

Half-year Report 2007

07

Half-year Report 2007

Content

Letter from the Chairman of the Board of Directors	4
Calendar of the main events	7
1 Board of Directors' Report on Business Activity	9
The Czech telecommunications market in the first half of 2007	11
Regulation	12
Telefónica O2 Czech Republic Group in the first half of 2007	14
Telefónica O2 Slovakia	15
New products and services	16
Commented financial results	19
2 Corporate governance	27
3 Financial section	37
Consolidated Financial Results prepared in accordance with International Financial Reporting Standards	39
4 Information for shareholders	43
5 Glossary of terms and acronyms	47

Letter from the Chairman of the Board of Directors

To Our Shareholders,

Let me review the developments in Telefónica O2 Group in the first half of 2007. Our activities in the period followed the strategy and goals which were set for 2007.

One of our main goals is to slow down the decline in the number of fixed lines by offering a greater portfolio of products and services, improving the quality of the broadband internet service, the development of O₂ TV, our IPTV service, and by launching new converged services. Another priority is to develop our services for IT and integrated customer solutions, especially in the corporate segment, which also includes the government. Here we want to demonstrate that we are not just a provider of traditional telecommunications services but that we also have a long-term commitment to developing services on the IT and ICT markets. In the mobile segment our activities are focused on maintaining the Average Revenue per User (ARPU) by means of continuing the migration of customers from the pre-paid to the post-paid service, and by increasing revenues from mobile data and internet access services.

We are dedicated to supporting the development of our business in Slovakia where we secured a mobile network operation licence in 2006. Our primary concern is the development of systems, processes and networks, and the launch of innovative and competitive products and services. We aim to reach a level of customer experience that would be comparable to what we have achieved in the Czech Republic. Customer care and customer experience are the two areas that have become our new key priorities for 2007 – both in the Czech Republic as well as in Slovakia.

As for our financial performance, we focus on maintaining OIBDA, efficient investing in growth areas and strong free cash flow generation. We expect that 2007 will see our consoli-



Jaime Smith Basterra

Chairman of the Board of Directors

dated revenues increase by 1–3%. Due to the development of our Slovak venture, OIBDA is expected to decrease by 1% or remain on the level of 2006.

Our decisions were influenced also by the wishes of our customers and by the trends on the market. Strong demand for fixed-line fast internet access and related services, fixed-to-mobile substitution, migration of mobile customers from pre-paid to post-paid services and the development of new services combining voice and internet, and/or IPTV – these trends have all been palpably present in the market for some time and are still going strong.

I would now like to take a closer look at what the new developments and our accomplishments over the past six months have been. As in the last year, we increased the speed of our internet access service, O₂ Internet ADSL, by up to four times in April. The speeds in our wholesale offer to other licensed operators were also increased. With effect from 1 July we also increased the data limits by up to three times. The speed and data limit upgrades were implemented automatically and gradually for all customers. All the changes were free-of-charge. By the end of June, we have increased the speed for approximately 92% of our customers. We wish to allow our customers the benefits of high-speed internet – and our new O₂ Internet ADSL Start service demonstrates this commitment. Customers of the service enjoy two hours of internet access per month at a very attractive price. The new services have only confirmed our leadership in the ADSL broadband internet access services category on the Czech telecommunications market.

We also added new attractive features to our O₂ TV service. From February, customers can install the service themselves, with the help of our self-installation package. This method of installation has proven to work well already for the O₂ Internet ADSL service. At present, 99% of all orders that include a purchase of a modem from our range are installed this way. We believe that this option will become popular also for O₂ TV. We

expanded the offer of TV channels with packages of programmes for children and documentaries. Our partnership with Sony Pictures Hollywood International has granted us access to a back catalogue with more than 2,000 attractive feature films. Our customers can select their films in our Videothèque, one of the O₂ TV functions. In July we became the first Czech company to terrestrially broadcast the Czech Television's ČT1 channel in High Definition (HD) quality.

Both services, O₂ TV and O₂ Internet ADSL, became the corner stone of new service packages that combine several services, both fixed-line and mobile, for a single monthly fee. As part of this offer, we launched O₂ Duo, a service offering unlimited fixed-line telephony in combination with O₂ TV or O₂ Internet ADSL, and O₂ Trio, a service that combines all three components. I firmly believe that these services will add value to fixed line services. Being the only integrated operator in the Czech Republic, we have offered our customers the first converged product - O₂ Duo Mobil. This service combines a mobile voice tariff, O₂ Simple, and fixed-line high-speed internet access in the form of our O₂ Internet ADSL service. We plan to launch other converged services in the second half of 2007.

As I already stated at the beginning of my letter, customer experience is one of our key priorities for 2007. We have defined key projects in this area – each one dealing with one of its different aspects, such as product delivery, and quality of service, both for our residential and business customers. Our first step in defining the key customer experience projects was to make “promises” to our customers. These are values that our customers have the right to expect from us in all situations; they include trust, simplicity, real customer orientation and unique experience. The two key projects are *Product Delivery*, which seeks to adjust or re-engineer the processes relating to service delivery and provisioning, and *First Call Resolution*, which aims to increase the quality of customer care in call centres. I am pleased to say that the first steps to leading to implementation of these changes were started already in the first half of the year.

In the first half of 2007 we also commenced the commercial operation of our mobile service in Slovakia. Close co-operation and support from the parent company in the Czech Republic and the signing of the national roaming agreement with T-Mobile Slovensko have made it possible to launch our service a mere five months after we secured the licence. We recorded a substantial interest in our service right from the start and the speed of our entry to the Slovak mobile market, measured by the market share taken, has broken several records. Our campaign, in which customers who were interested in our services could register free-of-charge and without obligation, acquired more than 600 thousand registered potentials in a month and a half period ending on 2nd February. By the end of June 2007, the number of the registered customers in Slovakia has reached 455 thousand. Still in the first half of the year, we also started offering post-paid services to complement our existing pre-paid service. We were the first mobile operator in Slovakia to start offering an innovative post-paid service without a contract, branded as O₂ Volnost. We also focused on the development of our own network in order to at least meet the conditions of the licence. We rolled out our retail distribution network, which, in addition to our brand stores, comprises a good number of re-sale outlets. We were the first mobile operator in Slovakia to launch an e-shop.

Financial results confirmed our expectations for this year, namely in the area of revenues growth. Consolidated revenues went up 3.2% year on year to CZK 31.1 billion. While mobile segment confirmed healthy 5.5% growth, revenues in the fixed line segment in the first half of 2007 grew 0.2% for the time ever, Total consolidated operating expenses amounted to CZK 17.1 billion, up by 7.4%, mainly due to increase in external costs, cost of sales and costs related to our activities in Slovakia. This resulted in consolidated OIBDA of CZK 14.2 billion, down by 2.2% compared to the first half of 2006. OIBDA margin reached 45.9%. Slovak operation diluted OIBDA margin by about two points. Net income increased 14.2% year on year to CZK 4.9 billion on the back of decline in depreciation and amortisation and financial expenses.

Also in the second half of 2007, we will strive to deliver on our strategic objectives. We are set to promote the innovated and new services launched in the first six months of the year. We will continue to develop services in new, growth areas (broadband, ICT and Slovakia), with a view to stabilising the revenues in the fixed-line segment, maintaining the revenues in the mobile segment and growing the contribution of the Slovak operation to the consolidated revenues. At the same time, we plan to exercise stringent operating and capital expenditure control in order to preserve the high operating and financial performance of the Czech business. Our priority is to deliver on our consolidated revenues and OIBDA targets which I have outlined in the first part of my letter.

A handwritten signature in blue ink that reads "Jaime Smith". The signature is written in a cursive style and is positioned above a horizontal line.

Jaime Smith
Chairman of the Board of Directors

Calendar of the key events

January

Telefónica O2 launches a self-installation package for the O₂ TV service. This package guides customers through the installation process and eliminates the need for professional assistance.

Telefónica O2 becomes the first Czech telecommunications operator to start offering special discounts on fixed-line and mobile services to customers with disabilities or low incomes.

February

Telefónica O2 publishes its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2006.

The number of O₂ TV customers reaches the 20 thousand mark.

Both new and existing customers of the Telefónica O2 post-paid mobile service can enjoy special discounted rates on calls to selected international destinations.

March

Telefónica O2 launches O₂ Internet Komplet, a new converged service that combines high-speed internet over a fixed line and a mobile data service as part of a single subscription.

Telefónica O2 presents a new package of telecommunications and multimedia services under the brand O₂ Trio. The package combines O₂ Internet ADSL, a high-speed internet access service, O₂ TV, an IPTV service, and unlimited calling within the fixed-line network in the Czech Republic – all as part of a single monthly subscription.

April

The Ordinary General Meeting of shareholders of Telefónica O2 is held. The shareholders approve, among other things, a proposal of the Board of Directors for the payment of a dividend of CZK 50 per share before tax from the 2006 profit and retained earnings.

Telefónica O2 publishes its un-audited consolidated financial results prepared under International Financial Reporting Standards for the first quarter of 2007. The financial results include the results of Telefónica O2 Slovakia.

The number of ADSL high-speed internet users in the Czech Republic reaches the 500 thousand mark.

Telefónica O2 increases the speed of ADSL internet access to up to 8 Mb/s, while preserving the prices, and sets new standards for high-speed internet with speeds starting from 2 Mb/s.

A new service, O₂ Duo Mobil, offers customers internet access in the form of the O₂ Internet ADSL service, and a mobile voice tariff, as part of a single monthly subscription.

O₂ TV users can now watch 3D films on the TV screen.

May

The number of CDMA-EVDO customers of Telefónica O2 reaches the 100 thousand mark.

O₂ TV now has more than 30 thousand registered users.

Telefónica O2 becomes the only company in the Czech Republic to have qualified for the international Institute of Internal Auditors (IIA) certificates, which attests to the quality of internal controlling mechanisms.

June

The Chief Executive Officer of Telefónica O2, Jaime Smith Basterra, is appointed Chief Executive Officer of O2 Germany. His successor is Salvador Anglada Gonzalez, formerly Vice-President – Consumer Division of Telefónica O2.

Telefónica O2 announces it will raise the data limits (FUP) for new and existing customers of O₂ Internet ADSL to up to three times original levels.

01





Board of Directors' Report on Business Activity

The Czech telecommunications market in the first half of 2007	11
Regulation	12
Telefónica O2 Czech Republic Group in the first half of 2007	14
Telefónica O2 Slovakia	15
New products and services	16
Consolidated financial statements	19

In 1H 2007 Telefónica O2 customers sent and received in total 1.5 billion SMS.

The Czech telecommunications market in the first half of 2007

As in 2006, the developments on the telecommunications market in the Czech Republic in the first half of 2007 were characterised by growing demand for data, internet and other value added services. On the other hand, the demand for traditional voice services continued to decline, especially in the fixed line segment, despite a certain slowdown in this trend.

The main reason was the high rate of substitution of fixed-line services by mobile voice services, which is a phenomenon that is still going strong. According to estimates, the share of traffic generated in mobile networks of the total voice traffic has reached 74%, which is one of the highest values among countries of the European Union. The growth in mobile voice traffic is due to the higher number of customers and special marketing promotions by mobile operators, who offer free air time. At the other end, the fall of voice traffic in fixed-line networks is due to the declining numbers of fixed lines and fiercer competition from cable network operators who, in the second half of 2006, launched their own voice services.

The mobile market in the Czech Republic is typical for the continuing migration of customers from pre-paid to post-paid services. This trend is further facilitated by new, simpler tariffs offered by all three mobile operators. For their monthly subscription the customer gets a credit which they can spend flexibly – on voice, SMS or MMS services. Mobile operators also offer tariffs with free air time, free SMS or cheaper rates on calls (off-peak, to fixed-line networks, etc.). Roaming calls are also cheaper now as a result of new pricing offers launched by all three mobile operators in the first half of 2007.

The share of Telefónica O2 in the high-speed internet access market is approximately 40%. This figure includes fixed internet access based on ADSL technology (retail and wholesale) and mobile internet access using the CDMA and UMTS technologies. For retail ADSL connection Telefónica O2 continues to maintain a very high market share of approximately 82%. Despite the significant growth in the number of retail ADSL connections, the number of

wholesale accesses provided by Telefónica O2 in 1H 2007 stagnated. The number of ADSL accesses provided by other operators using Local Loop Unbundling (LLU) is growing. Wi-Fi access represents approximately a 38% share of the total high-speed internet access market. According to RT Audit, a market research survey conducted by TNS AISA, and Telefónica O2's own internal estimates, the number of customers in the Czech Republic who use Wi-Fi internet access has reached the 570 thousand mark. In this respect, the Czech Republic is in a unique position in the context of the European Union.

The fixed high-speed internet access market (fixed telephone lines and cable) in the first half of 2007 was characterised by speed and data limits upgrades. Starting from early April, Telefónica O2 increased the access speed of its retail and wholesale ADSL customers by up to four times. Data limits were increased as of 1 July 2007 by up to three times. UPC, the cable service provider, increased its data limits in February and speed from 1 April 2007.

In the first half of the year the first packages combining voice services, internet access and television were launched on the market. Telefónica O2 offered all three services as part of one package branded O₂ Trio; UPC has a similar offer. Alternative operators marketed packages combining voice services and internet access.

Being the only integrated operator on the Czech telecommunications market, Telefónica O2 presented O₂ Duo Mobil, the first package combining mobile voice and fixed internet access via ADSL. In June, Vodafone and Radiokomunikace concluded a framework agreement whereby Vodafone will use the wholesale offer of fixed internet access via ADSL provided by Radiokomunikace.

As regards to the competitive environment on the Czech telecommunications market, Liberty Global, the 100% owner of UPC, the largest cable networks operator, completed its acquisi-

tion of Karneval, the second largest player on the cable market. After the acquisition, it commands approximately 80% of the cable market. The company is presently undergoing restructuring.

The mobile market, too, is witnessing tougher competition. MobilKom, a venture owned by Penta, the Slovak investment company, announced its entry to the market. The new operator uses the commercial brand U:Fon and its services are based on CDMA technology. In May U:Fon unveiled its first offer of data and voice services. The services are available in selected smaller areas in the Czech Republic that are presently covered by the operator's network.

Regulation

In the first half of 2007, the regulatory environment on the electronic communications market in the Czech Republic witnessed several new developments. The most important of these were implemented and planned legislative changes, the implementation of remedies in regulated markets and preparations for international roaming regulation. The European Commission progressed in its drafting of the final proposal to amend the so-called new regulatory framework on electronic communications, and the amendment to the act on the protection of economic competition was adopted, which resulted in a new division of powers between the Czech Telecommunications Office (CTO) and the Office for the Protection of Economic Competition (OPEC) in the field of electronic communications. As of 1 July 2007, the Ministry of Informatics was disbanded and its agenda for electronic communications was transferred to the Ministry of Industry and Trade.

Telefónica O2 continued to honour its commitments that arise from the relevant markets analysis by the CTO in 2006. The Company prepared and published a new bitstream reference offer, as it was obliged to do by Regulatory Measure No. 12. The measure defined new

bitstream parameters (aggregate data limit, service support guarantee and virtual capacity in the IP transport network).

Telefónica O2 started to provide new types of regulated services as per Regulatory Measure No. 13. It also published a reference offer for the terminal segments of leased lines, by which it complied with the CTO requirement.

International roaming regulation

After almost 12 months of debate, the European Commission and other European institutions agreed on the language of a norm that regulates the provision of international roaming services. The most important part of the regulation concerns the regulation of retail roaming call prices in the European Union. The prices were capped at EUR 0.49 per minute for an outgoing call, and at EUR 0.24 per minute for an incoming call. The regulation further set the maximum average wholesale roaming price at EUR 0.30 per minute. The regulation will be fully effective on the market from the second half of 2007. The regulated tariffs will be activated automatically with customers having the option of choosing another tariff offered by their operator.

Universal Service

In June and July 2007 Telefónica O2 will petition the CTO for compensation of the losses and net costs incurred as a result of Universal Service provision in 2006. The CTO will review the losses and the net costs during the second half of 2007 and decide on reimbursement. Furthermore, the CTO will exercise the state supervision powers over compliance with the duties of the Universal Service Provider in the second half of 2007. The CTO also plans to launch a review of the scope of duties imposed as part of the Universal Service Obligation. This review may lead to amendments to the relevant decisions.

Government policy and support for broadband internet

A key development of the first half of 2007 in terms of government policy and support for broadband internet was the decision of the European Commission dated 30 May 2007. This concerns the plans of the Prague Metropolitan Authority to roll out a city-funded Wi-Fi network. Acting on a complaint from the Czech Operator's Association, the European Commission had been investigating the plans on the grounds that it might involve potential state aid and have been a threat to the market competition since June 2006. As a result of the action, the Prague Metropolitan Authority changed its plan. It had originally wanted to build a network that would allow internet access, but now the access would be limited only to the websites of government agencies. The amended project, and the use of public funds to that end, eventually received a clearance from the Commission.

In connection with the above decision, the Commission noted that the building of access networks was the remit of commercial operators and any government intervention would be justified only if no commercial service was available in the given area.

Telefónica O2 Czech Republic Group in the first half of 2007

In line with its strategy and the market trends, activities of the Telefónica O2 in the first half of 2007 focused on offering new products and services in the pro-growth areas. These include particularly broadband internet access, data services, IT and comprehensive customer solutions and the development of our Slovak operation. The Group also put emphasis on voice traffic and voice revenue stimulation.

Customer experience is one of our key priorities for 2007. We have defined key projects in this area, each one dealing with one of its different aspects, such as product delivery, and quality of service both for our residential and business customers. Our first step in defining the key customer experience projects was to make “promises” to our customers. These are values that our customers have the right to expect from us in all situations. They include trust, simplicity, real customer orientation and unique experience. Product Delivery comprises of projects that seek to adjust or re-engineer the processes relating to service delivery and provisioning. By the end of the first half of 2007 we want to see the first changes implemented, so that customers can have accurate information about product delivery and problem resolution. Two projects in the *First Call Resolution* area aim to increase the quality of customer care in call centres. We are already seeing partial successes in this area, too. Company's IVR systems were made simpler to use, order cancellation was improved, new processes and procedures were implemented and call centre staff underwent training to develop their skills and knowledge. The last project in the Customer Experience Programme is *Working Together*; its main goal is to improve the working environment in the Company, including the regional offices and call centres, to adjust internal processes that affect the daily lives of our people and employee remuneration and motivation systems. O₂ Reflect is also an inherent part of the initiative – it is a regular survey of employee satisfaction and of the quality of internal communication, which is a discipline that greatly contributes to the development of our new corporate culture.

In the first half of 2007 the running targets of the individual integration projects were accomplished. A new organisation was implemented in the network operation division. The unit now operates in three geographical areas (Prague, Bohemia and Moravia). The operation of NMC (Network Management Centres) was consolidated into three locations (Praha Olšanská, Praha Hvězdova and Olomouc), which provides efficient management and monitoring of all aspects of the operation and allows the ever-increasing portfolio of services to be flexibly accommodated. For IT infrastructure and operation, the internal IT Help Desk was consolidated after the gradual integration of the individual IT systems had been accomplished. Another step that was taken was the integration of the change management for the IT systems, with a new process for change management in all IT applications being implemented. The bill printing for all customers was consolidated into one location.

The *Point of Sale Integration project* succeeded in increasing the number of re-designed stores to 59. All stores now offer the full portfolio of products and services. The distribution network is undergoing gradual optimisation, with some stores being closed or moved to new, more attractive locations. The *Customer Care Integration project* also continues in the gradual integration of technology platforms. As part of these changes the processes of the operative management of call centres and reporting were re-engineered in order to achieve greater operating efficiency. The project *Products* succeeded in launching new products that combine a fixed-line and mobile component, such as O₂ Trio. The majority of activities in the *Re-branding* project were completed already last year. This year the project focuses primarily on the completion of the integration and re-branding of brand stores and the dealership network. Follow-up activities include the re-branding of the car fleet and web presentations, which are currently in progress.

In addition to the Customer Experience Programme, additional projects commenced in the first half of 2007: *Corporate Customer Care Integration* and *Corporate and Business Segment Systems Integration*. These projects seek to develop an integrated customer database and to implement functions for better customer management. Another project, Accounting Systems Stabilisation, aims to stabilise the BSCS system and other systems interfaced to this system, as well as the relevant interfaces. Lastly, the *Job and Competency Model*, whose objective is to implement a new competence model with a view to improving employee recruitment, development and evaluation. Management development at all levels forms an important part of this exercise. Its purpose is to improve the skills, efficiency and the quality of management.

The part New Products and Services of the Half Year Report (below) contains details of all new products and services, including O₂ Duo, O₂ Trio, O₂ Duo Mobil and the recent innovations of the O₂ Internet ADSL and O₂ Internet Komplex services. The impact of the above-mentioned market trends and activities on the financial and operating results in the first half of the year is described in the Commented Financial Results section.

Telefónica O2 Slovakia

In August 2006 Telefónica O2 Slovakia, s.r.o. (Telefónica O2 Slovakia), a wholly owned subsidiary of the Telefónica O2 Czech Republic, won a tender for the third mobile licence in Slovakia. The licence confers the right to use the GSM 900 MHz, GSM 1800 MHz, UMTS and FS 29 GHz frequencies for the purpose of providing telecommunications services in Slovakia for a period of 20 years. For the Telefónica Group, the licence represents an organic regional growth opportunity and synergetic potential with Telefónica O2 Czech Republic.

In November 2006, Telefónica O2 Slovakia signed a national roaming agreement with T-Mobile Slovensko which meant that Telefónica O2 Slovakia could start providing quality

and fully-fledged services from the first day of its operation. The Company's long term strategy is to roll out its own network in the next two years and rely on the national roaming only in locations not covered by its own network. In the first half of 2007, Telefónica O2 Slovakia focused on building its own network in urban areas in order to meet the minimum coverage required by licence terms and conditions, i.e. to launch 400 of its own base stations by September 2007.

Between 15 December 2006 and 31 January 2007, customers interested in the services of Telefónica O2 Slovakia could register, free-of-charge and without obligation, as O₂ Jednotky (O2 Units) in order to become eligible for special benefits applicable to their future communications within the network of Telefónica O2 Slovakia. The Company registered substantial interest from the first day. By 2 February 2007, the day when Telefónica O2 Slovakia launched the commercial pre-paid service for O₂ Jednotky, the number of registered potentials exceeded the 600 thousand mark. Most of the registered prospects requested their SIM cards, which were distributed during February 2007. As from 28 February 2007 the service was open also to non-registered customers.

On 19 April 2007, the Company announced that the number of customers using the service exceeded 400 thousand. By the end of June 2007 the number of registered customers rose to 455 thousand. Current customer base usage patterns show that certain percentage of customers using Telefónica O2 Slovakia SIM card as their second SIM. The Company is taking measures to further stimulate customers to use Telefónica O2 Slovakia as their prime mobile provider, and preparing the launch of new services for postpaid customer segment in 2H 2007.

Telefónica O2 Slovakia successfully rolled out the first part of its distribution network comprising 12 brand stores and more than 3,500 indirect points of sale. It also began to implement a franchise-based re-sale system. Following on from its successful electronic registration

of prospective customers as part of the O₂ Jednotky campaign, Telefónica O2 Slovakia became the first mobile operator in Slovakia to launch an e-shop in May 2007. The e-shop lets customers track the status of their order from its placement up to delivery.

In June 2007, Telefónica O2 Slovakia inaugurated its post-paid service, an innovative service, unique on the Slovak market, which offers customers the option of having a post-paid tariff without a written contract. Customers are eligible for subsidised mobile handsets, yet they need not commit for a period of time. They can also choose their own voice tariff, switch tariffs free-of-charge and carry over unused minutes. Telefónica O2 Slovakia gives its customers freedom to choose and select their post-paid service according to their needs.

New products and services

Voice services

The substitution of traffic generated in the fixed-line networks by mobile traffic continued also in the first half of 2007. The Company's main priority was to maintain the overall level of traffic, regardless of its origin network. Successful marketing campaigns aimed at stimulating mobile traffic more than compensated for the decline in the fixed-line voice traffic, resulting in a 2.8% growth in the total voice traffic generated by Telefónica O2 customers in the first half of 2007 over the same period of last year.

Telefónica O2 extended its special offer from new post-paid mobile customers to include also new pre-paid mobile customers. In the period from 15 February to 30 April, customers could buy a pre-paid O₂ SIM card and enjoy unlimited free calls to O₂ mobile numbers off-peak on week days and all weekends and holidays for a period of up to three months after the service activation. Customers could top-up their credit once at least by CZK 300 and automatically qualify for unlimited calling for a period of four weeks. Customers who migrated from the pre-paid to the post-paid service and activated one of O₂ mobile tariffs with 6 to 24 months

commitment by 30 April could, depending on their chosen tariff and the commitment, become eligible for unlimited 24/7 calling to O₂ mobile numbers and fixed lines in the Czech Republic, for a period of up to two years. Business and self-employed customers were given unlimited calls for up to 36 months, depending on the type of their contract.

Self-employed and small business clients could also opt for another economical offer on their calls – O₂ Moje firma is a package offering special rates on calls within a company, which gives customers unlimited calls to between two–five O₂ mobile numbers for a set fee. Activation is only CZK 20 exclusive of VAT for each SIM card added to the group. The qualifying condition is to have all the numbers in the group registered to one business. The monthly fee for using O₂ Moje firma is CZK 200 exclusive of VAT per one SIM card in the group.

In the first half of 2007, Telefónica O2 introduced a new summer roaming promotion. Post-paid customers who activated O₂ Cestování could, starting from 15 February, call from 15 popular destinations for prices up to 20% cheaper than the listed price. Calling in or from countries neighbouring the Czech Republic and calling in other countries in Europe costs CZK 20 per minute and CZK 28 per minute, respectively, exclusive of VAT. The offer was unlimited and applied to all calls from all roaming partners' networks to the Czech Republic, all calls to any network in a foreign country and to calls made locally. No set-up or any other fee was charged. Customers who activated the service from 15 February to 31 May did not have to pay subscriptions. After 31 May, they were charged CZK 10 per month, exclusive of VAT.

The above roaming promotion was, as of 20 June, complemented with O₂ Smart Roaming, a special roaming tariff that offered calls from 14 popular holiday destinations (the so-called O₂ Smart zones) for prices up to 82% cheaper than the standard listed roaming prices. Calls to the Czech Republic and within an O₂ Smart zone were charged at CZK 9.90 per minute,

exclusive of VAT. Customers pay CZK 25 per minute of a call from other EU countries, exclusive of VAT. O₂ Smart Roaming applies to: Croatia, Slovakia, France, Italy, Spain, Cyprus, Malta, Bulgaria, Greece, Egypt, Tunisia, Malaysia and Thailand. Customers who activated O₂ Smart Roaming received 30 free minutes of incoming calls to O₂ Smart zone countries. After the limit was used up, their incoming calls were charged at CZK 5 per minute, exclusive of VAT. No activation, flat or set-up charges were charged. The special rates applied to any time of the call and to all networks in the destination.

In order to stimulate voice traffic, O₂ Volám and O₂ Nonstop tariffs, offering free calls to all fixed-line networks in the Czech Republic at any time, were made a part of service packages combining a fixed-line voice tariff, high-speed internet and television (O₂ Duo and O₂ Trio).

Internet and value added services

Also in the first half 2007 Telefónica focused on the further development of broadband internet access and value added services, which were identified as the main pro-growth areas and priorities. As in 2006, activities concentrated on improving the range of services in order to add more value to fixed line operations and support the further development of high-speed internet. Speeds and data limits of ADSL internet were increased. Our IPTV service, O₂ TV, was also innovated.

With effect from 1 April 2007, Telefónica O2 increased the speed of ADSL internet access for all wholesale customers up to 8 MB/s. The new basic speed was raised from 512 kb/s to 2,048 kb/s. This development was followed up with an upgrade of the retail offer. As of 2 April retail customers were gradually upgraded to up to four times higher speed, while the prices remained the same. The lowest speed increased from 512 kb/s to 2,048 kb/s. The higher speeds were also upgraded: 2,048 kb/s to 4,096 kb/s; 3,072 kb/s to 6,144 kb/s;

and 4,096 kb/s to 8,192 kb/s. The speed upgrades were executed gradually, during April and May. By the end of June 2007, 92% of O₂ Internet ADSL customers were migrated to higher speeds. ADSL internet was in 1H 2007 available for 97% of all fixed lines and Telefónica O2 is constantly increasing this availability.

To demonstrate further improvements in the quality of ADSL internet, Telefónica O2 increased the data limits for all new and existing customers of O₂ Internet ADSL, free-of-charge, to up to three times previous levels, from 1 July. For the O₂ Internet ADSL 2048 service, the limit was increased from 3 GB to 10 GB; for O₂ Internet ADSL 4096 from 12 GB to 20 GB; for O₂ Internet ADSL 6144 from 20 GB to 30 GB; and for O₂ Internet ADSL 8192 from 30 GB to 40 GB. Similar data limit upgrades were granted also under the wholesale offer.

In order to increase the number of ADSL internet customers, Telefónica launched O₂ Internet ADSL Start on the 1 June for CZK 150 per month, exclusive of VAT. The subscription includes two hours of surfing the web per month, without data limits. The customers paid CZK 1 inclusive of VAT for every minute of connection above the two hours included in the tariff.

In the first half of 2007, Telefónica O2 added several new features to O₂ TV, the television service launched in September 2006, with a view to making it more attractive. From 15 January, customers could opt for a self-installation package which guides the user through the installation process without the need for additional assistance. The self-installation option for O₂ TV follows on a similar feature offered with O₂ Internet ADSL, where it is the preferred method of installation for 99% of users.

Also the Videotheque, one of the additional features of O₂ TV, was expanded to include more titles. After the signing of a three year partnership with Sony Pictures Hollywood International, a content distributor, Telefónica O2 was given access to a back catalogue containing more than 2 thousand film titles. The Videotheque has been offering another new attraction – 3D films – since April. The films need to be viewed with special 3D glasses, distributed by Telefónica O2 to customers free-of-charge. Customers can choose from a number of 3D wildlife documentaries and travel diaries. The programme menu was also expanded to include new content packages: O₂ TV Děti Plus, which contains four channels of content for children of all ages; O₂ TV Dokumenty Plus with four documentary channels; Viasat History, Viasat Explorer, National Geographic Wild and the Travel Channel.

The TV channels in the new improved O₂ TV service are also arranged differently. From June 2007 they are arranged into blocks according to genre and popularity. The new logical arrangement of TV channels provides for better orientation, with it being possible to add new channels later, in a more logical way. In July, Telefónica O2 became the first company in the Czech Republic to start the terrestrial broadcasting of Czech Television's first channel (ČT1) in High Definition (HD) quality. The complete programming is broadcast in HD quality – some content is converted to the higher quality and other content is created directly in the HD format using modern recording equipment with HD functionality.

The success of O₂ TV is manifested by the fact that the service already had 38 thousand customers at the end of June 2007.

Telefónica O2 also continued to promote its mobile data services. Its advantage is that it is offering the widest range of mobile data options, including CDMA, which is already available to approximately 60% of the Czech population. This fact gives Telefónica O2 a signifi-

cant head start over the other mobile operators. Customers in larger cities could enjoy the benefits of the UMTS technology, or the related higher-end technologies: HSDPA and HSCSD. The alternative access methods offered were GPRS and EDGE.

Converged services

In line with its strategy, and from the vantage point of being the only integrated operator on the Czech telecommunications market, Telefónica O2 prepared several services that combine fixed-line and mobile voice services, broadband internet and IP TV (O₂ TV) which were launched in the first half of 2007. The goal was to add more value to the fixed line offer and to reduce the rate of cancellation of fixed lines.

In March 2007, O₂ Trio, a service combining the O₂ Internet ADSL service, O₂ TV, a multi-media television service and unlimited calling to fixed-line networks in the Czech Republic under a single monthly subscription was launched. Customers could pick and match from the following components, to accommodate their needs and usage patterns: high-speed internet with speeds ranging from 2 MB/s to 8 MB/s, voice tariffs O₂ Nonstop or O₂ Volám and the television packages O₂ TV Zábava or Kino. On 1 May 2007, O₂ Duo, a service combining free calling to fixed-line networks in the Czech Republic and O₂ Internet ADSL or O₂ TV followed suit. The packages come at a price which represents a saving on the price the customer would pay should they order the services separately.

After the launch of the pilot converged service, O₂ Internet Komplet, in 2006, which included ADSL high-speed internet and CDMA mobile internet, Telefónica introduced O₂ Duo Mobil on 2nd April 2007. The service includes O₂ Internet ADSL and a mobile voice tariff as part of a single monthly subscription and already incorporates a fixed line rental fee. As with O₂ Duo and O₂ Trio, customers can pick one of the access speeds of the O₂ Internet ADSL service (2,048 or 4,096) and one of the alternatives of the O₂ Simple mobile voice

tariff (240, 600 or 980). The price of O₂ Duo Mobil as a package is again lower than if the individual services were to be ordered separately.

On 1 March 2007, the O₂ Internet Komplet service was re-launched specifically for business customers as O₂ Internet Komplet Business. In addition to the attractive price, users were eligible for a subsidised CDMA modem (USB or PCMCIA) for only CZK 1 exclusive of VAT, or an ADSL2+ modem/router with Wi-Fi wireless functionality for CZK 495 exclusive of VAT, service activation for CZK 1 exclusive of VAT, and free unlimited CDMA access for up to three months.

Commented financial results

This section presents the consolidated financial results of the Telefónica O2 Group prepared according to International Financial Reporting Standards (IFRS) and fully include the Slovak operation.

Consolidated financial statements

Revenues, operating costs and OIBDA

Consolidated revenues (business and recurring revenues) reached CZK 31.1 billion in the first half of 2007, up 3.2% yoy and CZK 15.9 billion in 2Q alone, up 4% yoy. Similarly to the previous quarter, the domestic mobile business was the key driver of this growth. Revenues in the domestic fixed segment recorded a slight increase in 1H 2007 compared to the same period of last year, confirming the reverse in trend seen in 1Q. Contribution of the Slovak operation to consolidated revenues was not material in the first six months of 2007. Total consolidated operating costs reached CZK 17.1 billion, up by 7.4% yoy. The increase in external costs and costs incurred in Slovakia were the major drivers of the OPEX increase in 1H 2007. Consolidated OIBDA amounted to CZK 14.2 billion, down by 2.2% yoy, while OIBDA reached CZK 7.1 billion in 2Q alone, down 2.3% yoy. OIBDA margin (OIBDA over Business revenues) reached 45.9% in the first half of 2007, compared to 48.5% in the same period

of 2006. The Slovak operation diluted OIBDA margin by about 2 p.p. in 1H 2007.

Depreciation and Amortization

Consolidated depreciation and amortization amounted to CZK 7.5 billion in the first half of 2007, a continued decline of 11.5% yoy.

Operating Income, Income before tax and Net income

Consolidated operating income and consolidated income before tax went up by 10.7% yoy and 12.8% yoy to reach CZK 6.7 billion and CZK 6.6 billion, respectively, in the first half of 2007, as a result of the decrease in consolidated depreciation and amortization and the tightly controlled financial expenses. Consolidated net income amounted to CZK 4.9 billion, up by 14.2% yoy.

CAPEX

Total consolidated CAPEX amounted to CZK 2.8 billion in 1H 2007, up 2.5% yoy. CAPEX in the Czech Republic was invested largely in the GSM network capacity increase, ADSL rollout related to the speed upgrades, fixed access network improvement and the information systems upgrade. CAPEX in Slovakia was represented mainly by investments in the network and systems deployment. After the lower investments activity in 1Q, CAPEX spending accelerated in 2Q. Based on the actual CAPEX amount in the first half of 2007 we confirm our full year guidance for the Group CAPEX of around CZK 9 billion, of which about 20% to be expended in Slovakia.

Free Cash Flows

The total amount of the Groups' free cash flows amounted to CZK 9.6 billion in 1H 2007, up by 23.4% yoy. Operating cash flows went up 8.5% yoy to CZK 12.1 billion, following the increase in net profit and lower amount of income tax paid. Lower investments resulted in net cash used in investing activities decreasing by 28.3% compared to 1H 2006 to CZK 2.4 billion.

Cash and Debt levels

The Group's consolidated financial debt (long-term and short-term) amounted to CZK 9.7 billion on 30 June 2007, up by 0.3% compared to the end of June 2006 and 3.7% up compared to 31 December 2006. The amount of cash and cash equivalents and short term financial investments reached CZK 17.3 billion on 30 June 2007. This resulted in net leverage of minus 9.8% and gross leverage of 12.6% compared to minus 2% and 11.4% as at 30 June 2006.

Czech Republic Overview Mobile Segment Overview¹

Total business revenues in the mobile segment increased by 5.5% yoy and amounted to CZK 15.7 billion in the first six months of 2007.

Revenues from voice services (monthly fees, traffic and interconnection) increased 5.5% yoy to CZK 11.7 billion.

The total number of mobile customers increased 2.6% yoy to 4,894 thousand at the end of June 2007. The total number of contract customers reached 2,077 thousand at 30 June 2007, up by 350 thousand yoy, which represents a 20.3% growth achieved

mainly due to our active prepaid to contract migration strategy. Contract customers net adds were 111 thousand in 2Q 2007 compared to 91 thousand in 1Q. Contract customers accounted for 42.4% of the total customer base at the end of 2Q 2007, up from 36.2% a year ago.

The number of prepaid customers decreased by 226 thousand yoy (and by 172 thousand in 1H 2007 alone) to 2,817 thousand at the end of 1H 2007, down by 7.4% yoy. Under the methodology which defines a prepaid customer as generating revenue in the last three months, the number of mobile prepaid customers as at 30 June 2007 was 2,540 thousand down by 6.5% yoy.

The blended monthly average churn rate reached 1.7% in 1H 2007, up from 1.5% in 1H 2006. Churn rate in 2Q 2007 reached 1.4% compared to 1.2% in the same period of 2006.

Revenues from monthly fees increased by 10.1% yoy to CZK 3.4 billion, mainly as a result of the 20.3% yoy growth in the contract customer base.

Traffic revenues increased by 5.5% yoy to CZK 5.8 billion, while outgoing traffic usage increased by 22.2% yoy in 1H 2007. Average MOU per subscriber improved to 115 minutes in 1H 2007, up from 99 minutes (16.2% yoy) in 1H 2006, mainly due to the growing number of contract customers generating higher average traffic per customer and the successful launch of traffic stimulation tariffs.

Interconnection revenues were CZK 2.5 billion in 1H 2007, down by 0.2% yoy. In 1H 2007, blended monthly ARPU reached CZK 510, up by 2.4% yoy, while it reached

¹ Figures are shown net of inter-segment charges between fixed and mobile segment.

CZK 524 in 2Q 2007 alone compared to CZK 507 in 2Q 2006. The contract monthly ARPU reached CZK 906 in 1H 2007, down 8.7% yoy and CZK 910 in 2Q 2007 (CZK 989 in 2Q 2006). The main reason for lower contract ARPU is the dilution caused by customer migration from the prepaid to the contract segment. The prepaid monthly ARPU increased by 3.9% yoy to CZK 241 in 1H 2007 (CZK 249 and CZK 239 in 2Q 2007 and 2Q 2006 respectively).

Total revenues from value added services (including SMS, MMS and content) increased 2.7% yoy to CZK 2.2 billion as a result of the growing volume of SMS and MMS messages. In 1H 2007 O₂ customers sent and received in total 1.5 billion SMS, up by 8.6% yoy.

Revenues from internet and data recorded an 18.1% yoy increase and reached CZK 920 million. The total number of data customers (GPRS and CDMA) increased by 14.2% to 177 thousand at 30 June 2007. The data ARPU improved by 2.9% yoy to CZK 108 in 1H 2007. Non-SMS data ARPU represented 42% of total data ARPU in 1H 2007 compared to 39% to the same period of 2006 as a result of the growth in CDMA and GPRS customers and in MMS.

Equipment sales (including connection fees) increased by 2.5% yoy in 1H 2007 to CZK 725 million. Other business revenues (IT services and other revenues) decreased by 13.4% yoy to CZK 116 million.

Fixed Segment Overview¹

Total business revenues in the fixed line segment went up 0.3% in 1H 2007. A continuing focus on broadband Internet-based services, bundles and fixed/mobile convergent products and increasing activity in the ICT/Business Solution area led to the reverse in

the trend of fixed segment revenues. Revenues from broadband, data and other value added telecommunication services accounted for 27.7% of business revenues in 1H 2007 compared to 24.3% in 1H 2006.

Total business revenues in the fixed segment increased by 0.3% yoy to CZK 15.1 billion in 1H 2007 and up by 0.7% yoy in 2Q alone, driven by the healthy growth of revenues from broadband Internet based services, value added services and IT services, which more than offset declines in traditional voice revenues.

The total number of fixed telephony accesses² amounted to 2,207 thousand as at the end of June 2007, down by 17.2% yoy mainly as the result of the strong fixed to mobile substitution effect. The net losses of fixed telephony access decreased to 81 thousand in 2Q 2007 from 114 thousand in 1Q 2007. This came as a result of the improving number of gross adds and the lower number of service cancellations. Revenues from traditional access decreased by 5.2% yoy to CZK 5.0 billion in 1H 2007. The tariff rebalancing made in April 2006 no longer has the positive effect on this category of revenues as seen in previous quarters.

Revenues from traditional voice services (voice traffic and interconnection) declined 8.7% yoy to CZK 4.8 billion. Revenues from voice traffic fell 21.1% yoy to CZK 2.4 billion, as a result of lower voice traffic generated by our customers, which decreased by 19.6% yoy to 1,435 million minutes.

Interconnection revenues went up 7.9% yoy in 1H 2007 and amounted to CZK 2.4 billion driven by higher international transit traffic and increase in number of LLU. Revenues from Internet & broadband increased in total by 18.3% yoy to CZK 1.9 billion

¹ Figures are shown net of inter-segment charges between fixed and mobile segment.

² Excluding incoming only lines.

as a result of 42.3% growth in revenues from broadband based services which more than offset decreasing revenues from narrowband, confirming our successful strategy to focus on ADSL based services.

Revenues from broadband services (ADSL, IPTV and content) were CZK 1.8 billion in 1H 2007, up by 42.3% yoy. Of this, CZK 1.6 billion represented revenues from retail broadband (up 48.6% yoy) and CZK 204 million from wholesale services (up 7.4% yoy). The total number of ADSL accesses reached 526 thousand at 30 June 2007, compared to 386 thousand a year ago (up 36.2% yoy). In 1H 2007 ADSL accesses net adds amounted to 56 thousand. Total number of O₂ TV's customers increased to 38 thousand at the end of June 2007, representing 22 thousand net adds in 1H 2007.

Revenues from narrowband Internet decreased 61.9% yoy to CZK 143 million in 1H 2007 on the back of 68.5% decrease in dial up Internet traffic.

Revenues from data services decreased 1.2% yoy to CZK 2.1 billion, mainly due to a 7.3% decline in revenues from leased lines to CZK 1.1 billion, while revenues from data network services increased 6.8% yoy to CZK 958 million as a result of the growth of IP Connect and IP VPN connections.

Revenues from IT services and business solutions reached CZK 810 million in 1H 2007 compared to CZK 222 million in 1H 2006, as a result of our growing activities in ICT and IT services for Government and large corporate customers. The substantial growth in this category of revenues in 2Q related to the customer solution for Ministry of Transport. Equipment sales amounted to CZK 217 million, down 31.1% yoy due to the lower number of units sold and special promotions.

Slovakia

In 2Q 2007, Telefónica O2 Slovakia successfully continued in setting its footprint on the Slovak market. After the launch of prepaid services in February 2007, which elicited enormous interest from customers, the company introduced the first hybrid postpaid offer in June. The innovative postpaid product "O₂ Volnost" is the first of its kind on the Slovak market, as it allows customers to use postpaid services without signing any written contract. In the first half of 2007 Telefónica O2 Slovakia also focused on the roll-out of its own network with the view to meeting, at the least, the license condition of having 400 own sites in operation by September 2007. In the first phase of the sales network roll-out in 4H 2007 Telefónica O2 Slovakia opened 12 brand shops in 1H 2007. The sales network comprises also of more than 3,500 indirect points of sale and the recently launched e-shops. By the end of June 2007 the Company had recorded 455 thousand registered customers. The current customer base usage patterns show that a certain percentage of customers are using the Telefónica O2 Slovakia SIM card as their second SIM. The Company is taking measures to further stimulate customers to use Telefónica O2 Slovakia as their primary mobile provider, and is preparing to launch its new postpaid service in 2H 2007.

Group Operating Expenses

Total Group operating costs (including the Slovak operation) were CZK 17.1 billion in 1H 2007, 7.4% up on the last year. This increase comes to a large extent as the result of the higher reliance on external services (sales and marketing, network & IT maintenance and other subcontracts) and the operating costs related to activities in Slovakia.

Supplies expenses grew by 10.1% yoy to CZK 8.2 billion in 1H 2007. Interconnection costs increased 7.3% yoy to CZK 5.4 billion due to the higher activity in the transit

business, the growth in the mobile off-net traffic generated by customers in the Czech Republic and the interconnection charges recorded in Slovakia. Cost of goods sold went up 20.4% yoy to CZK 1.7 billion as a result of increased costs in Slovakia, while this cost in the Czech Republic was flat. Other supplies increased by 9.9% to CZK 1.2 billion due to an increase in the sub-deliveries for ICT related projects.

Personnel costs, including headcount reduction costs, amounted to CZK 3.6 billion, up by 2.8% yoy in 1H 2007 as a result of a general increase in wages, methodology changes and higher personnel costs in subsidiaries (TO2 Services and TO2 Slovakia) related to the headcount growth. The total number of Group employees reached 9,365 as at 30 June 2007, down 6.5% yoy. Telefónica O2 Czech Republic headcount went down by 9.8% yoy to 8,973.

The cost of external services increased by 11.2% yoy and reached CZK 5 billion in 1H 2007. Marketing and sales went up by 22.1% yoy to CZK 1.6 billion due to more intensive marketing activity in relation to the promotion of new ADSL, IPTV and convergent offer in the Czech republic, and promotions and marketing costs in Slovakia. Network & IT repairs and maintenance increased by 9.5% yoy to CZK 1.3 billion due to higher costs related to maintenance staff outsourcing and the increased complexity of the network. Rentals, buildings and vehicles costs reached CZK 804 million, up by 2.9% yoy while utilities supplies increased 3.3% yoy to CZK 377 million. Other external services including consultancy fees, call centers and other external services went up 7.5% yoy to CZK 865 million due to increased costs related to customer care and costs incurred in Slovakia.

Taxes, comprising taxes other than income tax, fees and provisions fell 34.7% yoy to CZK 320 million mainly as a result of lower bad debt provisions.

Outlook for 2H 2007

In the second half of 2007, the Company will continue to address the current trends in the Czech telecommunication market, specifically in the areas of broadband, data, value added services and convergent products.

The Company expects that the recent introduction of new convergent services, offering a combination of fixed and mobile voice services, broadband services and IPTV, will increase the value of the fixed-line proposition. The Company will also continue to roll out its IPTV service. We see strong potential in the area of IT and integrated customer solutions primarily for corporate and government customers, where the Company will continue to focus its efforts in 2007. The strategy in the mobile segment continues to focus on ARPU sustainability via prepaid to postpaid migration and on growing mobile data and Internet revenues through CDMA and HSDPA services.

The area of customer experience continues to be one of our key priorities for 2007. This includes improvements in service delivery and provisioning, customer care and a higher quality of service.

The fixed/mobile integration process will continue through the realization of ongoing integration projects with the aim of achieving synergies leading to revenue growth and OPEX and CAPEX savings. At the same time we will continue to benefit from the global experience and close interaction with Telefónica, O2 and other Telefónica Group operating companies, largely in the areas of procurement and process improvement and new product development.

The Company will continue to support the gradual deployment of the Slovak operation. This includes further development of systems, processes and network roll-out. The key commercial goal remains to keep focused on new customer acquisition by means of introducing new innovative services for all segments. In Slovakia, we aspire to achieve a quality of service and of customer experience that would be on the same par with those of Telefónica O2 in the Czech Republic.

Based on the financial results delivered in the first half of 2007, we maintain our full year guidance for 2007. We expect Group revenues to grow by 1 to 3%, closer to upper range of this guidance and OIBDA¹ to decline by –1% to 0% compared to 2006. The expected negative impact of the Slovak operation is already included in this range. CAPEX is expected to be around CZK 9 billion in total, with around 20% of this figure invested in Slovakia.²

¹ In terms of guidance calculation, OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007. For comparison purpose, the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures (the main unforeseeable expense deducted from 2006 OIBDA was the impairment charge).

² Guidance assumes constant exchange rates as of 2006.

02





Corporate governance

Corporate Governance of Telefónica O2 Czech Republic Group	29
Executive macrostructure of Telefónica O2 Czech Republic	31
Personnel composition of the Board of Directors and the Supervisory Board	32
Changes in the executive macrostructure of Telefónica O2 Czech Republic	33

Corporate Governance of Telefónica O2 Czech Republic Group

O₂ TV had 38 thousand customers at the end of June 2007.

Implementation of the corporate governance model continued in the first half of 2007. This had begun as part of the process of forming the new integrated company, Telefónica O2 Czech Republic. The corporate governance framework of the Company, as laid down in the Articles of Association and other corporate documents, was continually expanded due to experience and best practice sharing within the Telefónica Group.

In the period under review, the Board of Directors held 17 meetings, while the Supervisory Board had four sessions. Committees established by the Supervisory Board met as follows: the Nomination and Remuneration Committee and the Ethics and Corporate Social Responsibility Committee met twice, and the Audit and Control Committee met three times.

The Ordinary General Meeting of Telefónica O2 Czech Republic was held on 26th April 2007. The supreme governing body of the Company approved the regular financial statements and the consolidated financial statements for the fiscal year 2006. Both sets of documents were prepared under International Financial Reporting Standards (IFRS) and verified by Ernst & Young, the external auditor. The General Meeting approved a proposal by the Board of Directors to pay dividends of CZK 8.109 billion from the profit of 2006 and of CZK 7.995 billion from the retained earnings of previous periods. The dividends totalled CZK 16.104 billion, which represents a dividend of CZK 50 per share, before tax. According to the Board of Directors, the proposed dividend amount is based on a detailed analysis of the Company's results in the past period, the current balance sheet situation and on the predicted future performance of the Company. The proposal is also in line with the Company's investment strategy – to focus on investing in pro-growth areas (broadband internet, the mobile segment, corporate solutions and the Slovak operation) – and it conforms to the repeatedly proclaimed intention of the Company to distribute its surplus cash to the shareholders. The Board of Directors noted that the continuing free cash flow generation in 2007 would allow for the payment of a dividend from the Company's own resources. The General

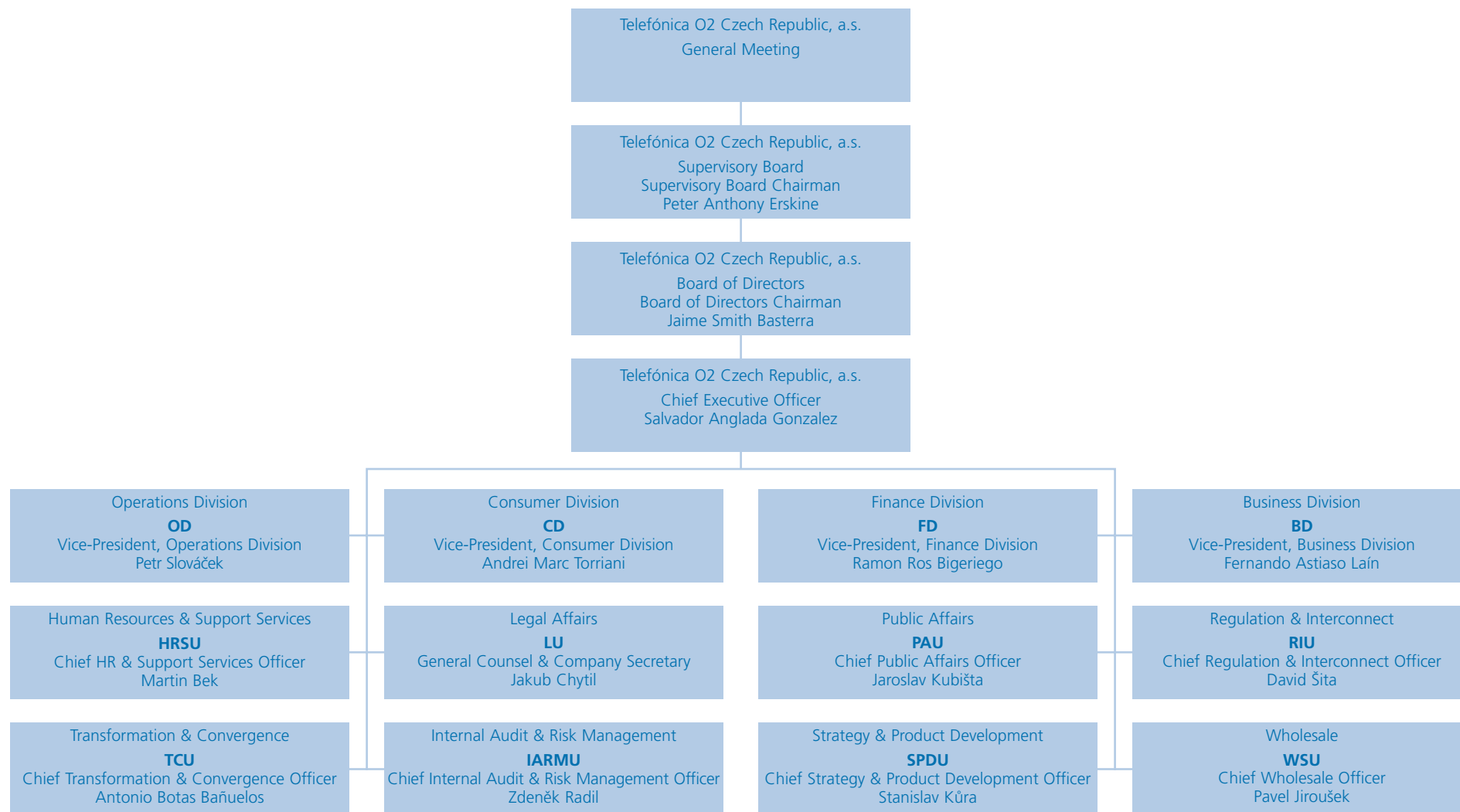
Meeting confirmed by vote the membership of Andrew Harley to the Supervisory Board, to which he had been co-opted on 15 January 2007. Mr. Harley was nominated to a position in the Supervisory Board that had been vacated by the resignation of Gerhard Mayrhofer in October 2006. The General Meeting also decided that the annual remuneration due to the Board of Directors and Supervisory Board members would be the same amount as last year. It further approved the conclusion of the Member of the Supervisory Board Discharge of Office contract with Andrew Harley.

In response to personnel changes in the executive management of Telefónica O2 Europe division, which includes all the Telefónica Group European operations with the exception of Spain, changes occurred in the executive management of Telefónica O2 Czech Republic, effective from the 1 July 2007. Jaime Smith Basterra, who is leaving to assume the position of Chief Executive Officer of O2 Germany, was succeeded by decision of the Board of Directors by Salvador Anglada Gonzalez, the new Chief Executive Officer. Salvador Anglada Gonzalez had been Vice-President – Consumer Division until 30 June 2007. He was succeeded by Andrei Marc Torriani, previously Chief Marketing Officer – Residential Segment. These changes did not affect the composition of the Board of Directors and the staffing of the chair positions – Jaime Smith Basterra remains as Chairman of the Board of Directors.

Shareholders and other stakeholders can find all material information relating to the corporate governance of Telefónica O2 Czech Republic, including the up-to-date personnel composition of the Board of Directors and the Supervisory Board, on the Company's website (www.cz.o2.com).

In the first half of 2007, no changes occurred in information concerning subsidiary and affiliated companies as published in the 2006 Annual Report of Telefónica O2 Czech Republic.

Executive macrostructure of Telefónica O2 Czech Republic (as at 1 July 2007)



Personnel composition of the Board of Directors and the Supervisory Board (as at 1 July 2007)

Personnel composition of the Supervisory Board of Telefónica O2 Czech Republic (as at 1 July 2007)

Peter Anthony Erskine, Chairman of the Supervisory Board
Julio Esteban Linares López, First Vice-Chairman of the Supervisory Board
Lubomír Vinduška, Second Vice-Chairman of the Supervisory Board
Luis Lada Díaz, member of the Supervisory Board
Catherine Jane Keers, member of the Supervisory Board
Sohail Qadri, member of the Supervisory Board
Andrew Harley, member of the Supervisory Board
Ángel Vilá Boix, member of the Supervisory Board
Alfonso Alonso Durán, member of the Supervisory Board
Guillermo José Fernández Vidal, member of the Supervisory Board
Vlastimil Barbořák, member of the Supervisory Board
Pavel Heršítk, member of the Supervisory Board
Miloslav Krch, member of the Supervisory Board
Dušan Stareček, member of the Supervisory Board
Petr Zatloukal, member of the Supervisory Board

Personnel composition of the Board of Directors of Telefónica O2 Czech Republic (as at 1 July 2007)

Jaime Smith Basterra, Chairman of the Board of Directors
Juraj Šedivý, First Vice-Chairman of the Board of Directors
Petr Slovák, Second Vice-Chairman of the Board of Directors
Salvador Anglada Gonzalez, member of the Board of Directors
Ramon Ros Bigeriego, member of the Board of Directors
Fernando Astiaso Laín, member of the Board of Directors
Martin Bek, member of the Board of Directors
Antonio Botas Bañuelos, member of the Board of Directors
Jakub Chytil, member of the Board of Directors

Executive macrostructure of Telefónica O2 Czech Republic (as at 1 July 2007)

Chief Executive Officer (Salvador Anglada Gonzalez)
Vice-President – Business Division (Fernando Astiaso Laín)
Vice-President – Consumer Division (Andrei Marc Torriani)
Vice-President – Operations Division (Petr Slovák)
Vice-President – Finance Division (Ramon Ros Bigeriego)
Chief Regulation & Interconnect Officer (David Šita)
Chief Transformation & Convergence Officer (Antonio Botas Bañuelos)
General Counsel and Company Secretary (Jakub Chytil)
Chief Wholesale Officer (Pavel Jiroušek)
Chief Public Affairs Officer (Jaroslav Kubišta)
Chief Strategy & Product Development Officer (Stanislav Kůra)
Chief Human Resources & Support Services Officer (Martin Bek)
Chief Internal Audit & Risk Management Officer (Zdeněk Radil)

Changes in the executive macrostructure of Telefónica O2 Czech Republic (as at 1 July 2007)



Salvador Anglada Gonzalez
Chief Executive Officer and member
of the Board of Directors



Andrei Marc Torriani
Vice-President – Consumer Division

Salvador Anglada Gonzalez (*1965)

Chief Executive Officer and member of the Board of Directors

Graduated in Industrial Engineering in Madrid, holds MBA from Instituto de Empresa and PDG from IESE Madrid. Before joining Telefónica he held a number of executive positions in Dell Computer and Dow Jones Markets. In 2002 he joined Telefónica Group as Sales and Marketing Director for corporate clients in Telefónica de España. From June 2005 he was Chief Executive Officer and Statutory Representative of Eurotel, and member of the Board of Directors of ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic); later he became Vice-President – Consumer Division of Telefónica O2 Czech Republic. As of 1 July 2007, he is Chief Executive Officer of Telefónica O2 Czech Republic. On 21 June 2007 he also became a member of the Board of Directors of Telefónica O2 Europe plc.

Andrei Marc Torriani (*1967)

Vice-President – Consumer Division

Graduated in Economics and Foreign Trade from the Dickinson College, Pennsylvania, USA. He earned his MBA at the American Graduate School of International Management (Thunderbird), and later he worked in various management positions in telecommunications companies in Europe, Middle East and in the United States. Before the integration of ČESKÝ TELECOM a Eurotel, he was Chief Commercial Officer at Eurotel – he was in charge of sales, marketing, roaming and customer care. After the integration, he went on to become Chief Marketing Officer – Consumer Division. On 1 July 2007 he became Vice-President – Consumer Division of Telefónica O2 Czech Republic.

New member of the Supervisory Board elected by the General Meeting of 26 April 2007

**Andrew Harley (*1960)
member of the Supervisory Board**

He joined O2 from British Telecommunications plc where he had worked since 1980 in a number of senior HR positions at BT Cellnet (now O2 UK), BT openworld, BT's fixed internet service provider, and BT Wireless. He was also Human Resources Director for Telenordia in Sweden. At present, he is Group HR Director for Telefónica O2 Europe. He was appointed to the Telefónica O2 Europe plc Board on 1 January 2007. He is also a Fellow of the Chartered Institute of Personnel.



Andrew Harley
member of the Supervisory Board

03





Financial section

Consolidated Financial Results prepared in accordance with International Financial Reporting Standards	39
Consolidated income statement	40
Consolidated balance sheet	41

Consolidated Financial Results prepared in accordance with International Financial Reporting Standards

These consolidated financial results have been prepared in accordance with International Financial Reporting Standards (IFRS). These results are unaudited. All amounts are in CZK millions.

Consolidated revenues reached CZK 31.1 billion in the first half of 2007, up 3.2% yoy.

Consolidated income statement

	Period ended	
	30 June 2007 not audited	30 June 2006** not audited
Revenue	31,085	30,102
Gain from sale of non-current assets	32	29
Internal expenses capitalised in fixed assets	291	403
Operating expenses	(17,237)	(15,991)
Impairment loss	10	(38)
Depreciation and amortisation	(7,471)	(8,443)
Operating profit	6,710	6,062
Interest income	174	37
Interest expense	(217)	(216)
Other financial income (+) / expense (-)	(13)	17
Profit before income tax	6,654	5,900
Taxes on income	(1,763)	(1,618)
Profit for the year	4,891	4,282
Attributable to:		
Equity holders of the Company	4,891	4,282
Minority interest	0	0
Earnings per share (CZK) – basic*	15	13

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

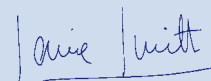
** Comparative figures for companies of ČESKÝ TELECOM, a.s. Group.

Consolidated balance sheet

	30 June 2007 not audited	31 December 2006 audited
ASSETS		
Property, plant and equipment	74,352	78,755
Intangible assets	21,273	21,628
Investments in associates	11	11
Available-for-sale and Held-to-maturity investments	29	27
Other financial assets	509	403
Non-current assets	96,174	100,824
Inventories	620	987
Receivables and prepayments	8,986	8,336
Income tax receivable	1	0
Available-for-sale and Held-to-maturity investments	0	56
Other short-term financial assets	79	10
Cash and cash equivalents	17,185	7,461
Current assets	26,871	16,850
Non current assets classified as held for sale	223	203
Total assets	123,268	117,877
EQUITY AND LIABILITIES		
Ordinary shares	32,209	32,209
Share premium	30,816	30,816
Retained earnings, funds and reserves	14,243	25,456
Total equity	77,268	88,481
Long-term financial debts	9,298	9,156
Deferred taxes	4,319	4,495
Non-current provisions for liabilities and charges	2,063	2,037

Non-current other liabilities	547	807
Non-current liabilities	16,227	16,495
Short-term financial debts	408	207
Trade and other payables	7,808	7,850
Income tax liability	1,360	730
Provisions for liabilities and charges	1,029	835
Other current liabilities	19,168	3,279
Current liabilities	29,773	12,901
Total liabilities	46,000	29,396
Total equity and liabilities	123,268	117,877

These consolidated results were approved by the Board of Directors on 17 July 2007 and were signed on its behalf by:



Jaime Smith Basterra
Chairman of the Board of Directors



Ramon Ros Bigeriego
Member of the Board of Directors and Chief Financial Officer

04





Information for shareholders

The total number
of contract customers
reached 2,077 thousand
of 30 June 2007,
up by 350 thousand yoy.

Information for shareholders

Struktura akcionářů společnosti Telefónica O2 k 30. červnu 2007 byla následující:

Shareholder	% of share capital
Telefónica, S.A.	69.4%
Investment funds and individual shareholders	30.6%

Trading in Telefónica O2 shares

The volume of trades in Telefónica O2 shares on the Prague Stock Exchange (PSE) reached CZK 55.1 billion in the first half of 2007, compared to CZK 50.5 billion in the first half of 2006. The Company's shares thus rank among the five most liquid issues. The trades represented approximately 11% of the total volume of share trading. The average daily number of trades in the first half of 2007 grew from CZK 397.6 million in the first half of 2006 to CZK 437 million. As at 30 June 2007, market capitalisation was CZK 192.1 billion. In terms of market capitalisation, Telefónica O2 is the third highest of all stocks traded on the PSE, representing 10.6% of the total market capitalisation of the PSE stock market.

In the period from 1 January 2007 to 30 June 2007, the share price of Telefónica O2 grew by 25.3% to CZK 596.3. In the same period, the PSE stock market performance measured by the PX Index grew by 17.1% to 1,859 points, which was the peak value for the first half of 2007 and a PSE record. The price of Telefónica O2 shares reached its first half-year maximum on 25 April 2007 when it closed at CZK 622.8.

General Meeting

The Ordinary General Meeting of the Company was held on 26th April 2007 in Prague. The Corporate Governance section recapitulates the main conclusions of the General Meeting.

Dividends

At the Ordinary General Meeting the shareholders approved a dividend payment from the 2006 net profit and part of the retained earnings from previous years, in the total amount of CZK 16,104.5 million, 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 will be 10 September 2007 and the disbursement date will be 3 October 2007. Česká spořitelna is the selected house for the disbursement of dividends. After the record day, Česká spořitelna will inform all eligible shareholders of the method of disbursement.

05





Glossary of terms and acronyms

As at the end of June,
Telefónica O2 operated
526 thousand ADSL lines.

Glossary of terms and acronyms

ADSL Asymmetric Digital Subscriber Line

ARPU an indicator – average monthly revenues from services per user, excluding roaming visitors

CDMA (Code Division Multiple Access), a digital technology for wireless data and broadband internet

CTO Czech Telecommunications Office

EDGE (Enhanced Data Rates for GSM Evolution), a mobile digital technology with a faster and more reliable data transmission

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

IFRS International Financial Reporting Standards

IP Connect a service for IP protocol based data communication

IPTV Internet Protocol Television

IP VPN (Internet Protocol Virtual Private Network), a service of intra-corporate data or voice over IP communication

ISDN (Integrated Services Digital Network), a digital network powering modern and quality services of telephony, fast internet and high-speed data transmission

MMS a multimedia format for mobile data transmission

O₂ Cestování a long term promotion of Telefónica O2, offering discounted rates on calls for customers of the post-paid service calling from roaming partners' network in fifteen popular international destinations.

O₂ Duo a converged service of Telefónica O2, combining unlimited fixed line voice service with either O₂ Internet ADSL or O₂ TV

O₂ Duo Mobil a converged service of Telefónica O2, combining a mobile voice tariff and O₂ Internet ADSL

O₂ Internet ADSL a broadband internet service of Telefónica O2 with speeds up to 8 Mb/s

O₂ Internet ADSL Start a service of Telefónica O2, giving the customer two hours of high-speed internet a month for an economical flat rate monthly subscription

O₂ Internet Komplet a service of Telefónica O2, combining fixed (ADSL) and mobile (CDMA) high-speed internet access

O₂ karta a pre-paid SIM card of Telefónica O2

O₂ Moje firma an intra-company communications solution of Telefónica O2, with attractive terms and conditions for businesses

O₂ Nonstop a fixed line tariff of Telefónica O2, with unlimited calling to fixed-line networks

OPEC (Office for the Protection of Economic Competition), the anti-trust authority

O₂ Simple a family of mobile tariffs of Telefónica O2, letting the customer scale their expenditure to the anticipated need for mobile communication

O₂ Smart roaming a tariff of Telefónica O2, offering lower rates on calling from 14 popular foreign destinations compared to the listed roaming prices

O₂ Smart zóna 14 foreign destinations (Croatia, Slovakia, Bulgaria, Italy, Spain, France, Greece, Cyprus, Malta, Tunisia, Turkey, Egypt, Thailand, Malaysia) covered by the O₂ Smart roaming tariff

O₂ Trio a bundle of O₂ Internet ADSL, O₂ TV and fixed line voice service of Telefónica O2

O₂ TV an IPTV service of Telefónica O2

O₂ Volám a fixed line tariff of Telefónica O2, combining an economical fixed-line voice service with ADSL internet and digital television.

O₂ Volnosť a mobile tariff of Telefónica O2 Slovakia, giving the customer the advantages of a post-paid tariff without a contract

OIBDA Operating Income before Depreciation and Amortisation

SMS a format for short text messages used in mobile telephony

UMTS (Universal Mobile Telecommunications System); a standard for the so-called 3 generation mobile networks

VPN Virtual Private Network

Wi-Fi a local wireless network for accessing the internet

Telefónica O2 Czech Republic, a.s.
Za Brumlovkou 266/2, 140 22 Prague 4, Czech Republic
Tel.: +420 271 411 111
Fax: +420 271 469 868
Telephone Service Centre: 800 02 02 02
CIN: 60193336
www.cz.o2.com

Half-year Report 2007

© 2007

Published by: Telefónica O2 Czech Republic, a.s.

Conception, production and print realization: Ogilvy CID, s.r.o.

CAUTIONARY STATEMENT: Any forward-looking statements concerning the future economic and financial performance of Telefónica O2 Czech Republic, a.s. contained in this Half-year 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 O2 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 O2 Czech Republic, a.s. could materially differ from those expressed in the forward-looking statements contained in this Half-year Report.

Telefónica O2 Czech Republic, a.s., member of the Telefónica Group