bohemia and South Moravia branches, for projects helping the development of children with autistic spectrum disorders.The O2 Foundation Award of CZK 1 million expresses a special recognition to a project that the Board of Trustees of the Foundation has found appealing for its effort to change the established social habits and open tabooed social topics.

Safety Line 116 111

Already for 16 consecutive years, the O2 Foundation was the general partner of this only national free and anonymous helpline for children in difficult life situations. In 2010, the O2 Foundation was also the general partner of the concert benefit for the Safety Line. Television viewers sent donor SMS, raising more than CZK 800,000. The benefit yielded over CZK 8.6 million with Telefónica O2 becoming the largest donor with CZK 4.65 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 2010, the helpline answered more than 27,000 calls, of which more than 3,500 were of serious nature. The funding from the O2 Foundation helped to keep the service free of charge. The O2 Foundation, in partnership with Elpida, ran an outreach campaign Let's Talk about the Elderly – Leave My Grandmother Alone to stimulate dialogue between generations and to draw the public attention to the frequent stereotyping of age in the society.

Stop Bullying!

The programme has been successfully ongoing in more than 60 schools, where teachers are systematically trained for several months to acquire skills that will come useful in recognizing and fighting bullying. The programme is funded from several sources; for the most part from European Social Fund. In 2010, the O2 Foundation focused mainly on awareness raising and cyberbullying was the main subject. In collaboration with Aisis, the main implementer of the programme, O2 Foundation executed a nationwide awareness raising campaign in all elementary schools in the Czech Republic. Teachers, parents and pupils received information about how to fight cyberbullying and what can be done against it.

O2 Duck Race

In 2010, O2 Foundation ran a fundraising project to benefit the Safety Line and the Senior Line, and to raise awareness of these two organisations among the Company's customers. Anybody could come to an O2 brand store and buy a yellow duck for CZK 60 – Telefónica O2 did not take a cut of the proceeds and CZK 60 for every duck went to help the Safety Line and the Senior Line. The Safety Line and the Senior Line received CZK 548,448 and CZK 137,112, respectively.

Volunteer programmes for employees

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

In 2010, a record 3,048 employees, which is 54% more than in 2009, got involved in the projects of the O2 Foundation. As for employee volunteering, Telefónica O2 Czech Republic achieved the highest level of engagement among Telefónica Europe companies.

In 2010, employees also participated in successful fundraising campaign; a total of CZK 2,135,058 was raised from 2,371 employees. The most successful fundraiser was the one for the benefit of the victims of August 2010 floods in North Bohemia with a total CZK 703,153 raised; second, with CZK 631,655, came the fundraiser to benefit Haiti, which had been stricken by a catastrophic earthquake. Telefónica O2 matched both of these amounts by almost 100% and donated the funds to the needy families by way of the People in Need relief organisation. During 2010, employee donations turned around the lives of eighteen people who were able to buy necessary health aids. Customers 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, 725 employees (17 teams) donated 5,800 hours of work to non-profit organisations. Seven times more employees volunteered in 2010 than in 2009. 81 employees donated their personal free time: they spent 700 hours organising leisure activities for children from children's homes; 238 helping out in Thomayer Hospital in Prague; and 194 hours organising and helping out at swimming competitions for severely disabled athletes. They also spent 1,680 hours assisting the O2 Foundation's principal grant programme – they sat on regional committees and selected the best projects from NGOs, among which the foundation distributed CZK 10 million.

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 22 employees in 2010, which was in turn donated to the non-profit organisations they worked with on a long-term basis.

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 2010, employees spent close to CZK 550,000 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 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

Also the project Give Blood with O2, continued in 2010, seeking to promote voluntary blood donorship in the Czech Republic. During the year, 140 employees participated and collectively donated more than 113 litres of blood. Blood donations took place in Company premises.

Fair Trade

The project Be Fair with O2, which focused on promoting Fair Trade products and services, continued also in 2010. Employees, customers and the general public could help the people in the poorest countries on the planet by buying Fair Trade products at a number of events organised by Telefónica O2 in 2010: Christmas and Easter markets of products made in sheltered workshops and Fair Trade products, Employee Blood Donation Days or the Open Air Festival, where people could learn about Fair Trade and help by buying them. In 2010, employees of Telefónica O2 purchased Fair Trade products in the value of CZK 100,000 and helped in the fight against poverty and child labour. A total of 5 thousand employees were involved in supporting Fair Trade. Fair Trade products were also used as courtesy gifts for conference participants and as Christmas gifts for business partners. In 2010, employees could also buy Fair Trade products at cut-rate prices through the e-shop, and order Fair Trade and ethnic catering for various corporate events.

04

Corporate governance

Inspirational leadership

04

Corporate governance

Corporate governance of the Telefónica O2 Czech Republic Group

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

Telefónica O2's ownership rights in its subsidiary companies, save for those incorporated in foreign jurisdictions, are exercised by the Board of Directors of Telefónica O2 acting in the capacity of the sole member. Persons with power of attorney given by the Board of Directors of the parent company exercise the ownership rights in foreign subsidiaries within the limits of the mandate approved by the Company's Board of Directors. Personnel changes in the subsidiary companies' statutory and supervisory bodies and in companies where Telefónica O2 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 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 15 March 2011)

The only change with respect to subsidiary and associated companies in 2010 concerned Telefónica O2 Slovakia; the parent company Telefónica O2 decided in May to increase the registered capital of the subsidiary by way of a pecuniary contribution to EUR 240,000,000.

Corporate name	Registered capital	The share of Telefónica O2 Czech Republic, a.s.
Telefónica O2 Slovakia, s.r.o.	EUR 240,000,000	100.00%
Telefónica O2 Business Solutions, spol. s r.o.	CZK 10,000,000	100.00%
CZECH TELECOM Austria GmbH	EUR 35,000	100.00%
CZECH TELECOM Germany GmbH	EUR 25,000	100.00%
První certifikační autorita, a.s.	CZK 20,000,000	23.25%
AUGUSTUS, spol. s r.o.*	CZK 166,000	39.76%

* Telefónica O2 Czech Republic, a.s. does not control this company.

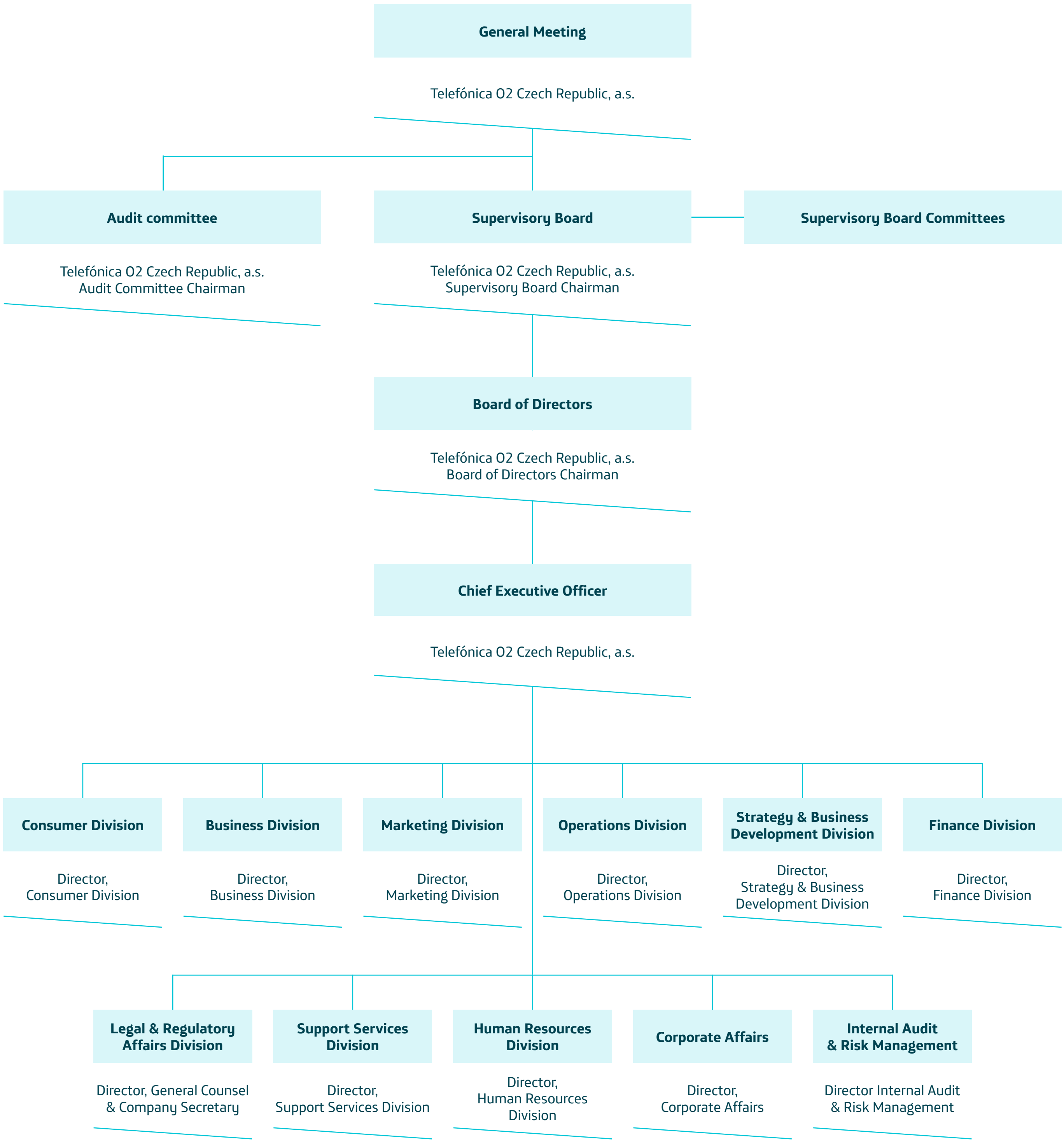
Effective from November 2010, Telefónica O2 owns a 14% stake in MOPET CZ a.s. (see sub-section Payment services further below).

The organisation of Telefónica O2

Telefónica O2 pursues continuous efficiency improvements and optimisation of its functions. The past period saw further optimisation of the organisational and governance architecture. The following changes occurred at the level of executive line organisational macrostructure during 2010:

— A central Marketing Division was created in May by way of consolidating marketing activities and authority previously assigned to various business units in the Company to one unit. At the same time, the scope of the Strategy and Business Development Division was expanded to newly include, among other things, the Wholesale Unit;
— In September, the Strategic Accounts Division was transferred under the line of management of the Business Division.

Executive macrostructure of O2 Czech Republic (as at 15 March 2011)



Governing bodies (as at 15 March 2011)

General Meeting

The General Meeting, which comprises the Company's shareholders, decides on fundamental business, organisational and operating matters. Its authority and powers are determined by the Commercial Code and the Company's Articles of Association. As a rule, the Board of Directors convenes the General Meeting once a year. Basic information on the General Meeting and its status and authority can be found in Articles 7–13 of the Company's Articles of Association.

Audit Committee

The Audit Committee has six members and is an independent governing body of the Company, with special powers in matters relating to the statutory audit, compilation and auditing of financial statements and the evaluation of effectiveness of the internal control system of the Company. Members of the Audit Committee are appointed and recalled by the General Meeting of the Company; only the members of the Supervisory Board or persons external to the Company may be members of the Audit Committee. The tenure of Audit Committee members is five years. As a rule, the Audit Committee meets as required, usually once in a quarter, but at least four times in the course of a calendar year. Basic information about the Audit Committee and its powers can be found in Articles 26a-26f of the Company's Articles of Association.

Supervisory Board

The Supervisory Board has fifteen members and supervises the discharge of the Board of Directors' powers and the running of the Company's business. Its composition, authority and powers are determined by the Commercial Code and the Company's Articles of Association. As a rule, the Supervisory Board meets as required, usually once in a quarter, 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. Basic information about the Supervisory Board and its authority can be found in Articles 20–25 of the Company's the Articles of Association.

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 usually 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. Basic information on the Board of Directors and its authority can be found in Articles 14–19 of the Company's Articles of Association.

Committees of the Supervisory Board

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 committees are elected and recalled by the Supervisory Board. The tenure of a member of a committee is 2.5 years. Committees established by the Supervisory Board can comprise only the members of the Supervisory Board. The scope of authority of the Supervisory Board's committees is set out in Article 26 of the Company's Articles of Association.

The Company has the following committees of the Supervisory Board:
— Nomination and Remuneration Committee;
— Ethics and Corporate Social Responsibility Committee.

Board of Directors (as at 15 March 2011)

Luis Antonio Malvido (*1964)

Chairman

Graduated in Industrial Engineering at the Instituto Tecnológico 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, a Telefónica subsidiary in Brazil. In February 2010 he was appointed Chief Executive Officer and Chairman of the Board of Directors of Telefónica O2 Czech Republic, and simultaneously also member of the Board of Telefónica Europe.

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 O2 Czech Republic, a.s. he worked in Bank of America, Arthur Andersen, Jazz Telecom, S.A., and Telefónica Móviles, S.A. Jesús collected extensive experience in the telecommunications and finance area at these companies – 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 the operations of Telefónica Móviles 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 O2 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 Institution, Prague, he joined SPT TELECOM (the legal predecessor of Telefónica O2 Czech Republic) in 1989, working in switching, technical development, network management projects and OSS. In June 2008 he was re-elected 2nd Vice Chairman of the Board of Directors of Telefónica O2 Czech Republic. He currently holds the position of Director, Operations Division.

Martin Bek (*1969)

Member

Studied foreign trade at University of Economics, Prague, and completed his studies at the European Business School, Paris, where he majored in Finance. He worked for ABC International, DRT International and later at Guérard Viala Prague as senior consultant and tax advisor. From 1996, he worked at ČESKÝ TELECOM (the legal predecessor of Telefónica O2 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 O2 Czech Republic) and since September 2004 he has been Eurotel's Chief Operating Officer. Now he holds the position Director Support Services in Telefónica O2 Czech Republic. He is a member of the Board of Trustees of O2 Foundation (Nadace O2).

John Gerald McGuigan (*1960)

Member

Before joining O2, John was the Chief Executive 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. Since 2009 has been appointed Chief Executive Officer of Telefónica O2 Slovakia.

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 in the Legal Department 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 O2 Czech Republic) in December 2003 he has been in the position of Director, Legal Affairs, and from 2010 he has been Director, Legal and Regulatory Affairs. From May 2006 he has been the Company Secretary and he is also a member of the Board of Trustees of O2 Foundation (Nadace O2).

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. Under his leadership, the Prague branch tripled its annual revenues and twice won the accolades for the best Dell country office in the EMEA region. František joined Telefónica O2 Czech Republic, a.s. in April 2008 as Director, Corporate Sales, and presently holds the position of Director, Business Division.

Personnel composition of the Board of Directors of Telefónica O2 Czech Republic, a.s., as at 15 March 2011

Name	Function	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	27 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

Information about the term of office of Board of Directors members is given in sub-section Governing bodies of Telefónica O2 Czech Republic.

All changes in the personnel composition in the Board of Directors in the first half of 2010 were described in the 2009 Annual Report and in the 2010 Half-year Report.

The following changes occurred in the personnel composition of the Board of Directors in the second half of 2010 and in the period from 1 January to 15 March 2011:

Jose Severino Perdomo Lorenzo	his duties as member of the Board of Directors were terminated after the Supervisory Board discussed his resignation on 10 September 2010
František Schneider	elected member of the Board of Directors by the Supervisory Board on 4 November 2010

Executive management (as at 15 March 2011)

The executive management of the Company comprises the following top managers:

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

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

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

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

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

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

Jiří Dvorjančanský (*1970)
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 O2 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 Telekom from the position of Sales Director at COTY.

Tony Hanway (*1967)

Director, Consumer division

Holds an MSc in Human Resources Management / Training from Leicester University. Prior to joining O2 Ireland, worked for AOL Time Warner for eight years where he held a number of senior Board positions, namely Vice President of Customer Care at AOL UK and Managing Director of AOL Europe Operations Ltd. in Ireland. He has also worked in Sales and support roles for Gateway Computers Inc. and AIB Bank plc (UK). He joined O2 in 2005 as Customer Care Director. Under his leadership, O2 Ireland was awarded the Contact Centre of the Year and Best Retail Employer awards. He came to the Czech Republic from position of Consumer Sales Director. His role in Ireland involved managing O2 Ireland's retail, online, franchising, partner and telesales channels to drive revenues while providing a great customer experience.

Jiří Šuchman (*1964)

Director, Corporate Affairs

Graduated in Foreign Trade at the University of Economic in Prague. After gaining experience in foreign trade companies, since 1992 he has worked exclusively in the field of telecommunications. During that time he worked in various management positions in SPT Telecom, France Télécom, Aliatel and T-Mobile; from 1999 until 2008 he was responsible for regulatory and corporate affairs at T-Mobile. He joined Telefónica O2 Czech Republic in 2008 as Director, Public Affairs. On 1 Februrary 2010 he was nominated Director, Corporate Affairs. He chairs the Board of Trustees of O2 Foundation.

Steven Tree (*1958)

Acting Director, Human Resources Division

With post graduate qualifications in Human Resources, Teaching and Marketing as well as an MBA from Warwick Business School, his career has involved a mixture of Human Resources and Management Consulting. In 1990 he joined WS Atkins, a global consulting business, as Personnel Manager and in 1992 he transferred into the Management Consulting division where he worked on international projects including several projects in the Czech Republic. He then moved to KPMG as a Human Capital Consultant and then on to Arthur Andersen (UK) shortly before it merged with Deloitte, where he was a Director. His specialist areas were Mergers and Acquisitions and the transformation of Human Resource management. In 2003 he moved to Heidrick & Struggles, the global leadership advisory and executive search firm where he was Vice President of HR for Europe and Asia. He joined Telefónica O2 Czech Republic in November 2010.

Report by the Company's Supervisory Board

In keeping with the Company's Articles of Association, the Supervisory Board of Telefónica O2 Czech Republic in 2010 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 the Company is done in compliance with the law, the Company's Articles of Association and instructions of the General Meeting.

The Supervisory Board continuously monitored the activities of Telefónica O2 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 O2 Czech Republic regarding all principal matters falling to the authority of both the governing bodies.

At the meeting held on 18 February 2011, the Supervisory Board reviewed the audited annual financial statements for the year 2010 (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 2010 and of the retained earnings of the Company from previous years, and, as the case may be, any disposable funds of the Company, and the determination of royalties for the year 2010. In both instances, the Supervisory Board issued a recommendation to the General Meeting of the Company to approve the proposals.

In Prague, 18 February 2011

Alfonso Alonso Durán
Chairman of the Supervisory Board

Supervisory Board (as at 15 March 2011)

Alfonso Alonso Durán (*1957)

Chairman

Holds a BA degree in Economics from the Universidad Autónoma Madrid, and an MBA from IESE Business School Barcelona. He started his professional career in 1974 with Banco de Bilbao as manager/controller. He joined Telefónica as economist and worked in several departments: internal audit, accounts, infrastructure, international communications, financial controlling and cost management in the Spanish fixed business unit. In 1999 he left Telefónica de España for Telefónica, S.A., as Deputy Director for Planning and Management Control. In 2003, he became General Manager for Strategy, Budget and Control. In 2008 took the position of Director of Operations in the corporation and became in the same year Director of Transformation in charge of Purchases, Technology, Information systems and Strategy and Innovation to transform in the scope of the operative integration of the business units of Telefónica.

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 as 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 Telefonica SA since the beginning of 2008 and She is a non –executive director of Old Mutual plc since February 2011. She has Bachelor of Arts degrees in Business and Law from the Universidad Pontificia de Comillas - ICADE E3 in Madrid.

Lubomír Vinduška (*1956)

2nd Vice Chairman

Graduated in radio and communication 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 O2 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 O2 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.

Eduardo Andres Julio Zaplana Hernández-Soro (*1956)

Member

Eduardo Zaplana has a degree in law and was the President of the regional Government of Valencia from 1995 to 2002. He has been a member of the Spanish Parliament and Senator, as well as the Spanish Minister for Labour and Social Affairs and government spokesman from 2002 to 2004. Among other official posts, he has also been President of the Commission for Regional Policy and Structural Funds, member of the Bureau and first Vice President at the Committee of the Regions (CoR). In April 2008, Telefónica appointed Eduardo Zaplana as the Company's representative for Europe. Telefónica has an office in Brussels and operations in the UK, Germany, Ireland, the Czech Republic and Slovakia. Mr. Zaplana is a member of the Board of Directors of Telefónica Europe plc from July 2008. Since December 2008, he has been the Deputy to the Technical Secretary General of the Presidency.

Antonio Botas Bañuelos (*1963)

Member

Antonio earned his Bachelor degree at Universidad Complutense in law and a Master 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 O2 Czech Republic. Since September 2007 he holds the position of Managing Director Product Development & Brand Management at Telefónica O2 Germany GmbH & Co. OHG. He has been member of the Supervisory Board of Telefónica O2 Czech Republic since April 2008. Since 2010 he has been Director of International Coordination Global Marketing in Telefónica S.A.

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 decree 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. In September 1997 he started a private consultancy. His clients include the U.S. investment bank Goldman Sachs or ABB ČR. Since 2000 he has been teaching at the Faculty of Social Sciences, Charles University in Prague, and since 2004 also at the University of Economics in Prague. He authored many research papers and is a member of the Trilateral Commission. He is fluent in English, Spanish, Russian and speaks also German and French.

Anselmo Enriquez Linares (*1964)

Member

Joined from Diageo where he was HR Director for the leading premium drinks company's Africa region, took up his position on 1 July 2008 as a new Group Human Resources Director and is responsible for the company's businesses in Europe outside of Spain, and also serves as a Member of the Board at Telefónica Europe plc. He has significant experience in management development at an international level thanks to his previous roles as HR Director for Africa and Iberia regions at Diageo. Prior to Diageo, he worked for a number of major companies in the financial services and consumer goods industries, including Barclays, Lloyds TSB and Grand Metropolitan. British born with Spanish parents, he is bilingual in English and Spanish. His global career experience has included responsibility for regions as diverse as Thailand, Latin America and North America. He currently resides in London.

Tomáš Firbach (*1976)

Member

Graduated in Management and Economics in Transportation from the Czech Technical University, Department of Transportation. After his graduation in 1999 he worked in JSJ spol. s r.o. as information systems manager. In 2001 he joined Eurotel Praha, spol. s r.o. (the legal predecessor of Telefónica O2 Czech Republic) as network planning specialist. In 2004–2005 we worked in ČD Telekomunikace, a.s. (presently ČD Telematika, a.s.) as business consultant. He has been with Telefónica O2 Czech Republic, a.s. since 2005, working as Senior Product Manager for fixed line data services. In the last five years he was not a member of any other statutory or supervisory bodies except for the Supervisory Board of Telefónica O2 Czech Republic, a.s.

Petr Gazda (*1965)

Member

Graduated in Economics and Management (BA) from the Business College Ostrava. He has been with Telefónica O2 Czech Republic (and its legal predecessors) since 1991; he presently works as Network Operations Director for Regions; previously: 1991–2006 Eurotel Praha, spol. s r.o.; 1988–1991 ČESKÝ TELECOM, a.s.; 1986–1988 AŽD Praha, specialist; 1983–1984 AŽD Praha, electrical engineer. In the last five years he was not a member of any other statutory or supervisory bodies except for the Supervisory Board of Telefónica O2 Czech Republic, a.s.

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 O2 Czech Republic and member of the European Works Council of the European division of the Telefónica Group. He has not, for the last five years, been a member in another supevisory body of another company.

Guillermo José Fernández Vidal (*1946)

Member

Guillermo holds a degree in Industrial Engineering and Computer Science and in 1989 he joined Telefónica, first as a manager and later he was promoted to Commercial Director (1992–1995) and General Manager of Companies of Telefónica (1995–1999). In 1999 he was appointed Chief Executive Officer of Telefónica Data and President of Telefónica Data España. In the same year he was also a member of statutory bodies at Telefónica Móviles, Telefónica de España, Vía Digital and Portugal Telecom. In 2003 he was appointed General Manager for Subsidiaries. From 2004 to 2005 he was General Manager for Commercial Development and Affiliates at Telefónica, S.A. In 2005 he was appointed as Corporate General Manager of Telefónica, S.A. and member of the Board of Telefónica Móviles de España, Telefónica de España and TPI. He is presently advisor to Telefónica, S.A.

Luis Lada Díaz (*1949)

Member

Luis holds a degree in telecommunications engineering and joined the Telefónica Group in 1973 in the Research and Development Department, rising through the ranks to hold various managerial and executive positions within the group. In 1989 he was Deputy Director for Technology, Planning and International Services. Later he joined Amper Group, a manufacturer of telecommunications system and equipment, as Director of Planning and Control. He returned to the Telefónica Group in 1993 as Chief Controller for Subsidiaries and Participated Companies. In 1994 he was appointed Chief Executive Officer of Telefónica Móviles de España, S.A., and in September 2000 he went on to become President and Chief Executive of Telefónica Móviles, S.A. until 2004, when he was named Director for Development, Planning and Regulatory Affairs of Telefónica, S.A. In 2005 he was elected Executive Chairman of Telefónica de España, S.A.U. Until he left his executive positions in Telefónica in July 2006, he had served on the Boards of Directors of Telefónica, S.A., Telefónica Móviles, S.A., Telefónica Internacional, S.A. and other Telefónica Group's corporations, and currently is Professor "Ad Honorem" of the Politechnic University of Madrid, C.E.O. of Ribafuerte S.L., Member of the Royal Academy of Engineering, the Bankinter Foundation for Innovation and the Telefónica Latinoamérica and the Telefónica España Advisory Boards, and Member of the Boards of Directors of INDRA Sistemas S.A., Gamesa Corporación Tecnológica, S.A., Telefónica I+D, Telcel (Telefónica Venezuela) and Ydilo Advanced Voice Solutions, S.A.

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. Pilar 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 1st March 2007, she was appointed Chief Financial Officer of Telefónica O2 Europe plc (now Telefónica Europe plc).

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 O2 Czech Republic). At present, he works as Specialist for Operation and Maintenance of Digital Telecommunications Technology in Ostrava. He is a member of the Trade Union Steering Committee of Telefónica O2 Czech Republic, Chairman of KOV MORAVA and member of EWC (European Works Council) at Telefónica Europe plc. and Vice Chairman of the Ethics and Corporate Social Responsibility Commitee of the Supervisory Board of Telefónica O2 Czech Republic.

Ángel Vilá Boix (*1964)

Member

Ángel Vilá is Managing Director in charge of Corporate Development and Affiliates at Telefónica, S.A. Mr. Vilá graduated in Industrial Engineering from Universitat Politècnica de Catalunya and holds a MBA from Columbia University (New York). Ángel Vilá is responsible for group wide Mergers & Acquisitions activity at Telefónica, having closed relevant corporate transactions such as O2 plc, Brasilcel and ČESKÝ TELECOM acquisitions, as well as Telefónica investments in Telecom Italia/ Telco SpA and China Unicom. Prior significant deals, among others, would include Telebras privatisation, the purchase of BellSouth and Motorola properties in LatinAmerica and the disposal of Meditel, Airwave, TPI and Antena 3 TV.
Mr. Vilá also oversees the Affiliates group, including Atento, T. Gestiona and Telefónica de Contenidos. Prior to joining Telefónica, Mr. Vilá held various positions at Citibank NA, McKinsey & Company, Grupo Planeta and Ferrovial. Ángel Vilá is Vice Chairman of the Board of Directors of Telco SpA (Italy), Chairman of Telefónica de Contenidos S. A., member of the Board of Directors of Atento, Digital+ and Telefónica O2 Czech Republic, and member of the European Advisory Panel of Macquarie's MEIF Funds. He previously served on the Boards of Banco Bilbao Vizcaya Argentaria (BBVA), Endemol, CTC Chile and Terra Lycos, among others.

Personnel composition of the Supervisory Board of Telefónica O2 Czech Republic, a.s. as at 15 March 2011

Name	Function	Member since
Alfonso Alonso Durán	Chairman of the Supervisory Board	23 June 2005 Re-elected by the General Meeting on 7 May 2010 (effective from 24 June 2010)
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
Eduardo Andres Julio Zaplana Hernández-Soro	Member of the Supervisory Board	3 April 2009
Antonio Botas Bañuelos	Member of the Supervisory Board	21 April 2008
Vladimír Dlouhý	Member of the Supervisory Board	18 February 2011
Anselmo Enriquez Linares	Member of the Supervisory Board	4 November 2010
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
Guillermo José Fernández Vidal	Member of the Supervisory Board	23 June 2005 Re-elected by the General Meeting on 7 May 2010 (effective from 24 June 2010)
Luis Lada Díaz	Member of the Supervisory Board	23 June 2005 Re-elected by the General Meeting on 7 May 2010 (effective from 24 June 2010)
Maria Pilar López Álvarez	Member of the Supervisory Board	21 April 2008
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 (effective from 24 June 2010)

Information about the term of office of Supervisory Board members is given in sub-section Governing bodies.

All changes in the personnel composition in the Supervisory Board in the first half of 2010 were described in the 2009 Annual Report and in the 2010 Half-year Report.

The following changes occurred in the personnel composition of the Supervisory Board in the second half of 2010 and in the period from 1 January to 15 March 2011:

Enrique Used Aznar	his membership in the Supervisory Board expired upon his death on 20 September 2010
Anselmo Enriquez Linares	co-opted as member of the Supervisory Board on 4 November 2010 as a substitute member until the next General Meeting
Jaime Smith Basterra	resigned from membership in the Supervisory Board effective from 18 February 2011
Vladimír Dlouhý	co-opted as member of the Supervisory Board on 18 February 2011 as a substitute member until the next General Meeting

Audit Committee (as at 15 March 2011)

Alfonso Alonso Durán (*1957)

Chairman

(résumé in section Supervisory Board)

María Eva Castillo Sanz (*1962)

Vice chairman

(résumé in section Supervisory Board)

Pavel Herštík (*1951)

Memeber

(résumé in section Supervisory Board)

Maria Pilar López Álvarez (*1970)

Memeber

(résumé in section Supervisory Board)

Jaime Smith Basterra (*1965)

Memeber

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 O2 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 Indurstrial Alliances of Telefónica, S.A. From October 2010 he is Director of Telefonica 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. and from 2008 to 2011 Chairman of the Supervisory Board of Telefónica O2 Czech Republic.

Personnel composition of the Audit Committee of Telefónica O2 Czech Republic, a.s. as at 15 March 2011

Name	Function	Member since
Alfonso Alonso Durán	Chairman of the Audit Committee	3 April 2009
María Eva Castillo Sanz	Vice Chairman of the Audit Committee	7 May 2010
Pavel Herštík	Member of the Audit Committee	3 April 2009
Maria Pilar López Álvarez	Member of the Audit Committee	3 April 2009
Jaime Smith Basterra	Member of the Audit Committee	3 April 2009
vacant	Member of the Audit Committee	Since 20 September 2010

Information about the duration of tenure of Audit Committee members can be found in section Governing bodies.

Changes in the personnel composition of the Audit Committee during the first half of 2010 were described in the 2009 Annual Report and in the 2010 Half-year Report.

The following changes occurred in the personnel composition of the Audit Committee in the second half of 2010 and in the period from 1 January until 15 March 2011:

Enrique Used Aznar	his membership in the Supervisoy Board expired upon his death on 20 September 2010

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

The group of persons with executive powers in Telefónica O2 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, are governed by the rules for the remuneration and awarding of discretionary benefits which are approved by the Company's General Meeting. The approval of the Rules for Provision of Non-Claim Perquisites to Board of Directors Members 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-chair and chair 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 2010, no changes occurred in the principles for remuneration of members of the Company's governing bodies as they were described in the 2009 Annual Report.

Basic information about the rules for the remuneration, including a list of discretionary 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 O2 is published in the Czech and English languages on the Company's website.

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 monthly flat remuneration, which comprises the following:
— an amount covering mandatory payments (e.g. taxes, health insurance contributions, etc.) which the 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.

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 Company's 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 O2 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 telecommunications industry), 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 management position, 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 in question; 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 Chair of the Supervisory Board: the amount as in (i) plus CZK 10,000; Chair of the Supervisory Board: the amount as in (ii) plus CZK 10,000.

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-chair of the committee: the amount as in (i) plus CZK 12,000; (iii) chair 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 telecommunications industry), 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 Provision of Non-Claim Perquisites to Supervisory Board Members as part of the amendment to this policy.

Car
The Supervisory Board Chair and Vice Chair are, according the Rules approved by the General Meeting, entitled to a higher middle class car 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 or similar equipment, 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 and the Audit Committee, only the Chairman and Vice Chairmen were eligible; the benefit has not been claimed in 2010);
— healthcare.

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 O2 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 discretionary benefits to members of the relevant governing body.

Other information relating to persons with executive powers

Information about all pecuniary and in-kind incomes accepted 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 O2 and entities controlled by it

(in CZK)	Pecuniary income	Of which royalties	In-kind income
Board of Directors – total	57,333,307	0	41,201,761
— of which by virtue of membership in the issuer's Board of Directors	447,713	0	1,559,760
Supervisory Board – total	6,718,190	0	3,847,901
— of which by virtue in the issuer's Supervisory Board	5,588,384	0	3,365,528

The information about pecuniary and in-kind incomes of the Board of Directors collectively includes also incomes from the subsidiary Telefónica O2 Slovakia, s.r.o. In 2010, members of the Supervisory Board received no pecuniary or in-kind income from entities controlled by Telefónica O2.

For the sake of reporting continuity with regard to data published in annual reports of Telefónica O2 in the past years, we chose to go beyond the scope of the statutory disclosure requirement and include below also information about all pecuniary income received in the accounting period by members of the executive management of the Company.

(in CZK)	Pecuniary income	Of which royalties	In-kind income
Executive management[1]	26 442 095	0	6 604 747

[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 O2 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	2,401
Supervisory Board	100
Audit Committee [1]	0
Other persons with executive powers – Executive management [2]	0
Persons related to persons with executive powers	100

[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 of the Executive Management of Telefónica O2 (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 2010, all members of the Board of Directors and of the Supervisory Board, with the exception of the substitute member of the Supervisory Board, Anselmo Enriquez Linares, who was co-opted by the Supervisory Board on 4 November 2010, 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 O2's Declaration of Compliance with the Code of Good Corporate Governance based on OECD Principles (2004)

Telefónica O2 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 O2.

Organisation of Corporate Governance

The Corporate Governance model of Telefónica O2 has not incurred any significant changes in 2010 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 O2 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 O2 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 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 7 May 2010. 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 and was also published in the 2010 Half-year Report. Information about the dividends, the record and disbursement dates for the dividend payment is given in section 9 of this Annual Report. An Extraordinary General Meeting of the Company was held on 10 September 2010, which resolved to transform all common shares of the Company from bearer shares in the nominal value of CZK 100 to common registered shares. The Extraordinary General Meeting also approved an amendment to the Company's Articles of Association which related to the change in the form of shares and the extension of the Company's subject of business. The last material decision taken by the Extraordinary

General Meeting was the granting of consent with the entering into an agreement to contribute a part of the enterprise into a wholly owned subsidiary company. Additional information and an overview of conclusions of the Extraordinary General Meeting are is available on the Company's website.

The decision making procedure at the General Meeting is outlined in the Company's Articles of Association (Articles 10 and 11); the Articles of Association are available on the Company's website (see also sub-section Transparency and open information policy) and also form a part of the Rules of Procedure of the General Meeting, the key principles of which are highlighted in sub-section Shareholder relations; the sub-section Governing bodies details information on the scope of authority of the supreme governing body of the Company.

The Board of Directors held twenty meetings in 2010, thus complying with the duty to hold a minimum of twelve meetings each year. Any personnel changes in the Board of Directors in the period January-March 2010 were detailed in the 2009 Annual Report. In September 2010, the Supervisory Board discussed the resignation tendered by the Board of Directors member Jose Perdomo Lorenzo, who went on to an executive position in the parent company Telefónica, S.A. In November 2010, the Supervisory Board elected František Schneider, Director, Business Division, to fill the vacancy. At its meeting in February 2011, the Supervisory Board consented with the re-election of Martin Bek and Jakub Chytil, whose tenure in the Board of Directors was to expire in April 2011. The full list of members of the Board of Directors, including their professional résumés, and the personnel changes in the Board of Directors are given in section Board of Directors.

The decision making procedure at meetings of the Board of Directors is laid down in the Company's Articles of Association (Articles 16-18); the activities of the Board of Directors observe the Rules of Procedure. Both documents are available on the Company's website (see also sub-section Transparency and open information policy).

The Supervisory Board held six meeting in 2010, 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. Also this year, the Supervisory Board met regularly once in a quarter (February, April, July, November); additional (extraordinary) Supervisory Board meetings were called as needed (in May and in September prior to the General Meeting). Any personnel changes in the Supervisory Board in the first half of 2010 are detailed in the 2010 Half-year Report; they included the resignation tendered by Anselmo Enriquez Linares, which was discussed by the Supervisory Board at its extraordinary meeting held prior to the General Meeting in May 2010, and the related decision of the shareholders to elect María Eva Castillo Sanz, an Independent member of the Board of Telefónica, S.A., to fill the vacancy after Mr. Linares. At the General Meeting, the shareholders also confirmed the election of Alfonso Alonso Durán, Ángel Vilá Boix, Luis Lada Díaz and Guillermo José Fernandéz Vidal, whose tenures were to expire in June 2010, into the Supervisory Board. In September 2010, due to the death of Enrique Used Aznar, another unfilled position was created in the Supervisory Board, to which the Supervisory Board co-opted Anselmo Enriquez Linares in November 2010. In the same period, the chairmanship of the Supervisory Board also changed; Jaime Smith Basterra was replaced as Chairman of the Supervisory Board by Alfonso Alonso Durán, with María Eva Castillo Sanz elected as 1st Vice-Chairman of the governing body. In February 2011, the Supervisory Board accepted Jaime Smith Basterra's request for release from the duties of a member of the Supervisory Board and, in a related decision, appointed Vladimír Dlouhý as substitute member of the governing body. The full list of personnel changes in the Supervisory Board in the given period, including its current personnel composition as at 15 March 2011 and professional résumés of all members of this body, is given in section Supervisory Board. The requirement of independence (introduced by the Commission Recommendation 2005/162/EC as regards the regime for the remuneration of listed companies, Annex II), meet two members, María Eva Castillo and Vladimír Dlouhý.

The decision making procedure at meetings of the Supervisory Board is laid down in the Company's Articles of Association (Articles 22-24); the activities of the Supervisory Board observe the Rules of Procedure. Both documents are available on the Company's website (see also sub-section Transparency and open information policy).

The Audit Committee (AC) of the Company held four meetings in 2010, 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 original personnel composition of the AC from 2009 (see the Company's 2009 Annual Report, sub-section Organisation of Corporate Governance) incurred changes, both by the decision of the Ordinary General Meeting held in May 2010, which recalled Ángel Vilá Boix from this body and elected María Eva Castillo Sanz in his stead, and the death of the AC member Enrique Used Aznar in September 2010 (the open position left by him remained vacant). At the July meeting of the AC, María Eva Castillo Sanz was elected Vice-Chairman of the committee. Section Supervisory Board. gives a full account of all personnel changes in the Audit Committee in the given period, including its present personnel composition as at 15 March 2011 and the professional résumés of all members of this body. The requirements of independence of the audited entity and a minimum experience of three years in the practice of accounting or statutory audit stipulated in the Act on Auditors (Act No. 93/2009 Coll., implementing the Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing the Council Directive 84/253/EEC) have been met by María Eva Castillo Sanz, member of the AC.

The rules for the remuneration of AC members, as well as the rules governing the granting of discretionary benefits to members of governing bodies, which were approved by the Ordinary General Meeting of the Company held in 2009, remained unchanged in 2010. Both documents are available on the Company's website (see also sub-section Transparency and open information policy). A detailed description of these rules is given in the Company's 2009 Annual Report (sub-section Organisation of Corporate Governance). In 2010, AC members collected pecuniary income of CZK 2,041,898 and in-kind income equivalent to CZK 1,523,487 from the Company, of which CZK 321,000 was the pecuniary income for their membership in the AC and no in-kind income. The committee members did not receive any pecuniary or in-kind income from entities controlled by Telefónica O2 in 2010. In 2010, 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. A detailed description of the non-competition covenant from the agreement on the discharge of office of an AC member is given in the Company's 2009 Annual Report (sub-section Organisation of Corporate Governance).

The decision making procedure at meetings of the Audit Committee is laid down in the Company's Articles of Association (Articles 26c-26e); the activities of the Audit Committee observe the Rules of Procedure. Both documents are available on the Company's website (see also sub-section Transparency and open information policy).

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 financial

statements. 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 discussed with the external auditor of the Company.
The audits performed in 2010 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 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 in question, 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 2010, 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 2010, Internal Audit & Risk Management carried out 42 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 O2, the Internal Audit unit also acts as internal auditor of Telefónica O2 Slovakia and other subsidiary companies in the group of Telefónica O2 Czech Republic. 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 O2, 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 Statute of Internal Audit 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.

In 2010, the Company continued in the development of its risk management function and in its harmonisation with the methodology and practice in 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 O2, including its subsidiary Telefónica O2 Slovakia, and provides for the identification, assessment, mitigation of their impacts and further monitoring of their development. The Board of Directors and the Supervisory Board receive regular monthly reports 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 O2 Czech Republic Group, and information about the methods used, the processes of risk management, etc. Members of the said bodies have equal and full access to the risk management reports and the risk register of Telefónica O2 and its subsidiary Telefónica O2 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 and continually developed in Telefónica O2 Czech Republic. It supports the exercise of powers of all governing bodies and provides for efficient administration of Corporate Governance in Telefónica O2 Czech Republic Group. 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), and the majority of documents in the field of corporate governance is systematically published 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. In addition to the minutes of meetings, the system also stores internal audit reports and risk reports, information about the Telefónica O2 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 2010 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 O2 has a position of Company Secretary is at the executive level in the new Corporate Governance Model of Telefónica O2 formally combined with that of General Counsel (Director, Legal & Regulatory 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 O2. The majority shareholder of Telefónica O2, which is Telefónica, S.A. (see sub-section Company policy towards stakeholders), exercises its rights in Telefónica O2 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; in doing so, the Company has always strived and managed to exceed the scope of minimum statutory disclosure. The Company uses it website as the main platform for communication (section About Us). 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 Company's 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 main 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 are made by shareholders usually in writing, and filed with the information centre. 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 Chairperson 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.

During both General Meetings of the Company held in 2010, the shareholders had all the necessary documents in print form, in two languages (Czech and English). All the documents for the General Meeting and other relevant documents (e.g. the Company's Articles of Association) were available to the shareholders also at the information centre 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, the Audit Committee 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 7 May 2010 (twenty three in total) and during the Extraordinary General Meeting of 10 September 2010 (one in total) 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. Shareholders did not raise any questions to the Audit Committe or Supervisory Board members, the chairpersons of the Supervisory Board committees and to representatives of the Statutory Auditor.

Transparency and open information policy

Telefónica O2 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 O2 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 also publishes various information beyond the scope of the disclosure duties on its website, and intends to continue its open information policy toward shareholders. 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, which, in 2010 included print media (Commercial Bulletin, the business daily Hospodářské noviny, annual and half-year reports, etc.), but more importantly the means of electronic communications, especially the Company website. The website (particularly the section About Us) 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 dictatesabout 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 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 and the Supervisory Board , 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 (in the case of AC members, the information is given 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 Remuneration of Members of the Audit Committee, Rules for Provision of Non-Claim Perquisites to Supervisory Board Members,Rules for Provision of Non-Claim Perquisites to Audit Committee Members).

In line with its Business Principles, Telefónica O2 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 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 O2 keeps a regularly updated list of 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 the Supervisory Board committees of listed companies, which was amended by Recommendation 2009/38/EC from April 2009. Basic information about the committees established by the Supervisory Board is given in section Governing bodies.

The decision making procedure at meetings of the committees of the Supervisory Board is laid down in the Company's Articles of Association (Article 26); the activities of the committees observe the Rules of Procedure. All documents are available on the Company's website (see also sub-section Transparency and open information policy).

The Nomination and Remuneration Committee (NRC) has five members and is, as per the Company's Articles of Association, a mandatory committee of the Supervisory Board. The committee reviews in particular all matters relating to personnel changes in the Board of Directors, the Audit Commitee, the 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 O2 Czech Republic Group. The NRC's remit extends to reviewing the remuneration and other benefits granted to members of the Board of Directors, the Audit Committee and the Supervisory Board. The committee continually monitors and assesses the performance of members of the Board of Directors, the Audit Committee the 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 three meetings in 2010. As at the end of the year, the committee had the following members: Jaime Smith Basterra, Chairman; Alfonso Alonso Durán, Vice-Chairman; Luis Lada Díaz, Guillermo José Fernández Vidal and María Eva Castillo Sanz, members. Jaime Smith Basterra left the NRC as a consequence of his resignation from the membership in the Supervisory Board in February 2011, and Anselmo Enriquez Linares was elected in his stead.

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, the Audit Committee, the Supervisory Board, Company's 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 help facilities, and it is regularly informed about the activities undertaken as part of the Compliance Programme for the prevention of the risks of unethical conduct. Another primary area of interest for the ECSRC is the promotion of Corporate Social Responsibility. The committee held two meetings in 2010. The personnel composition of ECSRC did not change during 2010. As at the end of 2010, the ECSRC had the following members: Pavel Herštík, Chairman; Dušan Stareček, Vice Chairman; Jaime Smith Basterra, Tomáš Firbach, Luis Lada Díaz and Guillermo José Fernández Vidal, members. María Eva Castillo Sanz was elected to the committee in February 2011 to fill a vacancy left after the resignation of Jaime Smith Basterra from the Supervisory Board.

Company policy towards stakeholders

Telefónica O2 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 (6) 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 regulate 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 O2 as at 31 December 2010 was as follows:

	(in CZK million)
Share capital	32,209
Share premium	24,374
Fund for share-related payments	34
Funds	6,450
Retained earnings	14,542
Total	**77,609**

The Company's share capital as at 31 December 2010 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

As of the effective date of the agreement on the transfer of shares between Telefónica S.A. (Telefónica) and the National Property Fund of the Czech Republic, the registered share (ISIN CZ0008467115) has lost the special rights which were attached to it pursuant to the provisions of Article IV (2) of Act No. 210/1993 Coll., amending Act No.92/1991 Coll., on the conditions of transfer of state property to other entities, as amended.

By decision of the Extraordinary General Meeting of 10 September 2010, the form of all ordinary shares in the nominal value of CZK 100 (ISIN CZ0009093209) issued as bearer shares was changed to registered shares. The change of the form of shares was entered in the Commercial Register on 13 September 2010.

The rights and obligations related to the registered share which represents a share in Telefónica O2 are set out in Article 5 of the Articles of Association of the Company.

The bearer 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, Czech Stock Exchange (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 33/906, 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 O2 as at 31 December 20010:

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

As at 31 December 2010, the share of Telefónica, S.A., in the voting rights of Telefónica O2 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 General Meeting 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 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.

05

Consolidated financial statements

for the year enden 31 December 2010 prepared in accordance with international financial reporting standards

We reward the best

05

Consolidated financial statements

for the year enden 31 December 2010 prepared in accordance with international financial reporting standards

Content

General information

Telefónica O2 Czech Republic, a.s. Group („Group") consists of Telefónica O2 Czech Republic, a.s. („Company") and its subsidiaries: Telefónica O2 Slovakia, s.r.o., Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. 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 („Telefónica Group") with a parent company, Telefónica, S.A. („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 8,145 in 2010 (2009: 8,974).

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 18 February 2011.

Restructuring and network outsourcing (Field Line Maintenance)

During 2010, the Group pursued the strategy of continuous efficiency and cost optimization by introducing new projects in various areas of its business. Restructuring projects resulted in transfer of some activities to outsourcing partners. During the restructuring process more than 1,000 employees were made redundant and the Group incurred restructuring costs of CZK 427 million (see Note 3).

As a result of network operation optimization Field Line Maintenance including fail rectification and supportive technological maintenance are being outsourced to a strategic partner of the Group.

Impairment of fixed line segment assets

As of 30 June 2010 and 31 December 2010, the management of the Group reviewed the indicators which could have indicated that previously recognised impairment loss of fixed line segment assets which constitute cash generating unit (CGU) made in 2003 may no longer be relevant.

Based on a detailed impairment analysis performed as of 30 June 2010 the Group has reversed previously recognised impairment loss of CZK 4,344 million attributable to the fixed line segment assets constituting the CGU.

As of 31 December 2010, the Group assessed whether there is any indication that the CGU may be impaired. Assessment carried out as of 31 December 2010 confirmed that no such indicator exists and the value of the existing CGU is fairly stated.

Independet auditor' report to the shareholders of Telefónica O2 Czech Republic, a.s.

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

We have audited the accompanying consolidated financial statements of Telefónica O2 Czech Republic, a.s. and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2010, and the consolidated statement of total comprehensive income, consolidated statement of changes in equity and 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 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 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 2010, 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.	Brian Welsh	Petr Vácha	18 February 2011
License No. 401	Partner	Auditor,	Prague,
Represented by		License No. 1948	Czech Republic

Consolidated statement of total comprehensive income

for the year ended 31 December 2010

In CZK million	**Notes**	**Year ended 31 December 2010**	**Year ended 31 December 2009**
Revenue	2	55,712	59,889
Gains from sale of non-current assets	8	92	422
Internal expenses capitalized in fixed assets	2	637	787
Operating expenses	3	(33,386)	(33,999)
Impairment reversal/(loss)	8, 9, 10	4,325	(23)
Depreciation and amortisation	8, 9	(11,856)	(12,001)
Operating profit		15,524	15,075
Interest income	4	80	167
Interest expense	4	(240)	(263)
Other finance expense (net)	4	(46)	(102)
Profit before income tax		15,318	14,877
Taxes on income	5	(3,038)	(3,211)
Profit for the year		**12,280**	**11,666**
Other comprehensive income			
Translation differences		(107)	151
Other comprehensive income, net of tax		(107)	151
Total comprehensive income, net of tax		**12,173**	**11,817**
Profit attributable to:			
Equity holders of the Company	6	12,280	11,666
Total comprehensive income attributable to:			
Equity holders of the Company		12,173	11,817
Earnings per share (CZK) – basic*	6	38	36

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

Consolidated balance sheet

as at 31 December 2010

In CZK million	Notes	31 December 2010	31 December 2009
ASSETS			
Property, plant and equipment	8	56,651	57,545
Intangible assets	9	21,437	22,477
Investment in associate	24	22	9
Other financial assets	12	170	285
Deferred tax asset	16	5	–
Non-current assets		**78,285**	**80,316**
Inventories	11	606	618
Receivables and prepayments	12	8,638	9,773
Income tax receivable		453	697
Cash and cash equivalents	13	4,798	1,269
Current assets		**14,495**	**12,357**
Non-current assets classified as held for sale	**8**	**12**	**95**
Total assets		**92,792**	**92,768**
EQUITY AND LIABILITIES			
Ordinary shares	22	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		16,593	17,296
Total equity		**73,176**	**73,879**
Long-term financial debts	15	2,883	3,044
Deferred taxes	16	3,936	3,333
Non-current provisions for liabilities and charges	18	52	24
Non-current other liabilities	14	25	21
Non-current liabilities		**6,896**	**6,422**
Short-term financial debts	15	141	87
Trade and other payables	14	12,408	12,092
Provisions for liabilities and charges	18	171	288
Current liabilities		**12,720**	**12,467**
Total liabilities		**19,616**	**18,889**
Total equity and liabilities		**92,792**	**92,768**

These consolidated financial statements were approved by the Board of Directors on 18 February 2011 and were signed on its behalf by:

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

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

Consolidated statement of changes in ekvity

for the year ended 31 December 2010

In CZK million	Notes	Share capital	Share premium	Foreign exchange translation reserve	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2009		**32,209**	**24,374**	**(206)**	**47**	**6,452**	**15,292**	**78,168**
Currency translation differences – amount arising in year		–	–	151	–	–	–	151
Net income and expense recognised directly in other comprehensive income		–	–	151	–	–	–	151
Net profit		–	–	–	–	–	11,666	11,666
Total comprehensive income		**–**	**–**	**151**	**–**	**–**	**11,666**	**11,817**
Capital contribution and other transfers		–	–	–	(9)	–	7	(2)
Dividends declared in 2009	7	–	–	–	–	–	(16,104)	(16,104)
At 31 December 2009		**32,209**	**24,374**	**(55)**	**38**	**6,452**	**10,861**	**73,879**
At 1 January 2010		**32,209**	**24,374**	**(55)**	**38**	**6,452**	**10,861**	**73,879**
Currency translation differences – amount arising in year		–	–	(107)	–	–	–	(107)
Net income and expense recognised directly in other comprehensive income		–	–	(107)	–	–	–	(107)
Net profit		–	–	–	–	–	12,280	12,280
Total comprehensive income		**–**	**–**	**(107)**	**–**	**–**	**12,280**	**12,173**
Capital contribution and other transfers		–	–	–	–	–	8	8
Dividends declared in 2010	7	–	–	–	–	–	(12,884)	(12,884)
At 31 December 2010		**32,209**	**24,374**	**(162)**	**38**	**6,452**	**10,265**	**73,176**

* Refer to Note 22 regarding amounts not available for distribution.

Consolidated statement of cash flows

Until 2009, the Group used indirect method for reporting cash flow from operating activities. Since year 2010, the Group presents cash flows from operating activities using the direct method as changed presentation is more appropriate. For cash flow from investing activities and cash flow from financing activities, direct method was used for both years 2009 and 2010.

for the year ended 31 December 2010

In CZK million	Poznámka	Rok končící 31. prosince 2010	Rok končící 31. prosince 2009
Cash from operating activities			
Cash received from operations		59 060	62 923
Cash paid to suppliers and employees		-34 913	-37 951
Dividends received		3	0
Net interest and other financial expenses paid		-218	-167
Taxes paid		-2 193	-3 659
Net cash from operating activities		**21 739**	**21 146**
Cash flow from investing activities			
Proceeds on disposals of property, plant and equipment and intangible assets		224	891
Payments on investments in property, plant and equipment and intangible assets		-5 526	-8 486
Payments made on financial investments		-13	0
Net cash used in investing activities		**-5 315**	**-7 595**
Cash flow from financing activities			
Dividends paid		-12 876	-16 087
Proceeds on loans, borrowings and promissory notes		0	943
Cancellation of debentures and bonds		0	-5
Repayments of loans, borrowings and promissory notes		0	-4 024
Net cash used in financing activities		**-12 876**	**-19 173**
Effect of foreign exchange rate changes on collections and payments		**-19**	**-225**
Net increase / (decrease) in cash and cash equivalents during the period		**3 529**	**-5 847**
Cash and cash equivalents at the beginning of the period	**13**	**1 269**	**7 116**
Cash and cash equivalents at the end of the period	**13**	**4 798**	**1 269**
Balance at the beginning of the period	**13**	**1 269**	**7 116**
Cash on hand and at banks		1 251	6 696
Other cash equivalents		18	420
Balance at the end of the period	**13**	**4 798**	**1 269**
Cash on hand and at banks		4 774	1 251
Other cash equivalents		24	18

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 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 policies applied by the Group between IFRS 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 2010, 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:

Revised IFRS 3 Business Combinations (effective 1 July 2009)

The standard introduces changes in the accounting for business combinations that will have an impact on the amount of goodwill recognised, the reported results in the period that an acquisition occurs and on future reported results. The Group applies IFRS 3 (Revised) to all business combinations from 1 January 2010.

IAS 27 Consolidated and Separate Financial Statements - Amendment (effective 1 July 2009)

The most significant changes to IAS 27 are as follows:

i) Changes in the ownership interest of a subsidiary (that do not result in a loss of control) are accounted for as an equity transaction and have no impact on goodwill nor give rise to a gain or loss.
ii) Losses incurred by the subsidiary are allocated between the controlling and non-controlling interests (previously referred to as „minority interest"); even if the losses exceed the non-controlling equity investment in a subsidiary.
iii) On loss of control of a subsidiary, any retained interest is remeasured to fair value and this has impact on the gain or loss recognized on disposal.

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

IFRS 2 Amendment (effective date 1 January 2010) Share-based Payments

The amendment is concerning the accounting for group cash-settled share-based payment transactions. The amendment clarifies how an individual subsidiary in a group should account for some share-based payment arrangements in its own financial statements. In these arrangements, the subsidiary receives goods or services from employees or suppliers but its parent or another entity in the group must pay those suppliers.

This amendment didn't have material impact on the Group consolidated financial statements.

IFRS 5 Amendment (effective 1 January 2010) Non-current Assets Held for Sale and Discontinued Operations – Disclosure

This amendment was issued in order to clarify the disclosure requirements in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Also clarifies that the general requirements of IAS 1 still apply.

There weren't any material changes to the disclosure in the notes to the consolidated financial statements.

IFRS 8 Amendment (effective 1 January 2010) Operating Segments - Disclosure

Minor textual amendment to the standard and amendment to the basis for conclusions, to clarify that an entity is required to disclose a measure of segment assets only if that measure is regularly reported to the chief operating decision-maker. There weren't any material changes to the disclosure in the notes to the consolidated financial statements resulting from this amendment.

IAS 1 Amendment (effective 1 January 2010) Presentation of Financial Statements

The amendment specifies current / non-current classification of convertible instruments and clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time.

This amendment did not have any material impact on the Group consolidated financial statements.

IAS 7 Amendment (effective 1 January 2010) Statement of Cash Flows

Amendment to require that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities. This amendment had no impact on the Group consolidated financial statements, since this treatment was already applied by the Group.

IAS 36 Amendment (effective 1 January 2010) Impairment of Assets

Amendment to clarify that the largest cash-generating unit (or groups of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment as defined by par. 5 of IFRS 8 Operating Segments.

There was no significant impact of the application of this amendment on the Group consolidated financial statements.

IAS 38 Amendments (effective 1 January 2010) Intangible Assets

The first amendment clarifies the effect of the decision in IFRS 3 (Revised) on the accounting for intangible assets acquired in a business combination.

The second amendment clarifies the description in IAS 38, 40 and 41 of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

The Group applies IAS 38 Amendments together with IFRS 3 (Revised) prospectively to all business combination from 1 January 2010.

IFRS 5 Amendment (effective 1 July 2009) Non-current Assets Held for Sale and Discontinued Operations

The amendment clarifies that all of subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control. Relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRS.

The Group applies the IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.

New IFRS and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) not effective as of 31 December 2010 (includes standards and interpretations applicable for the Group)

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

Standards and amendments, Interpretations		Mandatory application: annual periods beginning on or after
IAS 24	Related Party Disclosures (Amendment)	1 January 2011
IAS 32	Financial Instruments: Presentation – Classification of Rights Issues (Amendment)	1 February 2010
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2013
IFRIC 14	Prepayments of a minimum funding requirement (Amendment)	1 January 2011
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	1 July 2010

Improvements to IFRSs		Mandatory application: annual periods beginning on or after
IFRS 3	Business Combinations	1 July 2010 or 1 January 2011
IFRS 7	Financial Instruments: Disclosures	
IAS 1	Presentation of Financial Statements	
IAS 27	Consolidated and Separate Financial Statements	
IFRIC 13	Customer Loyalty Programmes	

The Group is currently assessing the impact of the application of these standards, amendments and interpretations. 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. Changes introduced by IFRS 9 may affect financial assets and future transactions with financial assets carried out on or after 1 January 2013.

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 expensed as are 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. For detail refer to Note E Intangible assets and also to Note 9.

Intercompany transactions and balances between 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.

The ultimate parent company of the Telefónica O2 Czech Republic, a.s. Group is 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 de-recognised or 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, trade names, customer base and roaming contracts. 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 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 9 and Note 10).

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 impairment is only being determined.

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 2010 and 2009, 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 on the finance balance outstanding. 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.

A sale and lease back transaction involves the sale of an asset and the leasing back of the asset. Within the Group's operations the selling price of the asset and lease payments are independent and established at fair value. Therefore the gain from the sale of the asset and the lease payments are accounted as two separate transactions.

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 on the balance sheet.

M. Financial debt

Borrowings are recognised initially at 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 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 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 shares granted 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 a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and 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 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 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 when concluding which accounting treatment to use for principal/agency arrangement.

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, e.g. premium rate lines.

Revenue from fixed price construction contracts (long-term contracts) is recognised on the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. An expected loss on 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. The Group follows the accounting policy of Telefónica Group. Until March 2008, the Group recognised revenues using netto principle and recognised revenues when the contribution was received. From April 2008 until June 2009 the Group reported revenue using gross principle and recognised the compensation when CTO approved the total compensation and decided about percentage shares and absolute amounts of other operators contributions. As a result of further favourable development in smoothing of the recovery process and associated environment, since July 2009 the Group started to recognise the compensation of revenues attributable to the Group on standard accrual basis while keeping the gross principle of recording.

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 Company's network, 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 and accessories and other sale of 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.

(2) Mobile business revenues

The Group earns mobile services revenue from customers usage of the Group's network, interconnection and roaming – collectively, "Mobile service revenue". 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 recognized 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 calculated from historical experience of expired airtime.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime and 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.

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.

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 15.

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 rate debts.

(iii) Liquidity risk

The Group's essential objective of liquidity risk management is to have ready access to 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

Concentrations of credit risk, with respect to trade accounts receivable, are 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 the national economy.

The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 12. There are no significant concentrations 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 to credit risk 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),
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) 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.

Credit management activities during last years

During last years the Group introduced new credit management activities such as:

a) implementation of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),
b) implementation of the integrated system solution RMCA for scoring, maintenance and collection of receivables (fixed and mobile) and reporting,
c) use of integrated Black Lists of fixed and mobile debtors during activation process,
d) implementation of strict activation rules for all distribution channels, especially for Indirect Sales partners.

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. As at 31 December 2010, the total amount of provision for current income taxes is CZK 2,488 million, advances paid for income taxes amount to CZK 2,941 million and the net deferred tax liability is CZK 3,936 million and the net deferred tax asset is CZK 5 million.

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 the income statement for the period. The decision to recognize an impairment loss involves estimates of the timing and 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 assess 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 10).

The Group tests at each reporting date goodwill for an impairment. 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. At 31 December 2010 the carrying amount of goodwill is CZK 13,448 million (See Note 9).

3) Provisions and contingent liabilities

As set out in Note 19 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 will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. 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. At 31 December 2010 the carrying amount of the provision for regulatory and court decisions is CZK 129 million (see Note 18).

V. Change in accounting policy

No significant changes in accounting policies were applied in 2010 and 2009.

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 include primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

Notes to the consolidated financial statements

Contents

1. Segment information

Business segments recognised by the Group are as follows:

- Fixed - network communications services using a fixed network and IS/ICT services provided by the Company and other consolidated subsidiaries,
- Mobile - mobile communications services provided by the Company and by Telefónica O2 Slovakia, s.r.o.

Year ended 31 December 2010 **In CZK million**	**Fixed**	**Mobile***	**Group**
Revenues	24,759	31,749	56,508
Inter-segment sales	(345)	(451)	(796)
Total consolidated revenues	24,414	31,298	55,712
Gains from sale of non-current assets	92	–	92
Internal expenses capitalised in fixed assets	383	254	637
Costs	(15,492)	(18,690)	(34,182)
Inter-segment purchases	451	345	796
Total consolidated costs	(15,041)	(18,345)	(33,386)
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 profit	6,441	9,083	15,524
Interest and other financial costs (net)			(206)
Profit before tax			15,318
Tax			(3,038)
Profit after tax			12,280
Net profit			**12,280**
Assets (excluding goodwill and non-current assets held for sale)	52,444	26,888	79,332
Goodwill	128	13,320	13,448
Non-current assets held for sale	12	–	12
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	**2,871**	**2,792**	**5,663**

* Standalone Revenues of Telefónica O2 Slovakia, s.r.o. of CZK 2,824 million included.

Year ended 31 December 2009 In CZK million	Fixed	Mobile**	Group
Revenues	27,387	33,500	60,887
Inter-segment sales	(394)	(604)	(998)
Total consolidated revenues	26,993	32,896	59,889
Gains from sale of non-current assets	422	–	422
Internal expenses capitalised in fixed assets	525	262	787
Costs	(15,323)	(19,674)	(34,997)
Inter-segment purchases	604	394	998
Total consolidated costs	(14,719)	(19,280)	(33,999)
Impairment charge	(17)	(6)	(23)
Depreciation	(7,040)	(2,937)	(9,977)
Amortisation	(850)	(1,174)	(2,024)
Total consolidated depreciation and amortization	(7,890)	(4,111)	(12,001)
Operating profit	5,314	9,761	15,075
Interest and other financial costs (net)			(198)
Profit before tax			14,877
Tax			(3,211)
Profit after tax			11,666
Net profit			**11,666**
Assets (excluding goodwill and non-current assets held for sale)	51,455	27,770	79,225
Goodwill	128	13,320	13,448
Non-current assets held for sale	95	–	95
Total assets	**51,678**	**41,090**	**92,768**
Trade and other payables	4,826	7,266	12,092
Other liabilities	3,129	3,668	6,797
Total liabilities	**7,955**	**10,934**	**18,889**
Capital expenditure	**3,256**	**3,233**	**6,489**

** Standalone revenues of Telefónica O2 Slovakia, s.r.o. of CZK 1,961 million 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 most appropriate for segment recognition.

The inter-segment pricing rates applied in 2010 and 2009 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. Revenue and Internal expenses capitalized in fixed assets

Revenue In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Voice - outgoing	11,875	13,162
Interconnection and other wholesale services	8,936	9,973
Monthly and one-off charges from voice services	13,564	15,370
Connection charges	5	147
SMS & MMS & Value added services	4,765	4,898
Leased lines and fixed data services	3,132	3,509
Internet (including monthly and one-off charges), mobile data services and IPTV	8,342	7,406
IT and business solutions	2,555	2,760
Equipment and activation fee	1,473	1,545
Other telecommunication revenues	915	981
Other revenues	150	138
Total revenues	**55,712**	**59,889**

Revenues from related parties are disclosed in Note 23.

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 2010	31 December 2009
No later than 1 year	104	146
Later than 1 year and not later than 5 years	348	605
Later than 5 years	89	156
Total	**541**	**907**

Internal expenses capitalized in fixed assets In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Material	–	15
Labour	637	772
Total	**637**	**787**

3. Operating expenses

The following items have been included into the operating expenses:

Operating expenses In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Wages and salaries*	4,770	5,057
Redundancy payments	458	161
Social security contributions (Note17)	1,595	1,642
Staff welfare costs	248	262
Total staff costs	**7,071**	**7,122**
Interconnection and roaming	**10,205**	**11,381**
Cost of goods sold	1,920	2,308
Contents	326	266
Customer loyalty program	–	77
Sub-deliveries	849	1,298
Commissions	1,332	1,212
Telecom services	199	232
Other cost of sales	472	672
Billing and collection	393	422
Marketing	1,287	1,576
Call centres	517	426
Network & IT repairs and maintenance	2,508	2,414
Rentals, buildings and vehicles	2,228	2,190
Utilities supplies	1,072	1,087
Consultancy and professional fees	162	184
Other external services	1,733	174
Provision for bad and doubtful debts and inventories	602	478
Taxes (other than income tax)	472	447
Other operating expenses	38	33
Total operating expenses	**33,386**	**33,999**

* Certain Group employees (including the Board of Directors) with specialised know how, or who have access to business secrets, or who are considered important to the development of the business, are bound by non-competition restrictions, for a maximum period of 12 months from the date of termination of their employment with the Group. The Group paid CZK 4 million in relation to such non-competition clauses in 2010 (2009: CZK 14 million).

An appropriately approved restructuring plan covering both employees and members of management has been introduced by the Group during 2010. As a result of the restructuring process the Group incurred restructuring costs of CZK 427 million during the period ended 31 December 2010 that have been recognised for the redundancy payments.

Statutory auditor's fees for the year ended 31 December were as follows:

In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Auditor's fees	27	25

Purchases from related parties are disclosed in Note 23.

4. Interest and other finance income and expense

In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Financial income		
Interest income	80	167
Gain on fair value adjustments of financial instruments	–	71
Other financial income	287	1,067
Total financial income	367	1,305
Financial expenses		
Interest expenses	(240)	(263)
Loss on fair value adjustments of financial instruments	(175)	–
Other financial expenses	(158)	(1,240)
Total financial expenses	(573)	(1,503)
Net financial loss	(206)	(198)

5. Income taxes

In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Total income tax expense is made up of:		
— Current income tax charge	2,440	3,178
— Deferred income tax charge (Note 6)	598	33
Taxes on income	3,038	3,211

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:

V milionech Kč	Year ended 31 December 2010	Year ended 31 December 2009
Profit before tax	15,318	14,877
Income tax charge calculated at the statutory rate of 19 % (2009: 20 %)	2,910	2,975
Not taxable income	(21)	–
Expenses not deductible for tax purposes	142	151
Tax related to prior periods	(63)	(69)
Unrecognised tax losses	70	154
Taxes on income	3,038	3,211
Effective tax rate	20 %	22 %

6. 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 2010	31 December 2009
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	12,280	11,666
Basic earnings per share (CZK)	38	36

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

7. Dividends

In CZK million	31 December 2010	31 December 2009
Dividends declared (including withholding tax)	12,884	16,104

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2010. Approval of the 2010 profit and the decision regarding the amount of any dividend payment for the 2010 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 2010	Year ended 31 December 2009
Dividend per share (nominal value of 100 CZK)	40	50

8. Property, plant and equipment

In CZK million	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress including advances paid	Total
At 31 December 2010						
Opening net book amount	11,424	33,144	8,029	1,728	3,220	57,545
Additions	483	968	2,680	547	4,289	8,967
Disposals and other movements	(40)	(4)	(16)	(6)	(4,653)	(4,719)
Assets classified as held for sale	(3)	(1)	–	–	–	(4)
Depreciation charge	(707)	(4,634)	(3,275)	(858)	–	(9,474)
Impairment charge	(1)	–	7	–	(14)	(8)
Impairment reversal	366	3,783	192	3	–	4,344
Closing net book amount	11,522	33,256	7,617	1,414	2,842	56,651
At 31 December 2010						
Cost	20,290	102,040	88,931	8,263	2,880	222,404
Accumulated depreciation and impairment allowance	(8,768)	(68,784)	(81,314)	(6,849)	(38)	(165,753)
Net book amount	11,522	33,256	7,617	1,414	2,842	56,651
At 31 December 2009						
Opening net book amount	10,764	36,227	11,187	1,891	3,360	63,429
Additions	562	760	2,273	871	4,307	8,773
Disposals and other movements	995	398	(1,334)	(103)	(4,435)	(4,479)
Assets classified as held for sale	(185)	(3)	–	–	–	(188)
Depreciation charge	(712)	(4,238)	(4,096)	(931)	–	(9,977)
Impairment charge	–	–	(1)	–	(12)	(13)
Closing net book amount	11,424	33,144	8,029	1,728	3,220	57,545
At 31 December 2009						
Cost	19,954	101,175	88,248	9,646	3,252	222,275
Accumulated depreciation and impairment allowance	(8,530)	(68,031)	(80,219)	(7,918)	(32)	(164,730)
Net book amount	11,424	33,144	8,029	1,728	3,220	57,545

As at 31 December 2010, the carrying value of non-depreciated assets amounted to CZK 215 million (2009: CZK 214 million).

No property, plant and equipment were pledged as at 31 December 2010.

No borrowing costs were capitalized during the years 2010 and 2009.

The Group reports and classifies the following assets held for sale at the balance sheet date:

In CZK million	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
At 31 December 2010				
Opening net book amount	95	–	–	95
Disposals and other movements	(76)	–	–	(76)
Impairment charge	(11)	–	–	(11)
Assets re-classified as held for sale	4	–	–	4
Closing net book amount	12	–	–	12
At 31 December 2010				
Cost	502	86	69	657
Accumulated depreciation and impairment allowance	(490)	(86)	(69)	(645)
Net book amount	12	–	–	12
At 31 December 2009				
Opening net book amount	96	–	–	96
Disposals and other movements	(179)	–	–	(179)
Impairment charge	(10)	–	–	(10)
Assets re-classified as held for sale	188	–	–	188
Closing net book amount	95	–	–	95
At 31 December 2009				
Cost	804	120	76	1,000
Accumulated depreciation and impairment allowance	(709)	(120)	(76)	(905)
Net book amount	95	–	–	95

Assets intended for sale in most cases represent buildings with land which the Group will not use in the future and it is expected that their sale will take place within one year.

The non-current assets classified as held for sale are presented in the fixed segment.

In 2010, the Group achieved a total gain from the sale of the above fixed assets amounting to CZK 92 million (2009: CZK 422 million) and total losses in amount CZK 19 million (2009: CZK 14 million).

At the beginning of 2009, the Group completed the substantial part of a real estate usage optimisation process and sold a construction site and two administrative buildings of the former headquarters in Olšanská street in Prague with a net gain exceeding CZK 300 million.

Cost of fully depreciated property, plant and equipment was CZK 71,620 million as at 31 December 2010 (2009: CZK 69,937 million).

9. Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2010				
Opening net book amount	13,448	4,029	5,000	22,477
Additions	–	–	1,373	1,373
Disposals and other movements	–	(7)	(24)	(31)
Amortisation charge	–	(394)	(1,988)	(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
At 31 December 2009				
Opening net book amount	13,448	4,425	4,475	22,348
Additions	–	–	2,161	2,161
Disposals and other movements	–	(2)	(6)	(8)
Amortisation charge	–	(394)	(1,630)	(2,024)
Closing net book amount	13,448	4,029	5,000	22,477
At 31 December 2009				
Cost	13,448	6,223	26,478	46,149
Accumulated amortisation and impairment allowance	–	(2,194)	(21,478)	(23,672)
Net book amount	13,448	4,029	5,000	22,477

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 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. There is no other intangible asset with indefinite useful life.

The Group performed impairment tests and as result of the test the Group did not recognize any impairment losses of goodwill in 2010 and 2009. 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 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, which has been approved by the management and which is 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 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 weighted average of cost of capital ("WACC").

Licences

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks in the Czech Republic. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 MHz spectrum. In 1999, Eurotel acquired an additional GSM 1800 MHz spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of six years.

In 2002, Eurotel renewed its 450 MHz license; the current license enables the mobile segment to offer every internationally recognized public mobile telecommunication services on frequency of 450 MHz. Mobile segment currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The NMT license is currently valid for the remaining period of two years.

In December 2001, Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, Eurotel was provided with deferred payment terms by the Czech Telecommunication Office ("CTO") to finance the license acquisition. In December 2003, Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement. UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

With respect to the operation launch in 2007, the license for GSM and UMTS networks was awarded to Telefónica O2 Slovakia on 7 September 2006 for SKK 150 million (EUR 4.1 million).

Carrying value of licences:

In CZK million	31 December 2010	31 December 2009
GSM 900 license	402	474
GSM 1800 license	324	382
NMT 450 license	19	26
UMTS license	2,769	3,019
GSM and UMTS license – TO2 Slovakia	114	128
Total	3,628	4,029

No borrowing costs were capitalized during the years 2010 and 2009.

Cost of fully amortised intangible assets was CZK 19,063 million as at 31 December 2010 (2009: CZK 16,403 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.

10. 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 of 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 of 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 at 31 December 2010, the management of the Group reviewed the indicators which could have indicated whether the CGU's assets may be impaired. Assessment carried out as of 31 December 2010 confirmed that no such indicator exists and the value of the existing assets are fairly stated.

11. Inventories

In CZK million	**31 December 2010**	**31 December 2009**
Telecommunication material	235	159
Cables	20	31
Other inventory including goods for resale	337	404
Finished products and work in progress	14	24
Total	606	618

The inventories noted above are stated net of an allowance of CZK 61 million (2009: CZK 68 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 67 million (2009: CZK 55 million). The amount of inventories recognised as an expense is CZK 2,477 million (2009: CZK 2,765 million).

12. Receivables and prepayments

In CZK million	31 December 2010	31 December 2009
Trade receivables (net)	7,533	8,464
Other debtors (net)	272	402
Prepayments	821	799
Other financial assets - short-term	3	–
Derivative instruments	9	108
Total	8,638	9,773

Trade receivables are stated net of bad debt provision of CZK 3,831 million (2009: CZK 3,661 million). In order to preserve the tax-deductible status of the bad debt expense, the Group's trade receivables are not written off and removed from the primary books and records until certain statutory collection requirements have been satisfied.

Receivables from related parties are disclosed in Note 23.

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 2010	7,533	3,333	377	27	32	119
At 31 December 2009	8,464	3,579	321	207	131	50

Bad debt provisions	In CZK million
At 1 January 2009	3,457
Additions	3,422
Retirements/amount paid	(3,218)
At 31 December 2009	3,661
Additions	3,488
Retirements/amount paid	(3,318)
At 31 December 2010	3,831

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 2010 the Group presented non-current assets of CZK 170 million (2009: CZK 285 million) consisting of long-term credits and advance payments for long-term expenses, which are classified as other financial assets.

13. Cash and cash equivalents

In CZK million	31 December 2010	31 December 2009	Interest rate
Cash at current bank accounts	220	169	Floating
Cash at cash-pooling structures (inter-company)	4,578	1,100	Floating
Total cash and cash equivalents	4,798	1,269	

As at 31 December 2010 and 2009 cash equivalents of the Group comprise interest bearing deposits with maximum maturity of three months.

Since April 2006, the Group entered into mutual Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective operating free cash flow.

At 31 December 2010, the Group had available equivalent of CZK 4,240 million (2009: CZK 4,115 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 2010	31 December 2009
Cash and cash equivalents	4,798	1,269

As of 31 December 2010 and 2009 no cash and cash equivalents were pledged.

14. Trade and other payables

In CZK million	31 December 2010	31 December 2009
Trade creditors (net)	5,290	3,912
Other taxes and social security	185	198
Deferred revenue	1,012	1,032
Employee wages and benefits	748	784
VAT payable	418	598
Other creditors	279	297
Accruals	4,476	5,271
Total payables	12,408	12,092
Other non-current liabilities	25	21

As at 31 December 2010 and 2009 other non-current liabilities include primarily principals and liabilities with maturity in more than 12 months.

15. Financial debt

In CZK million	31 December 2010	31 December 2009
Bank loans in foreign currencies	2,883	3,044
Accrued interest including commitment fees	80	84
Derivatives	61	3
Other financial debt	141	87
Total financial debt	3,024	3,131
Repayable:		
Within one year	141	87
Between two and five years (total non-current)	2,883	3,044
Total financial debt	3,024	3,131

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 2010, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2010 and 2009 the Group does not utilize bank overdrafts.

The Group's loan interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2010	31 December 2009
At fixed rate	2,883	3,044

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate that the Board of Directors expects to be available to the Group at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2010	2009
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 2010 based on contractual undiscounted payments.

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	0
Trade and other payables (except for deferred revenue)	10,007	1,389	–	0
Derivatives (net)	61	–	–	0
Total	10,068	1,580	3,074	0
Non-current other liabilities	–	–	16	9

At 31 December 2009 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5 years
Interest bearing loans and borrowings	–	202	3,448	–
Trade and other payables (except for deferred revenue)	9,878	1,182	–	–
Derivatives (net)	3	–	–	–
Total	9,881	1,384	3,448	–
Non-current other liabilities	–	–	14	7

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	**2010**	**2009**	**2010**	**2009**
Financial assets				
Cash and cash equivalents	4,798	1,269	4,798	1,269
Short-term loans (incl. accrued interest)	3	–	3	–
Derivatives	9	108	9	108
Other financial assets	170	285	170	285
Financial liabilities				
Interest bearing loans and borrowings:				
— Fixed rate borrowings (incl. accrued interest)	2,963	3,128	3,169	3,432
Derivatives	61	3	61	3

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 which have a significant effect on the recorded fair value that are not based on observable market data.

As at 31 December 2010 and 31 December 2009, the Group held only the foreign exchange contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2010, 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	**2010**	**2009**
FX risk		
Value at Risk*	(163)	(298)
Stress testing*	(52)	(56)
IR risk		
Stress testing*	(108)	(76)

* 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.

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.

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	
	2010	**2009**	**2010**	**2009**
Foreign exchange contracts	136	171	(52)	105

16. 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 2009 and 2010.

In CZK million	2010	2009
At 1 January	3,333	3,300
Statement of comprehensive income tax charge / (credit) (Note 5)	598	33
At 31 December	3,931	3,333

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

As deferred income taxes of Telefónica O2 Business Solutions, spol. s r.o. are liable to different fiscal authority, deferred tax asset of this company is not offset and is reported separately in the position Deferred tax asset.

The following amounts are shown in the consolidated balance sheet:

In CZK million	31 December 2010	31 December 2009
Deferred tax assets	(254)	(318)
Deferred tax liabilities	4,185	3,651
Total	3,931	3,333

The deferred tax asset includes CZK 225 million (2009: CZK 291 million) recoverable in less than twelve months and CZK 29 million (2009: CZK 27 million) recoverable after more than twelve months. The deferred tax liability includes CZK 452 million (2009: CZK 380 million) payable in less than twelve months and CZK 3,733 million (2009: CZK 3,271million) payable in more than twelve months.

The deferred tax is determined by these components:

	Consolidated balance sheet		Consolidated profit or loss	
In CZK million	2010	2009	2010	2009
Temporary differences relating to:				
— property, plant and equipment and intangible assets	4,160	3,623	537	(303)
— trade receivables, inventories and other differences	(229)	(290)	61	336
Total	3,931	3,333	598	33

Telefónica O2 Slovakia, s.r.o. does not recognize a deferred tax asset due to uncertainty of taxable profits in future accounting periods.

As at 31 December 2010 the total amount of unused tax losses, deductible temporary differences between accounting and tax carrying amount of fixed assets and other deductible temporary differences of Telefónica O2 Slovakia, s.r.o. for which no deferred tax asset is recorded totals to CZK 4,079 million (2009: CZK 4,000 million).

As at 31 December 2010 the total amount of unused tax losses of Telefónica O2 Slovakia, s.r.o. that will be carried forward totals to CZK 3,312 million (2009: CZK 3,379 million).

The tax loss in the Slovak Republic generated until 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.

17. Government social security and pension schemes

The Group is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2010 and 2009, the Group paid contributions at a rate of 34 % of gross salaries and is not required to make any contributions in excess of this statutory rate. The total amount charged to operating expenses in respect of this scheme was CZK 1,595 million in 2010 (2009: CZK 1,642 million) (Note 3). Employees contribute 11 % of their gross salaries.

The Group has a voluntary pension plan for employees under which the Group makes contributions on behalf of the Group's employees to approved pension plan providers, under defined contribution schemes. The Group's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Group made contributions of CZK 52 million (2009: CZK 57 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2010 relating to employee retirement amounted to CZK 0.2 million (2009: CZK 0.1 million) and were charged as an operating expense.

All amounts discussed in the above note are included in staff costs (see Note 3).

18. Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Sale of real estate portfolio provision	Other	Total
At 1 January 2010	37	11	106	139	19	312
Additions during the year	124	422	115	23	29	713
Utilised during the year	(32)	(429)	(174)	(130)	(37)	(802)
At 31 December 2010	**129**	**4**	**47**	**32**	**11**	**223**
Short-term Provisions 2010	87	4	37	32	11	171
Long-term Provisions 2010	42	–	10	–	–	52
	129	**4**	**47**	**32**	**11**	**223**
Short-term Provisions 2009	21	11	98	139	19	288
Long-term Provisions 2009	16	–	8	–	–	24
	37	**11**	**106**	**139**	**19**	**312**

With the exception of the regulatory and court decisions and other small items 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.

Employee related costs

Provisions for employee-related costs include expected costs associated with untaken holiday compensation and share plans.

Sale of real estate portfolio

The provision was established to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold (see Note 8).

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Group companies (see Note 19).

19. Contingencies

The Company is involved in a number of legal disputes arising from standard business interactions. Throughout 2010 the Company continued the successful trend of defending itself against law-suits filed by third parties in the past. Major legal disputes and other proceedings relating to the Company are shown below. The Company's management team is convinced that all potential risks arising from the below disputes are sufficiently reflected in the financial statements. The publication of other details on the disputes is not deemed by the Company as appropriate as this could anticipate the position of the Company on these matters:

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 by its verdict of 30 September 2009 dismissed the remaining part of the legal action as groundless. The Company, based on the evolution so far, believes that the High Court will confirm this verdict in appeal proceedings. The hearing in this case is scheduled for February 2011.

ÚOHS (Office for Protection of Economic Competition)

I. Preliminary investigation
   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 not abused its dominant position in the broadband market. The investigation was also commented in the media. 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 immensely grew, 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.

II. Proceedings 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 proceedings 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 in the meantime had cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. In reaction to this evolution, the Company has created a provision in a relevant amount to cover all eventualities (even only for an interim period of time) to return the penalty to the Office's account.

Other legal disputes

I. AUGUSTUS, spol. s r.o. has been 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 proceedings 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. AUGUSTUS, spol. s r.o. filed an appeal but has not even paid the court charges until now. The Company in its reaction to the dismissal of the verdict and the subsequent dismissal of the lawsuit, filed a suit against AUGUSTUS, spol. s r.o. to return the amount of CZK 139 million. 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 is based on the contract for the issue of phone cards which ended in 1995. AUGUSTUS, spol. s r.o. is trying in this suit to present some other claims that have no legal grounds and are even in the mutual contradiction. The Company is taking all steps leading to a consistent defence from this illegitimate claim and believes in full success in these proceedings. Given the sued amount, the Company also publishes information about this suit. With respect to the judicature of the Supreme Court and the evolution of the proceedings, the Company's management team is confident in winning this case.
III. MEDIATEL, a.s., cooperating with the Company since 1992 on the publishing of the phone directory distributed to all telecommunications subscribers (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 suit. The hearing has not been scheduled so far. The Company is convinced of taking into account all potential risks of this suit.
IV. 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 Company has expressed its comments on the suit being convinced of taking fully into account all potential risks of this suit.

V. The Company is involved in other legal disputes. The aggregate value of all disputes over CZK 5 million not closed with a verdict in 2010 totals to nearly CZK 30 million. The annual profit and loss statement takes also into account some minor disputes, however, with risks of lesser importance.

20. Commitments

Operating leases

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2010	31 December 2009
No later than 1 year	1,421	1,453
Later than 1 year and not later than 5 years	4,630	4,900
Later than 5 years	4,087	4,747
Total	10,138	11,100

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2010 were CZK 1,522 million (2009: CZK 1,496 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 2010 were CZK 438 million (2009: CZK 371 million).

Capital and other commitments

In CZK million	31 December 2010	31 December 2009
Capital and other expenditure contracted but not provided for in the financial statements	4,699	5,422

The majority of contracted amounts relate to the telecommunications network and service contracts.

21. 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 and 516/3.

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 radio frequency assignment from CTO valid until 7 February 2011 is provided broadband mobile access to Internet.

Validity of radio frequency assignment 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.

No additional expenses or any limitations connected with renewal of the radio frequency assignments are expected in accordance with the existing interpretation of regulatory provisions.

Provision of electronic communications services in Slovakia

In 2006 Telefónica O2 Slovakia 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. Validity of the licence is possible to prolong for next period on the basis of application submitted to the Telecommunication Office of the Slovak Republic.

The following obligations were part of the licence:

a) putting into operation the 800 GSM base stations and to cover 45 % of population by the own network,
b) launch services in respect of welcome melodies and lease of phones.

These obligations were fulfilled in year 2008.

Imposition of obligations related to provision of universal service

During the year 2010 and 2009, 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) supplementary services to service of connection at a fixed location to the public telephone network and the service of access to publicly available telephone services at a fixed location:
   — phased payment of the price for the establishment of connection to the public telephone network for consumer,
   — free selective barring of outgoing calls for the subscribers, and
   — free itemised billing of the price for consumer*,
d) 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.

* Na základě rozhodnutí ČTÚ jsou služby uvedené pod písm. c) vyjmuty z režimu univerzální služby od 30. července 2009. Tyto služby jsou nadále poskytovány v komerčním režimu mimo univerzální službu.

22. Share capital and reserves

	31 December 2010	31 December 2009
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

* By the decision of the Extraordinary General Meeting held on 10 September 2010, the form of ordinary shares with a nominal value of CZK 100 issued as bearer shares was transformed in registered shares. The change in the form of shares was registered in the Commercial Register on 13 September 2010. Change of the shares form has no impact on existing rights of the shareholders.

Shareholdings in the Company were as follows:

	31 December 2010	31 December 2009
Telefónica, S.A.	69.41 %	69.41 %
Other shareholders	30.59 %	30.59 %

Funds include a statutory reserve fund of CZK 6,442 million (2009: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve 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. fixed and mobile broadband internet and data, IPTV, mobile services, corporate and public administration ICT solutions and further in the expansion and development of the mobile services in Slovakia.

At present, the approach that the Company follows is not to retain surplus cash. In the following periods, the Board of Directors will continue to evaluate and carry out 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.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2010	31 December 2009
Capital	73,138	73,841
Equity settled share based payment reserve	38	38
Total	**73,176**	**73,879**

23. Related party transactions

The Group provides services to all related parties on normal 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 no allowance or write off was incurred.

The following transactions were carried out with related parties:

I. Parent company:

In CZK million	For the period ended 31 December 2010	For the period ended 31 December 2009
Dividend paid to Telefónica, S.A.	8,943	11,179
Royalty fees (Telefónica, S.A.)	844	754
Management fees (Telefónica, S.A.)	213	–

Balance sheet in CZK million	31 December 2010	31 December 2009
a) Receivables	1	4
b) Payables	1,072	764

II. Other related parties – Telefónica Group:

Balance sheet in CZK million	31 December 2010	31 December 2009
a) Receivables	445	577
b) Payables	256	110
c) Short-term receivables (interest)	3	–
d) Cash equivalents (Note 13)	4,578	1,100

Profit or loss In CZK million	For the period ended 31 December 2010	For the period ended 31 December 2009
a) Sales of services and goods	808	1,058
b) Purchases of services and goods	777	566
c) Interest income	53	149
d) Interest expense	–	41

There were no capital purchases carried out with related parties for the period ended 31 December 2010 (for the period ended 31 December 2009 capital purchases amounted to CZK 54 million).

The list of the Telefónica companies with which the Company had any transaction in 2010 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica O2 Germany GmbH& CO.OHG, Telefónica O2 UK Ltd., Telefónica O2 Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Telefónica Deutschland GmbH, Telefónica Soluciones, ALTAIR ASSURANCES S.A., Telecom Italia Sparkle S.p.A., Manx Telecom Ltd., 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., Portugal Telecom, Telecom Italia S.p.A., Telfisa Global, BV., Telefónica Finanzas, S.A., Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., Telefónica Gestión de Servicios Compartidos, S.A., Telefónica Factoring E.F.C., S.A., Atento Chequia, 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.

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 2010	31 December 2009
Salaries and other short-term benefits	110	122
Personal indemnification insurance	5	5
Total	115	127

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2010 and 2009.

No other loan was provided to related parties by the Group.

24. Principal subsidiary undertakings

As at 31 December 2010

		Group's interest	Cost of investment In CZK million	Country of incorporation	Activity	Method of consolidation
Subsidiaries						
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

As at 31 December 2009

		Group's interest	Cost of investment In CZK million	Country of incorporation	Activity	Method of consolidation
Subsidiaries						
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 %	13	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 %	5,081	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

In May 2010, the Board of Directors approved increase of the registered capital of Telefónica O2 Slovakia, s.r.o. by a monetary investment in the amount of EUR 40 million from the amount of the registered capital of EUR 200 million to the amount of the registered capital of EUR 240 million. Effective date of increase of the registered capital was 6 May 2010.

The Company and six other shareholders have founded the company MOPET CZ a.s. The purpose of the company MOPET CZ a.s. is a launch of new services which would enable paying in real time for goods and services, paying bills and invoices, sending money or paying for purchases on the Internet using a mobile telephone.

25. Post balance sheet events

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 2010.

06

Financial statements

for the year ended 31 December 2010 prepared in accordance with international reporting standards

Open communication

06

Financial statements

for the year ended 31 December 2010 prepared in accordance with international reporting standards

Content

General information

Telefónica O2 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 7,511 in 2010 (2009: 8,282).

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 18 February 2011.

Restructuring and network outsourcing (Field Line Maintenance)

During 2010, the Company pursued the strategy of continuous efficiency and cost optimization by introducing new projects in various areas of its business. Restructuring projects resulted in transfer of some activities to outsourcing partners. During the restructuring process more than 1,000 employees were made redundant and the Company incurred restructuring costs of CZK 422 million (see Note 3).

As a result of network operation optimization Field Line Maintenance including fail rectification and supportive technological maintenance are being outsourced to a strategic partner of the Company.

Impairment of fixed line segment assets

As of 30 June 2010 and 31 December 2010, the management of the Company reviewed the indicators which could have indicated that previously recognised impairment loss of fixed line segment assets which constitute cash generating unit (CGU) made in 2003 may no longer be relevant.

Based on a detailed impairment analysis performed as of 30 June 2010 the Company has reversed previously recognised impairment loss of CZK 4,344 million attributable to the fixed line segment assets constituting the CGU.

As of 31 December 2010, the Company assessed whether there is any indication that the CGU may be impaired. Assessment carried out as of 31 December 2010 confirmed that no such indicator exists and the value of the existing CGU is fairly stated.

Independent auditors' report to the shareholders of Telefónica O2 Czech Republic, a.s.

To the shareholders of Telefónica O2 Czech Republic, a.s.

We have audited the accompanying financial statements of Telefónica O2 Czech Republic, a.s. ("the Company"), which comprise the balance sheet as at 31 December 2010, 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's 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 the 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 2010, 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.	Brian Welsh	Petr Vácha	18 February 2011
License No. 401	Partner	Auditor,	Prague,
Represented by		License No. 1948	Czech Republic

Statement of total comprehensive income

For the year ended 31 December 2010

In CZK million	**Notes**	**Year ended 31 December 2010**	**Year ended 31 December 2009**
Revenue	2	53,159	58,054
Gains from sale of non-current assets	8	91	422
Internal expenses capitalized in fixed assets	2	568	660
Operating expenses	3	(30,878)	(31,661)
Impairment reversal/(loss)	8, 9, 10	4,325	(23)
Depreciation and amortisation	8, 9	(11,421)	(11,688)
Operating profit		15,844	15,764
Interest income	4	86	165
Interest expense	4	(240)	(229)
Other finance income (expense)	4	39	(89)
Profit before income tax		15,729	15,611
Taxes on income	5	(3,033)	(3,197)
Profit for the year		**12,696**	**12,414**
Other comprehensive income			
Other comprehensive income, net of tax		–	–
Total comprehensive income, net of tax		**12,696**	**12,414**
Profit attributable to:			
Equity holders of the Parent	6	12,696	12,414
Total comprehensive income attributable to:			
Equity holders of the Parent		12,696	12,414
Earnings per share (CZK) – basic*	6	39	39

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

Balance sheet

As at 31 December 2010

In CZK million	Notes	31 December 2010	31 December 2009
ASSETS			
Property, plant and equipment	8	54,516	55,186
Intangible assets	9	20,735	21,677
Investment in subsidiaries and associates	24	6,396	5,351
Other financial assets	12	165	1,311
Non-current assets		**81,812**	**83,525**
Inventories	11	577	585
Receivables and prepayments	12	8,641	9,140
Income tax receivable		443	694
Cash and cash equivalents	13	4,781	1,241
Current assets		**14,442**	**11,660**
Non-current assets classified as held for sale	**8**	**12**	**95**
Total assets		**96,266**	**95,280**
EQUITY AND LIABILITIES			
Ordinary shares	22	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		21,026	21,207
Total equity		**77,609**	**77,790**
Long-term financial debts	15	2,883	3,044
Deferred taxes	16	3,936	3,333
Non-current provisions for liabilities and charges	18	51	23
Non-current other liabilities	14	21	19
Non-current liabilities		**6,891**	**6,419**
Short-term financial debts	15	141	87
Trade and other payables	14	11,468	10,710
Provisions for liabilities and charges	18	157	274
Current liabilities		11,766	11,071
Total liabilities		**18,657**	**17,490**
Total equity and liabilities		**96,266**	**95,280**

These financial statements were approved by the Board of Directors on 18 February 2011 and were signed on its behalf by:

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

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

Statement of changes in ekvity

For the year ended 31 December 2010

In CZK million	Notes	Share capital	Share premium	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2009		**32,209**	**24,374**	**45**	**6,450**	**18,401**	**81,479**
Net profit		–	–	–	–	12,414	12,414
Total comprehensive income		**–**	**–**	**–**	**–**	**12,414**	**12,414**
Capital contribution and other transfers		–	–	(9)	–	10	1
Dividends declared in 2009	7	–	–	–	–	(16,104)	(16,104)
At 31 December 2009		**32,209**	**24,374**	**36**	**6,450**	**14,721**	**77,790**
At 1 January 2010		**32,209**	**24,374**	**36**	**6,450**	**14,721**	**77,790**
Net profit		–	–	–	–	12,696	12,696
Total comprehensive income		**–**	**–**	**–**	**–**	**12,696**	**12,696**
Capital contribution and other transfers		–	–	(2)	–	9	7
Dividends declared in 2010	7	–	–	–	–	(12,884)	(12,884)
At 31 December 2010		**32,209**	**24,374**	**34**	**6,450**	**14,542**	**77,609**

* Refer to Note 22 regarding amounts not available for distribution.

Statement of cash flows

Until 2009, the Company used indirect method for reporting cash flow from operating activities. Since year 2010, the Company presents cash flows from operating activities using the direct method as changed presentation is more appropriate. For cash flow from investing activities and cash flow from financing activities, direct method was used for both years 2009 and 2010 .

For thr year ended 31 December 2010

In CZK million	Notes	Year ended 31 December 2010	Year ended 31 December 2009
Cash from operating activities			
Cash received from operations		56,679	61,629
Cash paid to suppliers and employees		(32,877)	(36,010)
Dividends received		111	11
Net interest and other financial expenses paid		(211)	(134)
Taxes paid		(2,178)	(3,632)
Net cash from operating activities		21,524	21,864
Cash flow from investing activities			
Proceeds on disposals of property, plant and equipment and intangible assets		224	891
Payments on investments in property, plant and equipment and intangible assets		(5,019)	(7,270)
Payments made on financial investments		(1,048)	(3,889)
Net cash used in investing activities		**(5,843)**	**(10,268)**
Cash flow from financing activities			
Dividends paid		(12,876)	(16,087)
Proceeds on loans, borrowings and promissory notes		1,214	60
Cancellation of debentures and bonds		-	(5)
Repayments of loans, borrowings and promissory notes		(472)	(1,077)
Net cash used in financing activities		**(12,134)**	**(17,109)**
Effect of foreign exchange rate changes on collections and payments		**(7)**	**(218)**
Net increase / (decrease) in cash and cash equivalents during the period		**3,540**	**(5,731)**
Cash and cash equivalents at the beginning of the period	**13**	**1,241**	**6,972**
Cash and cash equivalents at the end of the period	**13**	**4,781**	**1,241**
Balance at the beginning of the period	**13**	**1,241**	**6,972**
Cash on hand and at banks		1,224	6,554
Other cash equivalents		17	418
Balance at the end of the period	**13**	**4,781**	**1,241**
Cash on hand and at banks		4,762	1,224
Other cash equivalents		19	17

Accounting policies

Content

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 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 policies applied by the Company between IFRS 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 18 February 2011.

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 2010, 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:

Revised IFRS 3 Business Combinations (effective 1 July 2009)

The standard introduces changes in the accounting for business combinations that will have an impact on the amount of goodwill recognised, the reported results in the period that an acquisition occurs and on future reported results. The Company applies IFRS 3 (Revised) to all business combinations from 1 January 2010.

IAS 27 Consolidated and Separate Financial Statements - Amendment (effective 1 July 2009)

The most significant changes to IAS 27 are as follows:

i) Changes in the ownership interest of a subsidiary (that do not result in a loss of control) are accounted for as an equity transaction and have no impact on goodwill nor give rise to a gain or loss.
ii) Losses incurred by the subsidiary are allocated between the controlling and non-controlling interests (previously referred to as „minority interest"); even if the losses exceed the non-controlling equity investment in a subsidiary.
iii) On loss of control of a subsidiary, any retained interest is remeasured to fair value and this has impact on the gain or loss recognized on disposal.

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

IFRS 2 Amendment (effective date 1 January 2010) Share-based Payments

The amendment is concerning the accounting for group cash-settled share-based payment transactions. The amendment clarifies how an individual subsidiary in a group should account for some share-based payment arrangements in its own financial statements. In these arrangements, the subsidiary receives goods or services from employees or suppliers but its parent or another entity in the group must pay those suppliers.

This amendment didn't have material impact on the Company financial statements.

IFRS 5 Amendment (effective 1 January 2010) Non-current Assets Held for Sale and Discontinued Operations - Disclosure

This amendment was issued in order to clarify the disclosure requirements in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Also clarifies that the general requirements of IAS 1 still apply.

There weren't any material changes to the disclosure in the notes to the financial statements.

IFRS 8 Amendment (effective 1 January 2010) Operating Segments - Disclosure

Minor textual amendment to the standard and amendment to the basis for conclusions, to clarify that an entity is required to disclose a measure of segment assets only if that measure is regularly reported to the chief operating decision-maker. There weren't any material changes to the disclosure in the notes to the financial statements resulting from this amendment.

IAS 1 Amendment (effective 1 January 2010) Presentation of Financial Statements

The amendment specifies current / non-current classification of convertible instruments and clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time.

This amendment did not have any material impact on the Company financial statements.

IAS 7 Amendment (effective 1 January 2010) Statement of Cash Flows

Amendment to require that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities. This amendment had no impact on the Company financial statements, since this treatment was already applied by the Company.

IAS 36 Amendment (effective 1 January 2010) Impairment of Assets

Amendment to clarify that the largest cash-generating unit (or groups of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment as defined by par. 5 of IFRS 8 Operating Segments. There was no significant impact of the application of this amendment on the Company financial statements.

IAS 38 Amendments (effective 1 January 2010) Intangible Assets

The first amendment clarifies the effect of the decision in IFRS 3 (Revised) on the accounting for intangible assets acquired in a business combination.

The second amendment clarifies the description in IAS 38, 40 and 41 of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

The Company applies IAS 38 Amendments together with IFRS 3 (Revised) prospectively to all business combination from 1 January 2010.

IFRS 5 Amendment (effective 1 July 2009) Non-current Assets Held for Sale and Discontinued Operations

The amendment clarifies that all of subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control. Relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRS.

The Company applies the IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.

New IFRS and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) not effective as of 31 December 2010 (includes standards and interpretations applicable for the Group)

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
IAS 24	Related Party Disclosures (Amendment)	1 January 2011
IAS 32	Financial Instruments: Presentation – Classification of Rights Issues (Amendment)	1 February 2010
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2013
IFRIC 14	Prepayments of a minimum funding requirement (Amendment)	1 January 2011
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	1 July 2010

Improvements to IFRSs		Mandatory application: annual periods beginning on or after
IFRS 3	Business Combinations	1 July 2010 or 1 January 2011
IFRS 7	Financial Instruments: Disclosures	
IAS 1	Presentation of Financial Statements	
IAS 27	Consolidated and Separate Financial Statements	
IFRIC 13	Customer Loyalty Programmes	

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 financial statements in the initial period of application. Changes introduced by IFRS 9 may affect financial assets and future transactions with financial assets carried out on or after 1 January 2013.

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 de-recognised or 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, trade names, customer base and roaming contracts. 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 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 9 and Note 10).

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 and impairment is only being determined.

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 2010 and 2009, 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 the income statement.

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 on the finance balance outstanding. 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.

A sale and lease back transaction involves the sale of an asset and the leasing back of the asset. Within the Company's operations the selling price of the asset and lease payments are independent and established at fair value. Therefore the gain from the sale of the asset and the lease payments are accounted as two separate transactions.

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 on the balance sheet.

L. Financial debt

Borrowings are recognised initially at 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 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 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 shares granted 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 a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and 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 when concluding which accounting treatment to use for principal/agency arrangement.

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, e.g. premium rate lines.

Revenue from fixed price construction contracts (long-term contracts) is recognised on the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. An expected loss on 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. The Company follows the accounting policy of Telefónica Group. Until March 2008, the Company recognised revenues using netto principle and recognised revenues when the contribution was received. From April 2008 until June 2009 the Company reported revenue using gross principle and recognised the compensation when CTO approved the total compensation and decided about percentage shares and absolute amounts of other operators contributions. As a result of further favourable development in smoothing of the recovery process and associated environment, since July 2009 the Company started to recognise the compensation of revenues attributable to the Company on standard accrual basis while keeping the gross principle of recording.

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, 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 and accessories and other sale of 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.

2) Mobile business revenues

The Company earns mobile services revenue from customers usage of the Company's network, interconnection and roaming – collectively, "Mobile service revenue". 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 recognized 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 Group applies a percentage of expiry rate calculated from historical experience of expired airtime.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime and 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.
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.

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 15.

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 rate debts.

(iii) Liquidity rate risk

The Company's essential objective of liquidity risk management is to have ready access to 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

Concentrations of credit risk, with respect to trade accounts receivable, are 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 the national economy.

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 12. There are no significant concentrations 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 to credit risk 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),
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) 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.

Credit management activities during last years

During last years the Group introduced new credit management activities such as:

a) implementation of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),
b) implementation of the integrated system solution RMCA for scoring, maintenance and collection of receivables (fixed and mobile) and reporting,
c) use of integrated Black Lists of fixed and mobile debtors during activation process,
d) implementation of strict activation rules for all distribution channels, especially for Indirect Sales partners.

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. As at 31 December 2010, the total amount of provision for current income taxes isCZK 2,478 million, advances paid for income taxes amount to CZK 2,921 million and the net deferred tax liability is CZK 3,936 million.

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 the income statement for the period. The decision to recognize an impairment loss involves estimates of the timing and 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 assess 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 11).

The Company tests at each reporting date goodwill for an impairment. 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. At 31 December 2010, the carrying amount of goodwill is CZK 13,320 million (See Note 9).

3) Provisions and contingent liabilities

As set out in Note 19 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 will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. 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. At 31 December 2010 the carrying amount of the provision for regulatory and court decisions is CZK 126 million (see Note 18).

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 2010 and 2009.

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 include 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 communications services using a fixed network and IS/ICT services,
- Mobile - mobile communications services.

Year ended 31 December 2010 **In CZK million**	**Fixed**	**Mobile**	**Company**
Revenues	24,662	29,293	53,955
Inter-segment sales	(345)	(451)	(796)
Total revenues	24,317	28,842	53,159
Gains from sale of non-current assets	91	–	91
Internal expenses capitalised in fixed assets	350	218	568
Costs	(15,425)	(16,249)	(31,674)
Inter-segment purchases	451	345	796
Total costs	(14,974)	(15,904)	(30,878)
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 profit	6,400	9,444	15,844
Interest and other financial income (net)			(115)
Profit before tax			15,729
Tax			(3,033)
Net profit			**12,696**
Assets (excluding goodwill and non-current assets held for sale)	52,576	30,358	82,934
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	–	13,320	13,320
Non-current assets held for sale	12	–	12
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**

Year ended 31 December 2009 In CZK million	Fixed	Mobile	Company
Revenues	27,239	31,813	59,052
Inter-segment sales	(394)	(604)	(998)
Total revenues	26,845	31,209	58,054
Gains from sale of non-current assets	422	–	422
Internal expenses capitalised in fixed assets	456	204	660
Costs	(15,204)	(17,455)	(32,659)
Inter-segment purchases	604	394	998
Total costs	(14,600)	(17,061)	(31,661)
Impairment charge	(17)	(6)	(23)
Depreciation	(7,031)	(2,727)	(9,758)
Amortisation	(842)	(1,088)	(1,930)
Total depreciation and amortization	(7,873)	(3,815)	(11,688)
Operating profit	5,233	10,531	15,764
Interest and other financial costs (net)			(153)
Profit before tax			15,611
Tax			(3,197)
Net profit			**12,414**
Assets (excluding goodwill and non-current assets held for sale)	51,570	30,295	81,865
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	–	13,320	13,320
Non-current assets held for sale	95	–	95
Total assets	**51,665**	**43,615**	**95,280**
Trade and other payables	4,938	5,772	10,710
Other liabilities	3,126	3,654	6,780
Total liabilities	**8,064**	**9,426**	**17,490**
Capital expenditure	**3,229**	**2,622**	**5,851**

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 most appropriate for segment recognition.

The inter-segment pricing rates applied in 2010 and 2009 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. Revenue and Internal expenses capitalized in fixed assets

Revenue In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Voice - outgoing	10,745	12,578
Interconnection and other wholesale services	8,244	9,380
Monthly and one-off charges from voice services	13,321	15,032
Connection charges	7	192
SMS & MMS & Value added services	4,374	4,669
Leased lines and fixed data services	3,132	3,509
Internet (including monthly and one-off charges), mobile data	8,278	7,376
IT and business solutions	2,407	2,609
Equipment and activation fee	1,409	1,492
Other telecommunication revenues	850	901
Other revenues	392	316
Total revenues	**53,159**	**58,054**

Revenues from related parties are disclosed in Note 23.

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 2010	31 December 2009
No later than 1 year	100	142
Later than 1 year and not later than 5 years	338	593
Later than 5 years	89	156
Total	527	891

Internal expenses capitalized in fixed assets In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Material	–	15
Labour	568	645
Total	568	660

3. Operating expenses

The following items have been included into the operating expenses:

Operating expenses In CZK million	**Year ended 31 December 2010**	**Year ended 31 December 2009**
Wages and salaries*	4,363	4,592
Redundancy payments	454	161
Social security contributions (Note 17)	1,481	1,510
Staff welfare costs	214	228
Total staff costs	**6,512**	**6,491**
Interconnection and roaming	9,386	10,650
Cost of goods sold	1,833	2,225
Contents	299	270
Customer loyalty program	–	74
Sub-deliveries	1,003	1,453
Commissions	1,122	1,116
Telecom services	186	205
Other cost of sales	451	583
Billing and collection	366	413
Marketing	958	1,220
Call centres	517	426
Network & IT repairs and maintenance	2,486	2,401
Rentals, buildings and vehicles	1,995	1,952
Utilities supplies	1,017	1,037
Consultancy and professional fees	156	156
Other external services	1,577	98
Provision for bad and doubtful debts and inventories	578	472
Taxes (other than income tax)	402	386
Other operating expenses	34	33
Total operating expenses	**30,878**	**31,661**

* Certain Company employees (including the Board of Directors) with specialised know how, or who have access to business secrets, or who are considered important to the development of the business, are bound by non-competition restrictions, for a maximum period of 12 months from the date of termination of their employment with the Company. The Company paid CZK 4 million in relation to such non-competition clauses in 2010 (2009: CZK 14 million).

Categories of costs were rearranged in order to improve the presentation of costs.

An appropriately approved restructuring plan covering both employees and members of management has been introduced by the Company during 2010. As a result of the restructuring process the Company incurred restructuring costs of CZK 422 million during the period ended 31 December 2010 that have been recognised for the redundancy payments.

Purchases from related parties are disclosed in Note 23.

4. Interest and other finance income and expense

In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Financial income		
Interest income	86	165
Gain on fair value adjustments of financial instruments	–	71
Other financial income	371	1,055
Total financial income	457	1,291
Financial expenses		
Interest expenses	(240)	(229)
Loss on fair value adjustments of financial instruments	(175)	–
Other financial expenses	(157)	(1,215)
Total financial expenses	(572)	(1,444)
Net financial loss/income	(115)	(153)

5. Income tax

In CZK million	Year ended 31 December 2010	Year ended 31 December 2009
Total income tax expense is made up of:		
— Current income tax charge	2,430	3,163
— Deferred income tax charge (Note 16)	603	34
Taxes on income	3,033	3,197

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 2010	Year ended 31 December 2009
Profit before tax	15,729	15,611
Income tax charge calculated at the statutory rate of 19 % (2009: 20 %)	2,989	3,122
Not taxable income	(21)	–
Expenses not deductible for tax purposes	129	144
Tax related to prior periods	(64)	(69)
Taxes on income	3,033	3,197
Effective tax rate	19 %	20 %

6. Earnings per share

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 2010	31 December 2009
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	12,696	12,414
Basic earnings per share (CZK)	39	39

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

7. Dividends

In CZK million	2010	2009
Dividends declared (including withholding tax)	12,884	16,104

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2010. Approval of the 2010 profit and the decision regarding the amount of any dividend payment for the 2010 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 2010	Year ended 31 December 2009
Dividend per share (nominal value of 100 CZK)	40	50

8. Pozemky, budovy a zařízení

In CZK million	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress including advances paid	Total
At 31 December 2010						
Opening net book amount	10,794	33,141	7,095	1,661	2,495	55,186
Additions	294	968	2,240	531	4,099	8,132
Disposals and other movements	(3)	(4)	37	(1)	(3,966)	(3,937)
Assets classified as held for sale	(3)	(1)	–	–	–	(4)
Depreciation charge	(662)	(4,634)	(3,079)	(822)	–	(9,197)
Impairment charge	(1)	–	7	–	(14)	(8)
Impairment reversal	366	3,783	192	3	–	4,344
Closing net book amount	10,785	33,253	6,492	1,372	2,614	54,516
At 31 December 2010						
Cost	19,452	102,037	87,308	8,085	2,652	219,534
Accumulated depreciation and impairment allowance	(8,667)	(68,784)	(80,816)	(6,713)	(38)	(165,018)
Net book amount	10,785	33,253	6,492	1,372	2,614	54,516
At 31 December 2009						
Opening net book amount	10,520	36,227	10,116	1,789	2,546	61,198
Additions	322	759	2,074	856	3,924	7,935
Disposals and other movements	813	396	(1,133)	(101)	(3,963)	(3,988)
Assets classified as held for sale	(185)	(3)	–	–	–	(188)
Depreciation charge	(676)	(4,238)	(3,961)	(883)	–	(9,758)
Impairment charge	–	–	(1)	–	(12)	(13)
Closing net book amount	10,794	33,141	7,095	1,661	2,495	55,186
At 31 December 2009						
Cost	19,264	101,172	86,987	9,464	2,527	219,414
Accumulated depreciation and impairment allowance	(8,470)	(68,031)	(79,892)	(7,803)	(32)	(164,228)
Net book amount	10,794	33,141	7,095	1,661	2,495	55,186

As at 31 December 2010, the carrying value of non-depreciated assets amounted to CZK 215 million (2009: CZK 214 million).

No property, plant and equipment were pledged as at 31 December 2010.

No borrowing costs were capitalized during the years 2010 and 2009.

The Company reports and classifies the following assets held for sale at the balance sheet date:

In CZK million	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
At 31 December 2010				
Opening net book amount	95	–	–	95
Disposals and other movements	(76)	–	–	(76)
Impairment charge	(11)	–	–	(11)
Assets re-classified as held for sale	4	–	–	4
Closing net book amount	12	–	–	12
At 31 December 2010				
Cost	502	86	69	657
Accumulated depreciation and impairment allowance	(490)	(86)	(69)	(645)
Net book amount	12	–	–	12
At 31 December 2009				
Opening net book amount	96	–	–	96
Disposals and other movements	(179)	–	–	(179)
Impairment charge	(10)	–	–	(10)
Assets re-classified as held for sale	188	–	–	188
Closing net book amount	95	–	–	95
At 31 December 2009				
Cost	804	120	76	1,000
Accumulated depreciation and impairment allowance	(709)	(120)	(76)	(905)
Net book amount	95	–	–	95

Assets intended for sale in most cases represent buildings with land, which the Company will not use in the future and it is expected that their sale will take place within one year.

The non-current assets classified as held for sale are presented in the fixed segment.

In 2010, the Company achieved a total gain from the sale of the above fixed assets amounting to CZK 91 million (2009: CZK 422 million) and total losses in amount CZK 16 million (2009: CZK 14 million).

At the beginning of 2009, the Company completed the substantial part of a real estate usage optimisation process and sold a construction site and two administrative buildings of the former headquarters at Olšanská street in Prague with a net gain exceeding CZK 300 million.

Cost of fully depreciated property, plant and equipment was CZK 71,491 million as at 31 December 2010 (2009: CZK 69,826 million).

9. Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2010				
Opening net book amount	13,320	3,901	4,456	21,677
Additions	–	–	1,282	1,282
Disposals and other movements	–	–	–	–
Amortisation charge	–	(387)	(1,837)	(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
At 31 December 2009				
Opening net book amount	13,320	4,287	4,095	21,702
Additions	–	–	1,906	1,906
Disposals and other movements	–	–	(1)	(1)
Amortisation charge	–	(386)	(1,544)	(1,930)
Closing net book amount	13,320	3,901	4,456	21,677
At 31 December 2009				
Cost	13,320	6,073	25,776	45,159
Accumulated amortisation and impairment allowance	–	(2,172)	(21,310)	(23,482)
Net book amount	13,320	3,901	4,456	21,677

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. There is no other intangible asset with indefinite useful life.

The Company performed impairment tests and as result of the test the Company did not recognize any impairment losses of goodwill in 2010 and 2009. 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, which has been approved by the management and which is 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 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 weighted average of cost of capital ("WACC").

Licences

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks in the Czech Republic. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, former Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of six years.

In 2002, Eurotel renewed its 450 MHz license; the current license enables the mobile segment to offer every internationally recognized public mobile telecommunication services on frequency of 450 MHz. Mobile segment currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The NMT license is currently valid for the remaining period of two years.

In December 2001, Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, Eurotel was provided with deferred payment terms by the Czech Telecommunication Office ("CTO") to finance the license acquisition. In December 2003, Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement. UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

Carrying value of licences:

In CZK million	31 December 2010	31 December 2009
GSM 900 license	402	474
GSM 1800 license	324	382
NMT 450 license	19	26
UMTS license	2,769	3,019
Total	3,514	3,901

No borrowing costs were capitalized during the years 2010 and 2009.

Cost of fully amortised intangible assets was CZK 19,003 million as at 31 December 2010 (2009: CZK 16,381 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.

10. 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 of 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 of 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 at 31 December 2010, the management of the Company reviewed the indicators which could have indicated whether the CGU's assets may be impaired. Assessment carried out as of 31 December 2010 confirmed that no such indicator exists and the value of the existing assets are fairly stated.

11. Inventories

In CZK million	**31 December 2010**	**31 December 2009**
Telecommunication material	231	153
Cables	20	31
Other inventory including goods for resale	312	387
Finished products and work in progress	14	14
Total	577	585

The inventories noted above are stated net of an allowance of CZK 59 million (2009: CZK 65 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 67 million (2009: CZK 55 million). The amount of inventories recognised as an expense is CZK 2,345 million (2009: CZK 2,630 million).

12. Receivables and prepayments

In CZK million	31 December 2010	31 December 2009
Trade receivables (net)	7,291	7,910
Other debtors (net)	289	389
Prepayments	768	733
Other financial assets - short-term	284	–
Derivative instruments	9	108
Total	8,641	9,140

Trade receivables are stated net of a bad debt provision of CZK 3,604 million (2009: CZK 3,448 million). In order to preserve the tax-deductible status of the bad debt expense, the Company's trade receivables are not written off and removed from the primary books and records until certain statutory collection requirements have been satisfied.

Receivables from related parties are disclosed in Note 23.

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 2010	7,291	3,308	273	25	30	119
At 31 December 2009	7,910	3,361	309	20	26	55

Bad debt provisions	In CZK million
At 1 January 2009	3,241
Additions	3,421
Retirements/amount paid	(3,214)
At 31 December 2009	3,448
Additions	3,474
Retirements/amount paid	(3,318)
At 31 December 2010	3,604

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 2010, the Company presented non-current assets of CZK 165 million (2009: CZK 1,311 million) consisting of other long-term credits and advance payments for long-term expenses, which are classified as other financial assets (2009: a long-term loan of CZK 1,032 million to Telefónica O2 Slovakia, s.r.o. presented in other financial assets).

13. Cash and cash equivalents

In CZK million	31 December 2010	31 December 2009	Interest rate
Cash at current bank accounts	203	141	Floating
Cash at cash-pooling structures (inter-company)	4,578	1,100	Floating
Total cash and cash equivalents	4,781	1,241	

As at 31 December 2010 and 2009 cash equivalents of the Group comprise interest bearing deposits with maximum maturity of three months.

Since April 2006, the Company entered into mutual Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective operating free cash flow.

At 31 December 2010, the Company had available equivalent of CZK 4,135 million (2009: CZK 4,056 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 2010	31 December 2009
Cash and cash equivalents	4,781	1,241

As of 31 December 2010 and 2009 no cash and cash equivalents were pledged.

14. Trade and other payables

In CZK million	31 December 2010	31 December 2009
Trade creditors	5,062	3,642
Other taxes and social security	180	182
Deferred revenue	884	926
Employee wages and benefits	706	678
VAT payable	341	575
Other creditors	279	296
Accruals	4,016	4,411
Total payables	11,468	10,710
Other non-current liabilities	20	19

Payables to related parties are disclosed in Note 23.

As at 31 December 2010 and 2009 other non-current liabilities include primarily principals and liabilities with maturity in more than 12 months.

15. Financial debt

In CZK million	31 December 2010	31 December 2009
Bank loans in foreign currencies	2,883	3,044
Accrued interest including commitment fees	80	84
Derivatives	61	3
Other financial debt	141	87
Total financial debt	3,024	3,131
Repayable:		
Within one year	141	87
Between two and five years (total non-current)	2,883	3,044
Total financial debt	3,024	3,131

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 2010, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2010 and 2009 the Company does 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 2010	31 December 2009
At fixed rate	2,883	3,044

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate that the Board of Directors expects to be available to the Company at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2010	2009
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 2010 based on contractual undiscounted payments.

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 (excluding deferred revenue)	9,252	1,332	–	–
Derivatives (net)	61	–	–	–
Total	9,313	1,523	3,074	–
Non-current other liabilities	–	–	15	5

31 December 2009 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5 years
Interest bearing loans and borrowings	–	202	3,448	–
Trade and other payables (excluding deferred revenue)	8,763	1,021	–	–
Derivatives (net)	3	–	–	–
Total	8,766	1,223	3,448	–
Non-current other liabilities	–	–	12	7

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	**2010**	**2009**	**2010**	**2009**
Financial assets				
Cash and cash equivalents	4,781	1,241	4,781	1,241
Long-term loans	–	1,032	–	1,032
Short-term loans (incl. accrued interest)	284	–	284	–
Derivatives	9	108	9	108
Other financial assets	165	279	165	279
Financial liabilities				
Interest bearing loans and borrowings:				
Fixed rate borrowings (incl. accrued interest)	2,963	3,129	3,169	3,432
Derivatives	61	3	61	3

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

As of 31 December 2009 the Company provided a long-term loan in the amount of EUR 39 million (CZK 1,032 million) to Telefónica O2 Slovakia, s.r.o.

As of 31 December 2010 the Company provided a short-term loan in the amount of EUR 11.2 million (CZK 281 million) to Telefónica O2 Slovakia, s.r.o.

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 which have a significant effect on the recorded fair value that are not based on observable market data.

As at 31 December 2010 and 31 December 2009, the Company held only the foreign exchange contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2010, 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	**2010**	**2009**
FX risk		
Value at Risk*	(163)	(298)
Stress testing*	(52)	(56)
IR risk		
Stress testing*	(110)	(82)

* 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.

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

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 EUR million	
	2010	**2009**	**2010**	**2009**
Foreign exchange contracts	136	171	(52)	105

16. 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 2009 and 2010.

In CZK million	2010	2009
At 1 January	3,333	3,299
Income statement tax charge / (credit) (Note 5)	603	34
At 31 December	3,936	3,333

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts, determined after offsetting, are shown in the balance sheet:

In CZK million	31 December 2010	31 December 2009
Deferred tax assets	(248)	(316)
Deferred tax liabilities	4,184	3,649
Total	3,936	3,333

The deferred tax asset includes CZK 220 million (2009: CZK 289 million) recoverable in less than twelve months and CZK 28 million (2009: CZK 27 million) recoverable after more than twelve months. The deferred tax liability includes CZK 452 million (2009: CZK 378 million) payable in less than twelve months and CZK 3,732 million (2009: CZK 3,271 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Balance sheet		Profit or loss	
In CZK million	2010	2009	2010	2009
Temporary differences relating to:				
— property, plant and equipment and intangible assets	4,162	3,621	541	(304)
— trade receivables, inventories and other differences	(226)	(288)	62	338
Total	3,936	3,333	603	34

17. Government social security and pension schemes

The Company is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2010 and 2009, the Company paid contributions at a rate of 34 % of gross salaries and is not required to make any contributions in excess of this statutory rate. The total amount charged to operating expenses in respect of this scheme was CZK 1,481 million in 2010 (2009: CZK 1,509 million) (see Note 3). Employees contribute 11 % of their gross salaries.

The Company has a voluntary pension plan for employees under which the Company makes contributions on behalf of the Company's employees to approved pension plan providers, under defined contribution schemes. The Company's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Company made contributions of CZK 51 million (2009: CZK 56 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2010 relating to employee retirement amounted to CZK 0.2 million (2009: CZK 0.1 million) and were charged as an operating expense.

All amounts discussed in the above note are included in staff costs (see Note 3).

18. Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Sale of real estate portfolio provision	Other	Total
At 1 January 2010	37	11	91	139	19	297
Additions during the year	120	422	112	23	29	706
Utilised during the year	(31)	(429)	(168)	(130)	(37)	(795)
At 31 December 2010	**126**	**4**	**35**	**32**	**11**	**208**
Short-term provisions 2010	84	4	26	32	11	157
Long-term provisions 2010	42	–	9	–	–	51
	126	**4**	**35**	**32**	**11**	**208**
Short-term provisions 2009	21	11	84	139	19	274
Long-term provisions 2009	16	–	7	–	–	23
	37	**11**	**91**	**139**	**19**	**297**

With the exception of the regulatory and court decisions provision and other small items 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.

Employee related costs

Provisions for employee-related costs include expected costs associated with untaken holiday compensation and share plans.

Sale of real estate portfolio

The provision was established to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold (see Note 8).

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 19).

19. Contingencies

The Company is involved in a number of legal disputes arising from standard business interactions. Throughout 2010 the Company continued the successful trend of defending itself against law-suits filed by third parties in the past. Major legal disputes and other proceedings relating to the Company are shown below. The Company's management team is convinced that all potential risks arising from the below disputes are sufficiently reflected in the financial statements. The publication of other details on the disputes is not deemed by the Company as appropriate as this could anticipate the position of the Company on these matters:

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 by its verdict of 30 September 2009 dismissed the remaining part of the legal action as groundless. The Company, based on the evolution so far, believes that the High Court will confirm this verdict in appeal proceedings. The hearing in this case is scheduled for February 2011.

ÚOHS (Office for Protection of Economic Competition)

I. Preliminary investigation
   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 not abused its dominant position in the broadband market. The investigation was also commented in the media. 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 immensely grew, 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.

II. Proceedings 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 proceedings 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 in the meantime had cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. In reaction to this evolution, the Company has created a provision in a relevant amount to cover all eventualities (even only for an interim period of time) to return the penalty to the Office's account.

Other legal disputes

I. AUGUSTUS, spol. s r.o. has been 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 proceedings 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. AUGUSTUS, spol. s r.o. filed an appeal but has not even paid the court charges until now. The Company in its reaction to the dismissal of the verdict and the subsequent dismissal of the lawsuit, filed a suit against AUGUSTUS, spol. s r.o. to return the amount of CZK 139 million. 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 is based on the contract for the issue of phone cards which ended in 1995. AUGUSTUS, spol. s r.o. is trying in this suit to present some other claims that have no legal grounds and are even in the mutual contradiction. The Company is taking all steps leading to a consistent defence from this illegitimate claim and believes in full success in these proceedings. Given the sued amount, the Company also publishes information about this suit. With respect to the judicature of the Supreme Court and the evolution of the proceedings, the Company's management team is confident in winning this case.

III. MEDIATEL, a.s., cooperating with the Company since 1992 on the publishing of the phone directory distributed to all telecommunications subscribers (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 suit. The hearing has not been scheduled so far. The Company is convinced of taking into account all potential risks of this suit.

IV. 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 Company has expressed its comments on the suit being convinced of taking fully into account all potential risks of this suit.

V. The Company is involved in other legal disputes. The aggregate value of all disputes over CZK 5 million not closed with a verdict in 2010 totals to nearly CZK 30 million. The annual profit and loss statement takes also into account some minor disputes, however, with risks of lesser importance.

20. Commitments

Operating leases

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2010	31 December 2009
No later than 1 year	1,311	1,352
Later than 1 year and not later than 5 years	4,431	4,684
Later than 5 years	4,079	4,710
Total	9,821	10,746

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2010 were CZK 1,425 million (2009: CZK 1,396 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 2010 were CZK 369 million (2009: CZK 344 million).

Capital and other commitments

In CZK million	31 December 2010	31 December 2009
Capital and other expenditure contracted but not provided for in the financial statements	4, 699	5, 422

The majority of contracted amounts relate to the telecommunications network and service contracts.

21. 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 and 516/3.

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 radio frequency assignment from CTO valid until 7 February 2011 is provided broadband mobile access to Internet.

Validity of radio frequency assignment 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.

No additional expenses or any limitations connected with renewal of the radio frequency assignments are expected in accordance with the existing interpretation of regulatory provisions.

Imposition of obligations related to provision of universal service

During the year 2010 and 2009, 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) supplementary services to service of connection at a fixed location to the public telephone network and the service of access to publicly available telephone services at a fixed location:
   — phased payment of the price for the establishment of connection to the public telephone network for consumer,
   — free selective barring of outgoing calls for the subscribers, and
   — free itemised billing of the price for consumer*,
d) 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.

* Services listed under letter c) above are excluded from the universal service regime on the basis of CTO decision since 30 July 2009. Providing of these services continues in commercial regime out of universal service.

22. Share capital and reserves

	31 December 2010	31 December 2009
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

* By the decision of the Extraordinary General Meeting held on 10 September 2010, the form of ordinary shares with a nominal value of CZK 100 issued as bearer shares was transformed in registered shares. The change in the form of shares was recorded in the Commercial Register on 13 September 2010. Change of the shares form has no impact on existing rights of the shareholders..

Shareholdings in the Company were as follows:

	31 December 2010	31 December 2009
Telefónica, S.A.	69.41 %	69.41 %
Other shareholders	30.59 %	30.59 %

Funds include a statutory reserve fund of CZK 6,442 million (2009: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve 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. fixed and mobile broadband internet and data IPTV, mobile services, corporate and public administration ICT solutions and further in the expansion and development of the mobile services in Slovakia.

At present, the approach that the Company follows is not to retain surplus cash. In the following periods, the Board of Directors will continue to evaluate and carry out 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.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2010	31 December 2009
Capital	77,575	77,754
Equity settled share based payment reserve	34	36
Total	**77,609**	**77,790**

23. Related party transactions

The Company provides services to all related parties on normal 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 no allowance or write off was incurred.

The following transactions were carried out with related parties:

I. Parent company:

In CZK million	For the period ended 31 December 2010	For the period ended 31 December 2009
Dividend paid to Telefónica, S.A.	8,943	11,179
Royalty fees (Telefónica, S.A.)	844	754
Management fees (Telefónica, S.A.)	205	–

Balance sheet In CZK million	31 December 2010	31 December 2009
a) Receivables	1	4
b) Payables	1,072	764

II. Other related parties – Telefónica Group:

Balance sheet In CZK million	31 December 2010	31 December 2009
a) Receivables	594	652
b) Payables	406	404
c) Short-term receivables (interest)	3	–
d) Cash equivalents (Note 13)	4,578	1,100
e) Short-term loans (Note 13)	281	–
f) Long-term loans (Note 13)	–	1,032

Profit or loss In CZK million	For the period ended 31 December 2010	For the period ended 31 December 2009
a) Sales of services and goods	1,145	1,306
b) Purchases of services and goods	1,157	1,049
c) Interest income	60	151
d) Interest expense	–	10

There were capital purchases of CZK 25 million carried out with related parties for the period ended 31 December 2010 (for the period ended 31 December 2009 capital purchases amounted to CZK 101 million).

The list of the Telefónica companies with which the Company had any transaction in 2010 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica O2 Germany GmbH& CO.OHG, Telefónica O2 UK Ltd., Telefónica O2 Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Telefónica Deutschland GmbH, Telefónica Soluciones, ALTAIR ASSURANCES S.A., Telecom Italia Sparkle S.p.A., Manx Telecom Ltd., 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., Portugal Telecom, Telecom Italia S.p.A., Telfisa Global, BV., Telefónica Finanzas, S.A., Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., Telefónica Gestión de Servicios Compartidos, S.A., Telefónica Factoring E.F.C., S.A., Atento Chequia, 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 O2 Business Solutions, spol. s r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica O2 Slovakia, s.r.o., Telefónica Global Roaming GmbH.

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 2010	31 December 2009
Salaries and other short-term benefits	110	122
Personal indemnification insurance	5	5
Total	115	127

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2010 and 2009.

As at 31 December 2010 the Company provided a short-term loan of CZK 281 million (EUR 11 million) to Telefónica O2 Slovakia, s.r.o. presented in other financial assets short-term (Note 12). 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 2009 the Company provided a long-term loan of CZK 1,032 million (EUR 39 million) to Telefónica O2 Slovakia, s.r.o. presented under other financial assets. The loan bears a floating interest based on 1M EURIBOR The loan conditions are based on the arm's length principle.

No other loan was provided to related parties by the Company.

24. Principal subsidiary undertakings

As at 31 December 2010

		Company's interest	Cost of investment In CZK million	Country of incorporation	Activity
Subsidiaries					
1.	Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o., merged with DELTAX Systems a.s.)	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
Associates					
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

As at 31 December 2009

		Company's interest	Cost of investment In CZK million	Country of incorporation	Activity
Subsidiaries					
1.	Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o., merged with DELTAX Systems a.s.)	100 %	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100 %	13	Germany	Data transmission services
3.	CZECH TELECOM Austria GmbH	100 %	11	Austria	Data transmission services
4.	Telefónica O2 Slovakia, s.r.o.	100 %	5,081	Slovakia	Mobile telephony, internet and data transmission services
Associates					
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

In May 2010, the Board of Directors approved increase of the registered capital of Telefónica O2 Slovakia, s.r.o. by a monetary investment in the amount of EUR 40 million from the amount of the registered capital of EUR 200 million to the amount of the registered capital of EUR 240 million. Effective date of increase of the registered capital was 6 May 2010.

The Company and six other shareholders have founded the company MOPET CZ a.s. The purpose of the company MOPET CZ a.s. is a launch of new services which would enable paying in real time for goods and services, paying bills and invoices, sending money or paying for purchases on the Internet using a mobile telephone.

25. Post balance sheet events

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 2010.

07

Other information for shareholders and investors

We are one team

07

Other information for shareholders and investors

Basic information:

Corporate name:	Telefónica O2 Czech Republic, a.s. (Telefónica O2, 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

Trading in Telefónica O2 shares in 2010

	2010	2009
Number of shares (in millions)	322.1	322.1
Net profit/(loss) per share (in CZK) [1]	39.4	38.5
Highest share price (in CZK) [2]	452.5	500.0
Lowest share price (in CZK) [2]	369.0	359.8
Share price at the end of period (in CZK) [2]	381.5	418.0
Market capitalization (in CZK billions) [2]	122.9	134.6

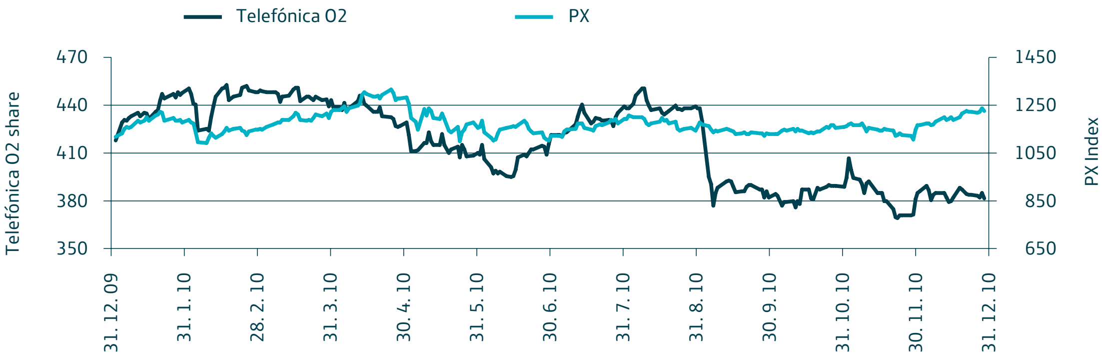
[1] Unconsolidated net profit under IFRS
[2] Source: Prague Stock Exchange

In 2010, Telefónica O2 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 2010 was CZK 43.0 billion compared to CZK 65.7 billion in 2009. Trading in Telefónica O2 Czech Republic shares, measured by the total volume of shares traded, made up 11% of all trades on the PSE stock market. Telefónica O2 shares were the fourth most traded issue on the PSE in 2010. The average daily volume of trades in company shares in 2010 was CZK 166.7 compared to CZK 258 million in 2009.

As at 30 December 2010 (the last trading day on the PSE in 2010), the market capitalization reached CZK 122.9 billion, ranking Telefónica O2 fifth on the PSE stock market. The share price of Telefónica O2 on the last PSE trading day in 2010 reached CZK 381.5 resulting in a decline of 8.73% when compared with the previous year. The share price reached its maximum of CZK 452.5 on 17 February 2010, and its minimum of CZK 369 on 24 November 2010. The average share price in 2010 was CZK 416.2, compared to CZK 430.6 in 2009.

The above-average dividend yield, aided by the high free cash flow generation and a low level of debt, shares of Telefónica O2 still make a very attractive investment opportunity.

Trading in Telefónica O2 shares against the PX Index in 2010



Dividends

At the Annual General Meeting of 21 April 2008 held in Prague, the shareholders approved a dividend payment from the 2007 net profit and part of the reserve fund that can be applied by the Company at its sole discretion, 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 CZK 1,000, before tax. The record day for the payment of dividends was 17 September 2008 and the disbursement date 8 October 2008.

At the Annual 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 Annual 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.

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. 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 fixed and mobile broadband internet, IPTV, mobile services, business and ICT solutions for the government and the corporate segment and the development of the mobile operation in Slovakia.

Details of patents or licenses, industrial, commercial or financial contracts which have a significant bearing on the business

1) Patents and licences

Telefónica O2 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 using Siebel SW (Oracle), customer care and billing software (Amdocs and LHS) and enterprise resource planning software ERP (SAP).

2) Industrial and commercial contracts

Telefónica O2 maintained a diverse portfolio of technology suppliers in 2010. 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 2010, the main suppliers of technology and related services to the Company were IBM Česká republika, Alcatel 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 2010 divided into short-term and long-term (in CZK million):

Short-term (maturing within a year)	141
Long-term	2,883
Total	**3,024**

Loans, bonds issued and other financial obligations:

	Currency	Total loan in the currency	Outstanding in CZK thousand as at 31 December 2010	Redemption
Private Placement – debt instrument	EUR	115,040,673	2,882,919	2012
Other financial obligations			140,669	

EUR/CZK exchange used in the table for conversion purposes (as at 31 December 2010) is CZK 25.060/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 2010, Telefónica O2 had no overdue loan obligations.

Bonds issued by Telefónica O2

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 2010, no bond issue was made under the bond programme.

Investments

Main investments made by Telefónica O2 in the last two accounting periods (in CZK million):

	2010	**2009**
Network & Operations	3,011	2,976
Business Solutions	569	707
IT & Products	931	1,206
Property & Logistics	169	219
Brand stores	19	17
Subsidiary companies and other investments*	661	527
Projects of the Telefónica Group	–	187
Investments related to Telefónica O2 Slovakia made in the Czech Republic	49	39
Telefónica O2 Slovakia	254	611
Total	**5,663**	**6,489**

* Including additional internal work – capitalized

In 2010, the Company continued to implement an adequate 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 year, Telefónica O2 invested into projects aimed at internal integration of mobile and fixed line services.

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 by investments in the development of the Mobile Broadband in line with the Company's strategy (3G + EDGE); at the end of 2010, the 3G and EDGE coverage extended to 42.5% and 98%, respectively. The expansion of the 3G network was accompanied by related investments into the existing 2G network. In the fixed line segment, investments were directed mainly at boosting the speed, availability and quality of ADSL, IPTV, Voice over IP and value added services.

As far as business solutions are concerned, the volume of investment copied the projects executed for customers; data connectivity and ICT projects continued to dominate this segment. The flagship business and government solutions projects in 2010 included the ongoing implementation of the data box information system for the public sector and investments in the expansion of the capacities in the hosting centre in Hradec Králové.

Investments in information systems, where the pursuit of an 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, electronic applications and a new business segment proposition. Investments in the GSM network were carried out as per the licence and system development requirements. By the end of 2010 Telefónica O2 Slovakia had 965 BTS in operation, of which 48 were commissioned during 2010. The network of Telefónica O2 Slovakia covered almost 95% of the population

Key investments in the future

In the period 2011-2012, the Company will continue to implement the standard investment policy for the telecommunications sector, which favours performance increases and the implementation of progressive technologies and customer approaches, aimed at achieving the Company's overall general strategy and increasing the market share in the Slovak telecommunications market.

A key project in the Czech Republic is the country-wide deployment of the Mobile Broadband technology, which will considerably improve the quality, effectiveness and availability of telecommunication and data services. In the fixed data segment, the Company plans to focus on the development of xDSL technology.

Fees paid to auditors in the accounting period

The cost of external audit activities performed by Ernst & Young for Telefónica O2 in 2010:

Type of service	Fee in CZK thousand
Audit	26,570
Other audit-related consultancy	0
Other services	0
Total	**26,570**

Financial calendar

Date of release of the running financial results

For the first quarter of 2011	12 May 2011 *
For the first half of 2011	27 July 2011 *
For three quarters of 2011	9 November 2011 *
For the year 2011	No later than 28 February 2012

* subject to change

Institutional investors and shareholders please contact

Investor Relations
Tel.: +420 271 462 076, +420 271 462 169
Fax: +420 271 463 566
E-mail: investor.relations@o2.com
URL: http://www.telefonica.cz/en/investor-relations/
Address: Telefónica Czech Republic, a.s.
Za Brumlovkou 266/2
140 22 PraBP@ 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 O2 Czech Republic, a.s.

Jesús Pérez de Uriguen, 1st Vice-chairman of the Board of Directors and Director, Finance Division of Telefónica O2 Czech Republic, a.s.

hereby declare that, to their best knowledge, the consolidated 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 Malvido

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

Jesús Uriguen

Jesús Pérez de Uriguen
1st Vice-chairman of the Board of
Directors and Director, Finance Division

Appendix:

Report of the Board of Directors
of Telefónica O2 Czech Republic, a.s.

Appendix:
Report of the Board of Directors of Telefónica O2 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 2010
(pursuant to provisions of Section 66a art. 9, of Act No. 513/1991 Coll., the Commercial Code).

Contents

List of companies directly or indirectly controlled by Telefónica, S.A. in the period from 1 January 2010 to 31 December 2010;

Part A Applicable period

The report pursuant to Section 66a article 9, of the Commercial Code, on relationships between the controlling and the controlled entity and on relationships between the controlled entity and other entities – interconnected entities controlled by the same controlling entity (Report) is compiled for the last accounting period, i.e. for the period started on 1 January 2010 and ended on 31 December 2010

Part B Entities forming a holding

Section I. Identification details of the controlled entity – Telefónica O2 Czech Republic, a .s. (hereinafter referred to as "Company")

The company is registered in the Commercial Register of the Municipal Court in Prague, Section B, Enclosure 2322.

Registration date:	1 January 1994
Corporate name:	Telefónica O2 Czech Republic, a.s.
Registered address:	Prague 4, Michle, Za Brumlovkou 266/2, PSČ 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 registered capital of the controlled entity.

Overall summary of shares in Telefónica O2 Czech Republic, a.s.:

Telefónica O2 Czech Republic, a.s.	69.41 % Telefónica, S.A.
	30.59 % Other investors

Section III. Interconnected entities

Entities controlled by Telefónica, S.A.:

The list of entities controlled directly or indirectly by Telefónica, S.A. forms 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 interconnected entities including details of performance and counter-performance provided thereunder

In the applicable period following contracts, between the controlled entity and the controlling entity and other interconnected entities, were entered into: on provision of IT services (guaranty and post-guaranty service and system support), contract on IT outsourcing, contracts on provision of telecommunication services (carrier capacity), on sale and installation of telecommunication technology, on telecommunication network quality assurance, deposit agreement, contract on provision of the management support, contract on sharing of IP rights, on provision of the group email service and SW security, insurance contracts, contract on employment of the global wholesale prices of the roaming services, contact on provision of external call centers, contract on education and training of the employees abroad, derivative transaction contract (ISDA agreement) and human resources service agreement.

These contracts were entered into either with the controlling entity Telefónica, S.A. or with the interconnected entities hereunder: Telefónica O2 Business Solutions, spol. s r.o., TELEFONICA GLOBAL TECHNOLOGY S.A. UNIPERSONAL, CZECH TELECOM Austria GmbH, CZECH TELECOM Germany GmbH, Telefónica O2 Slovakia, s.r.o., Telfisa Global, B.V., O2 Holdings Ltd., Altair Assurances, S.A., Telefónica O2 UK Ltd., Telefónica Global Roaming GmbH, Atento Česká republika a.s., Telefónica Europe plc., Telefónica Finanzas, S.A. (TELFISA), Telefonica Europe People Services Ltd.

Details of contracts concluded are regarded as a trade secret by the controlled entity, according to the Commercial Code and other internal governance documents. The controlled entity has not suffered any damage in connection with contracts and agreements concluded in 2010 between the controlled entity and controlling entity and between controlled entity and other interconnected entities, under which performance and counter-performance was given, or in connection with provision of performance and counter-performance in 2010 under contracts and agreements concluded prior to 1 January 2010. Performance provided under the above contracts were always corresponding to usual market conditions for third parties´ services regarding price and quality while in various occasions the Company has benefited from synergies and possibility to participate on globally negotiated conditions in many areas.

Part D Other legal acts between holding entities in the accounting period 2010

In accounting period 2010, no other unilateral or other legal acts were made by the controlled entity in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage to the controlled entity.

Part E Measures between holding entities in the accounting period 2010

In accounting period 2010, no measures were taken by the controlled entity in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage to the controlled entity.

Part F Conclusion

a) The Report was prepared by the Board of Directors of the controlled entity, Telefónica O2 Czech Republic, a.s., and approved at the meeting of the Board of Directors held on 16 March 2010.
b) The Report was prepared using data and information obtained from the controlling entity and other interconnected entities, other available documents, and using results of examinations of relationships between the controlled entity on the one hand and the controlling entity and other interconnected entities on the other hand. The Board of Directors of the controlled entity, Telefónica O2 Czech Republic, a.s., declares that it proceeded with due professional diligence of a manager when collecting the data and information.
c) With regard to the fact that the controlled entity, Telefónica O2 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 attached to the 2010 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 16 March 2011

Telefónica O2 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 2010 to 31 December 2010

Name of the company	Country	% Telefónica Group	Holding company
TELEFÓNICA, S.A.	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%)
Telefónica S. de Informática y Comunicaciones de España, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Soluciones Sectoriales, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Interdomain, S.A.	Spain	100%	Telefónica Soluciones Sectoriales, S.A. (100%)
Teleinformática y Comunicaciones, S.A. (TELYCO)	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Telecomunicaciones Públicas, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Remesas, S.A.	Spain	100%	Telefónica Telecomunicaciones Públicas, S.A. (100%)
Telefónica Salud, S.A.	Spain	51.00%	Telefónica Telecomunicaciones Públicas, S.A. (51.00%)
Iberbanda, S.A.	Spain	58.94%	Telefónica de España, S.A.U. (58.94%)
Telefónica Cable, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Internacional, S.A.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Global Technology, S.A. Unipersonal	Spain	100%	Telefónica, S.A. (100%)
Telefonica International Holding, B.V.	Netherlands	100%	Telefonica International, S.A. (100%)
Latin American Cellular Holdings, B.V.	Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Datacorp, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telecomunicaçoes de Sao Paulo, S.A. – TELESP	Brazil	87.95%	Telefónica Internacional, S.A. (65.30%)
			Sao Paulo Telecomunicaçoes Participaçoes, Ltda. (22.65%)
Vivo Participaçoes, S.A.	Brazil	59.42%	Telefónica, S.A. (35.89%)
			Telefónica Brasil Sul Celular Participaçoes, Ltda. (4.37%)
			Portelcom Participaçoes, S.A. (19.16%)
Vivo, S.A.	Brazil	100%	Vivo Participaçoes, S.A. (100%)
Compañía Internacional de Telecomunicaciones, S.A.	Argentina	50.00%	Telefónica Holding de Argentina, S.A. (50.00%)
		39.40%	Telefónica Móviles Argentina Holding, S.A. (39.40%)
		10.60%	Telefonica International Holding, B.V. (10,60%)
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%)
			Telefonica International Holding, B.V. (0.95%)
			Telefónica, S.A. (1.80%)

Name of the company	Country	% Telefónica Group	Holding company
Telefónica Móviles Argentina Holding, S.A.	Argentina	100%	Telefónica, S.A. (100%)
Telcel, C.A.	Venezuela	100%	Latin America Cellular Holdings, B.V. (97.21%)
			Telefónica, S.A. (0.08%)
			Comtel Comunicaiones Telefónicas, S.A. (2.71%)
Telefónica Móviles Chile, S.A.	Chile	100%	Inversiones Telefónica Móviles Holding Ltda. (100%)
Telefónica Chile, S.A.	Chile	97.89%	Inversiones Telefónica Internacional Holding Ltda. (53,00%)
			Telefónica Internacional de Chile, S.A. (44.89%)
Telefónica del Perú, S.A.A.	Peru	98.34%	Telefónica Internacional, S.A. (49.90%)
			Latin America Cellular Holdings, B.V. (48.28%)
			Telefónica, S.A. (0.16%)
Telefónica Móviles Perú, S.A.C.	Peru	99.99%	Telefónica del Perú, S.A.A. (99.99%)
Colombia Telecomunicaciones, S.A. ESP	Colombia	52.03%	Telefónica Internacional, S.A. (52.03%)
Telefónica Móviles Colombia, S.A.	Colombia	99.99%	Olympic, Ltda. (50.58%)
			Telefónica, S.A. (49.42%)
Telefónica Móviles México, S.A. de C.V.	Mexico	100%	Telefónica Internacional, 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. (68.00%)
			Telefónica, S.A. (32.00%)
Telefónica Larga Distancia de Puerto Rico, INC.	Puerto Rico	98.00%	Telefonica International Holding, B.V. (98.00%)
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.	Salvador	99.08%	Telefónica Móviles El Salvador Holding, S.A. de C.V. (99.08%)
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 International Wholesale Services II, S.L.	Spain	100%	Telefónica, S.A. (100%)
Telefónica International Wholesale Services America, S.A.	Uruguay	100%	Telefónica, S.A. (76.85%)
			Telefónica International Wholesale Services, S.L. (23.15%)
Telefónica International Wholesale Services France, S.A.S.	France	100%	Telefónica International Wholesale Services II, S.L. (100%)
Telefónica International Wholesale Services Argentina, S.A.	Argentina	100%	T. International Wholesale Services America, S.A. (97.64%)
			Telefónica International Wholesale Services, S.L. (2.36%)

Name of the company	Country	% Telefónica Group	Holding company
Telefónica International Wholesale Services Brasil Participacoes, Ltd.	Brazil	100%	TIWS Participacoes Ltda (99.99%)
Telefónica International Wholesale Services Perú, S.A.C.	Peru	99.99%	T. International Wholesale Services America, S.A. (99.99%)
Telefónica International Wholesale Services USA, Inc.	USA	100%	T. International Wholesale Services America, S.A. (100%)
Telefónica International Wholesale Services Puerto Rico, Inc.	Puerto Rico	100%	T. International Wholesale Services America, S.A. (100%)
Telefónica International Wholesale Services Ecuador, S.A.	Ecuador	100%	T. International Wholesale Services America, S.A. (99.00%)
			Telefónica International Wholesale Services Perú, S.A.C. (1.00%)
Terra Networks Brasil, S.A.	Brazil	100%	Sao Paulo Telecomunicaçoes Participaçoes, Ltda. (100%)
Terra Networks Mexico, S.A. De C.V.	Mexico	100%	Terra Networks Mexico Holding, S.A. de C.V. (99.99%)
Terra Networks Perú, S.A.	Peru	99.99%	Telefónica Internacional, S.A. (99.99%)
Terra Networks Argentina, S.A.	Argentina	100%	Telefónica Internacional, S.A. (99.92%)
			Telefonica International Holding, B.V. (0.08%)
Terra Networks Guatemala, S.A.	Guatemala	99.99%	Telefónica Internacional, S.A. (99.99%)
Telefonica China, B.V.	Netherlands	100%	Telefónica Internacional, S.A. (100%)
Telefónica Europe plc	United Kingdom	100%	Telefónica, S.A. (100%)
mmO2 plc	United Kingdom	99.99%	Telefónica Europe plc (99.99%)
O2 Holdings Ltd.	United Kingdom	100%	mmO2 plc (100%)
Telefónica Europe People Services Ltd.	Ireland	100%	O2 Holdings Ltd. (100%)
Telefónica O2 UK Ltd.	United Kingdom	100%	O2 Networks Ltd. (80.00%)
			O2 Cedar Ltd. (20.00%)
The Link Stores Ltd.	United Kingdom	100%	Telefónica O2 UK Ltd. (100%)
Be Un Limited (Be)	United Kingdom	100%	Telefónica O2 UK Ltd. (100%)
Tesco Mobile Ltd.	United Kingdom	50.00%	O2 Communications Ltd. (50.00%)
O2 (Europe) Ltd.	United Kingdom	100%	Telefónica, S.A. (100%)
Telefónica O2 Germany GmbH & Co. OHG	Germany	100%	Telefónica O2 Germany Verwaltungs GmBh (99.99%)
			Telefónica O2 Germany Management GmBh (0.01%)
Tchibo Mobilfunk GmbH & Co. KG	Germany	50.00%	Telefónica O2 Germany GmbH & Co. OHG (50.00%)
Telefónica Global Services, GmbH	Germany	100%	Telefónica O2 Germany GmbH & Co. OHG (100%)
Telefónica Global Roaming, Gmbh	Germany	100%	Telefónica Global Services, GmbH (100%)
Telefonica O2 Ireland Ltd	Ireland	100%	O2 (Netherlands) Holdings, B.V. (99.00%)
			Kilmaine Ltd (1.00%)
Jajah Inc.	USA	100%	Telefónica Europe plc (100%)

Name of the company	Country	% Telefónica Group	Holding company
Hansenet Telekommunication GmbH	Germany	100%	Telefónica O2 Germany GmbH & Co. OHG (100%)
Telefónica O2 Czech Republic, a.s.	Czech Republic	69.41%	Telefónica, S.A. (69.41%)
Telefónica O2 Slovakia, s.r.o.	Slovensko	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
CZECH TELECOM Austria GmbH	Rakousko	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
CZECH TELECOM Germany GmbH	Germany	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
Telefónica O2 Business Solutions, spol. s r.o.	Czech Republic	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
Telefónica de Contenidos, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Atlántida Comunicaciones, S.A.	Argentina	100%	Telefonica Media Argentina S.A. (93.02%)
Televisión Federal S.A. – TELEFE	Argentina	100%	Atlántida Comunicaciones S.A. (79.02%)
Telefónica Servicios Audiovisuales, S.A.	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 On The Spot Services, S.A.U.	Spain	100%	Telefónica de Contenidos, S.A.U. (100%)
Atento Inversiones y Teleservicios, S.A.	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.	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.	Colombia	100%	Atento N.V. (94.98%)
			Atento Venezuela, S.A. (0.01%)
			Atento Brasil, S.A. (0.00%)
			Teleatento del Perú, S.A.C. (0.00%)
			Atento Mexicana, S.A. De C.V. (5.00%)
Atento Argentina, S.A.	Argentina	100%	Atento Holding Chile, S.A. (97.99%)
			Atento N.V. (2.01%)
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%)
Phenix Investments, S.R.L.	Luxembourg	5.00%	Telefónica, S.A. (5.00%)
Telfin Ireland Ltd.	Ireland	100%	Telefónica, S.A. (100%)
Terra Networks Asociadas, S.L.	Spain	100%	Telefónica, S.A. (100%)
Red Universal de Marketing y Bookings Online, S.A.	Spain	50.00%	Terra Networks Asociadas, S.L. (50.00%)
Telefónica Learning Services, S.L.U.	Spain	100%	Terra Networks Asociadas, S.L. (100%)
Telefónica Ingeniería de Seguridad, S.A.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Engenharia de Segurança do Brasil, Ltda.	Brazil	99.99%	Telefónica Ingeniería de Seguridad, S.A. (99.99%)

Name of the company	Country	% Telefónica Group	Holding company
Telefónica Capital, S.A.	Spain	100%	Telefónica, S.A. (100%)
Lotca Servicios Integrales, S.L.	Spain	100%	Telefónica, S.A. (100%)
Fonditel Pensiones, Entidad Gestora de Fondos de Pensiones, S.A.	Spain	70.00%	Telefónica Capital, S.A. (70.00%)
Fonditel Gestión, Sociedad Gestora de Instituciones de Inversión Colectiva, S.A.	Spain	100%	Telefónica Capital, S.A. (100%)
Telefónica Investigación y Desarrollo, S.A. (TIDSA)	Spain	100%	Telefónica, S.A. (100%)
Telefónica Investigación y Desarrollo de Mexico, S.A. de C.V.	Mexico	100%	Telefónica Investigación y Desarrollo, S.A. (100%)
Casiopea Reaseguradora, S.A.	Luxembourg	100%	Telefónica, S.A. (100%)
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A.	Spain	100%	Casiopea Reaseguradora, S.A. (83.33%)
			Telefónica, S.A. (16.67%)
Altaïr Assurances, S.A.	Luxembourg	100%	Casiopea Reaseguradora, S.A. (95.00%)
			Seguros de Vida y Pensiones Antares, S.A. (5.00%)
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. (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.	USA	0.01%	Telefónica Europe, B.V. (0.01%)
Telefónica Emisiones, S.A.	Spain	100%	Telefónica, S.A. (100%)
Spiral Investments, B.V.	Netherlands	100%	Telefónica Móviles España, S.A.U. (100%)
Solivella Investment, B.V.	Netherlands	100%	Telefónica Móviles España, S.A.U. (100%)
Aliança Atlântica Holding, B.V.	Netherlands	93.99%	Telefónica, S.A. (50.00%)
			Telecomunicaçoes de Sao Paulo, S.A. – TELESP (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. (95,00%)
			Telefónica, S.A. (4.99%)
Telefónica Gestión de Servicios Compartidos de Chile, S.A.	Chile	97.89%	Telefónica Chile, S.A (97.89%)
Telefónica Gestión de Servicios Compartidos, S.A.C.	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 of the company	Country	% Telefónica Group	Holding company
Telefonica Servicos Empresariais do Brasil, Ltda.	Brazil	99.99%	T. Gestión de Servicios Compartidos España, S.A. (99.99%)
Telefónica Gestión de Servicios Compartidos Mexico, 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%)
Telefónica Compras Electrónicas, S.L.	Spain	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Telefónica Factoring México, S.A. de C.V. SOFOM ENR	Mexico	50.00%	Telefónica, S.A. (40.50%)
			Telefónica Factoring España, S.A. (9.50%)
Telefónica Factoring España, S.A.	Spain	50.00%	Telefónica, S.A. (50.00%)
Telefónica Factoring Do Brasil, Ltd.	Brazil	50.00%	Telefónica, S.A. (40.00%)
			Telefónica Factoring España, S.A. (10.00%)
Telco, S.p.A.	Italy	46.18%	Telefónica, S.A. (46.18%)
Ipse 2000, S.p.A.	Italy	39.92%	Solivella Investment, B.V. (39,92%)
Jubii Europe N.V.	Netherlands	32.10%	LE Holding Corporation (32.10%)
DTS Distribuidora de Televisión Digital, S.A.	Spain	22.00%	Telefónica de Contenidos, S.A.U. (22.00%)
Hispasat, S.A.	Spain	13.23%	Telefónica de Contenidos, S.A.U. (13.23%)
Telecom Italia, S.p.A.	Italy	10.47%	Telco, S.p.A. (10.47%)
China Unicom (Hong Kong) Limited	China	8.37%	Telefónica Internacional, S.A. (8.37%)

Glossary of terms and acronyms

Glossary of terms and acronyms

ADSL Asymmetric Digital Subscriber Line

ARPU an indicator – average monthly revenues from services per user, excluding roaming visitors

BlackBerry a mobile office solution from Telefónica O2 designed for mobile corporate customers

BTS Base Transceiver Station for relaying signal to mobile telephones

CDMA Code Division Multiple Access, a modern digital technology for wireless data and broadband internet

CSR Corporate Social Responsibility

CTO Czech Telecommunications Office

DSLAM Digital Subscriber Line Access Multiplexer; a gateway to the network of ADSL access provider

e-účet a service offering online access to the fixed line billing balance

EDGE Enhanced Data Rates for GSM Evolution, a mobile digital technology with a faster and more reliable data transmission

FTP File Transfer Protocol; a platform-independent protocol for the transfer of files between computers

GPRS General Packet Radio Service, a technology for mobile data transmission

GSM Global System for Mobile Communication; the most widely deployed digital wireless communication standard for the digital mobile system which globally uses frequencies of 450, 900, 1,800 and 1,900 MHz, and frequencies of 900 and 1,800 MHz in the Czech Republic

HSCSD High-Speed Circuit-Switched Data, a technology for mobile data transmission in the GSM network

HSDPA High Speed Downlink Packet Access, a superstructure technology for data transmission in the UMTS network, with speeds from 8 to 10 Mb/s

HTTP Hypertext Transfer Protocol; an internet protocol for exchanging hypertext documents and other HTML content

ICT Information and Communication Technologies

IFRS International Financial Reporting Standards

IMAP Internet Message Access Protocol an internet protocol for remote access to email

IP Connect a service for communication using the IP protocol

IPsec (IP security) a security enhancement to the IP protocol

IPTV Internet Protocol Television; a television signal broadcast over broadband networks using the IP protocol

IP VP N Internet Protocol Virtual Private Network, a service of intra-corporate data or voice over IP communication

LAN Local Area Network a local network for communication between computers in the network

LTE Long Term Evolution for UMTS; the latest concept of data transmission technology in the 3rd generation mobile networks

MMS a multimedia format for mobile data transmission

My Europe a mobile tariff of Telefónica O2, with free-of-charge incoming calls for roaming users

My Europe SMS a mobile tariff of Telefónica O2, with free-of-charge incoming calls for roaming users

NMT Nordic Mobile Telephony, a technology standard for mobile telephony networks using the 450 MHz frequency

O2 Business Unlimited a tariff of Telefónica O2 for business customers, offering unlimited calls to all fixed line and mobile network free of charge, as part of the monthly subscription

O2 Business Nonstop Max a tariff of Telefónica O2 for business customers, offering free calls within the O2 mobile network and to all fixed line networks in the Czech Republic

O2 Duo a converged service of Telefónica O2 combining unlimited calls to fixed line networks in the Czech Republic with O2 Internet ADSL or O2 TV, all as part of one monthly subscription

O2 Duo Mobil a converged service of Telefónica O2 combining, as part of one monthly subscription, O2 Internet ADSL and a mobile voice tariff; the fixed line rental fee is already included

O2 Fér a service of Telefónica O2 Slovakia, offering a single rate on calls and SMS for the customers of prepaid and contract services, without monthly subscription fee

O2 Internet ADSL a broadband internet access service of Telefónica O2, formerly branded O2 Internet Expres

O2 Internet Komplet a service of Telefónica O2 combining fixed line and mobile services

O2 Internet Mobil a CDMA mobile service of Telefónica O2

O2 [:kůl:] a service of Telefónica O2 with fee SMS

O2 Neomezená linka the first VoIP service of Telefónica O2 for business customers

O2 Neon a family of flat rate tariffs

O2 Trio a converged service of Telefónica O2 combining O2 Internet ADSL, O2 TV and unlimited calls to fixed networks in the Czech republic, all for one monthly fee

O2 TV an IPTV service of Telefónica O2; digital television over a fixed line

O2 TXT a mobile tariff of Telefónica O2 designed for prepaid customers who prefer to communicate via SMS and MMS

OIBDA Operating Income before Depreciation and Amortisation

Platí to Kvído a service of Telefónica O2 which lets customers call for free for a duration of one minute

POP3 Post Office Protocol version 3; an internet protocol used for downloading email messages by the client remotely from the server

RSU Remote Subscriber Unit

SMS Short Message Service; a format of short messages used in mobile telephony

UMTS Universal Mobile Telecommunications System; a standard for the so-called 3rd generation mobile networks

VoIP Voice over Internet Protocol

VPN Virtual Private Network

VPN Expres an IP VPN data service of the former ČESKÝ TELECOM; it is based on the ADSL access technology with aggregation, and the MPLS backbone network

WAN Wide Area Network; a wider computer network giving remote branches full access to data and providing for communication between the headquarters and the branches and within the branch network

WAP Wireless Application Protocol, a protocol for displaying selected web pages on a mobile telephone display

WiFi a local wireless network for accessing the internet

Telefónica Czech Republic, a.s.
Za Brumlovkou 266/2, 140 22 Prague 4, Czech Republic
Phone: 840 114 114
Press Centre: 800 163 342
CIN: 60193336
www.telefonica.cz

Annual Report 2010

Published by: Telefónica Czech Republic, a.s.
Concept, design, realisation: Dynamo design s.r.o.
Photographs of Company management: Marek Musil and archive of Telefónica Czech Republic, a.s.

CAUTIONARY STATEMENT: Any forward-looking statements concerning the future economic and financial performance of Telefónica Czech Republic, a.s. contained in this Annual Report are based on assumptions and expectations of the future development of factors having material influence on the future economic and financial performance of Telefónica Czech Republic, a.s. These factors include, but are not limited to, public regulation in the telecommunications sector, the future macroeconomic situation, and the development of market competition and related demand for telecommunications and other services. The actual development of these factors, however, may be different. Consequently, the actual future results of the economic and financial performance of Telefónica Czech Republic, a.s. could materially differ from those expressed in the forward-looking statements contained in this Annual Report.