Press release

Telefónica O2 Czech Republic – 2010 Full Year Financial Results

February 18, 2011

Telefónica O2 Czech Republic, a.s. announces its audited financial results for the fiscal year of 2010. These results are consolidated and prepared according to International Financial Reporting Standards and fully include the results of Telefónica O2 Slovakia, Telefónica O2 Business Solutions and other smaller operating companies.

Operational Highlights

- Solid commercial momentum maintained in contract mobile customers, with 45.0 thousand net additions in 4Q 2010, helped by mobile broadband customers uptake.
- ADSL accesses grew by 11.1% year-on-year to reach 806 thousand (+29.4 thousand in 4Q 2010).
- Consolidated business revenues went down 7.0% year-on-year in 2010 largely due to additional MTR cuts, while mobile spend showed further stabilisation, fixed business maintained pressure due to lower ICT revenues in 4Q 2010.
- OIBDA increased by 1.1% year-on-year in 2010 due to the reversal of the impairment loss booked in 3Q 2010. On fully comparable basis[1], OIBDA declined by 6.7% year-on-year in 2010.
- Continuous efficiency agenda and MTR cuts allowed the Group to decrease the operating expenses by 6.0% year-on-year (excl. T-Mobile settlement in 2Q 2009), comparable OIBDA margin[2] reached 44.2% in 2010, flat in comparison with 2009.
- Telefónica O2 Slovakia maintained its good commercial momentum reaching 880 thousand customers at the end of 2010 (+99 thousand net adds in 4Q 2010) and further improved its financial performance, reporting positive OIBDA in 4Q 2010, likewise in 3Q.
- 2010 full year guidance[3] met for OIBDA and CAPEX.

2011 guidance[4]

- **OIBDA[5]** decline of –1% to –5%, **CAPEX** in the range of CZK 5.7 billion

2010 dividend

- The Board of Directors approved a proposal to the AGM of **CZK 40 per share.**

[1] OIBDA excluding brand & management fees and non-recurring items (2009: universal service, gain from real estate and settlement agreement with T-Mobile totaling CZK 1,548 million; 2010: universal service, restructuring costs and impairment reversal totaling CZK 3,913 million).
[2] Comparable OIBDA over Comparable business revenues (business revenues excluding universal service: CZK 367 million in 2009 and CZK 47 million in 2010).
[3] OIBDA decline of -5% to -9%, CapEx around CZK 6 billion. In terms of 2010 guidance calculation, OIBDA excludes brand fees and management fees (CZK 754 million in 2009 and CZK 1,057 million in 2010). In addition, 2009 OIBDA base excludes non-recurring items (settlement with T-Mobile, universal service and gain from real estate sale) totaling CZK 1,548 million and 2010 OIBDA excludes non-recurring items (universal service and impairment reversal) totaling CZK 4,371 million); 2010 guidance assumes no changes in consolidation and constant FX rates of 2009.
[4] 2011 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2010
[5] In terms of 2011 guidance calculation, OIBDA excludes brand fees and management fees (CZK 1,057 million in 2010). In addition, 2010 OIBDA base excludes reversal of the impairment loss of CZK 4,343 million.

"I am pleased with the 2010 results achieved in context of a gradually recovering economy, intense competition and tough regulation. Our continuous aim to maximize customer experience via proposition of services meeting their needs led to solid growth maintained in our focused areas, which are mobile contract and fixed broadband customers. At the same time, we substantially increased coverage of our mobile broadband networks responding to increasing demand in this area. Successful execution of our 2010 restructuring program focused very much on network transformation confirmed our persistent emphasis on operational efficiencies. In Slovakia, our simple and transparent proposition helped us to maintain healthy customers' growth and consolidate financial performance. As a result of these activities we maintained the comparable OIBDA margin at robust 44%, best in class among CEE integrated telco peers. Based on the thorough analysis of current financial position and prospective business performance, the Board of Directors will propose a dividend payment of CZK 40 per share, which offers solid dividend yield around 10%," says Jesús Pérez de Uriguen, the Chief Financial Officer and the First Vice-Chairman of the Board of Directors of Telefónica O2 Czech Republic when commenting on the operator's financial results.

Consolidated Financial Statements

Consolidated **business revenues** went down 7.0% year-on-year to CZK 55,561 million in 2010 with a 7.0% year-on-year decline to CZK 13,964 million in 4Q alone. The financial performance of the Group in 2010 was impacted by additional MTR cuts, lower number of ICT projects for public office sector and USO booked in 2009. Excluding the impact of USO[6], Group business revenues would have declined 6.5% year-on-year in 2010 and 6.9% year-on-year in the quarter. Fixed business revenues in the Czech Republic declined by 9.6% year-on-year reaching CZK 24,290 million in 2010 (-8.5% year-on-year excluding the USO impact) and by 11.6% to 6,035 million in 4Q 2010 (-11.5% year-on-year excluding the USO impact). Mobile revenues in the Czech Republic declined by 7.8% to CZK 28,592 million in 2010 (-3.8 % year-on-year excluding the impact of MTR cuts) and by 6.0% to CZK 7,148 million in 4Q 2010, (-2.2 % year-on-year excluding the impact of MTR cuts, an improvement compared to previous quarter - 3Q: -4.5%). Moreover, revenues in Slovakia continued to grow steady and recorded a 50.5% year-on-year increase reaching EUR 111.7 million in 2010 (+42.6% in 4Q 2010). Similarly to 3Q, Telefónica O2 Slovakia recorded a positive OIBDA in 4Q 2010.

In 4Q 2010, the Company continued in its effort to realize savings in operating costs which have been reported already in previous quarters, to compensate for pressure in revenues. As a result, consolidated **operating costs** reached CZK 32,889 million in 2010, down 3.2% year-on-year and CZK 8,390 million in 4Q 2010, down 3.9% year-on-year. In 2010, the year-on-year comparison has been impacted by the settlement agreement with T-Mobile (CZK 1,027 million) booked in 2Q 2009. Excluding this item, consolidated costs would have declined by 6.0% in 2010. It is worth highlighting a 7.1% reduction in personnel expenses in 2010 (-8.5% in 4Q alone), what confirms a positive impact of restructuring program announced in 1Q 2010. In 2010, the Group headcount declined by as much as 13.4% year-on-year reaching 7,521 at 31 December 2010. In 4Q 2010 alone, the Group headcount has been reduced by 195 employees.

Group **Operating income before depreciation and amortization (OIBDA)** increased by 1.1% year-on-year reaching CZK 27,380 million in 2010 helped by impairment reversal booked in 3Q, while it went down 12.6% to CZK 5,770 million in 4Q 2010, with no impact of impairment reversal in the quarter. Excluding the impact of impairment reversal, OIBDA would have dropped by 14.9% year-on-year to CZK 23,038 million in 2010 largely due to revenues decline and non-recurring items booked both in 2009 and 2010. **OIBDA margin** improved by 4.0 p.p. year-on-year to reach 49.3% in 2010, while in 4Q 2010 it declined by 2.7 p.p. to reach 41.3%. **Comparable OIBDA**[7] decreased by 6.7% year-on-year to CZK 24,524 million in 2010 (-8.3% year-on-year to 6,216 million in 4Q 2010), while **comparable OIBDA margin**[8] reached 44.2% in 2010 basically flat year-on-year (-0.7 p.p. year-on-year to 44.6% in 4Q 2010). **OIBDA adjusted for guidance**[9] decreased by 8.4% year-on-year to reach CZK 24,066 million in 2010, within the guidance range of -5% to -9%, on the back of the above mentioned efficiency agenda.

As a result of impairment reversal booked in 3Q 2010, depreciation and amortization charges were by CZK 316 million higher in 2010 (by CZK 173 million in 4Q 2010), while income tax was by CZK 765 million higher in 2010, but in 4Q alone by CZK 33 million lower.

Consolidated **net income** amounted to CZK 12,280 million in 2010, up by 5.3% year-on-year, largely due to the impairment reversal. In 4Q 2010 alone, the net income reached CZK 1,914 million, down by 30.9% year-on-year. Excluding the impact of impairment reversal, consolidated net income would have declined by 22.7% reaching CZK 9,018 million in 2010 and by 25.8% to CZK 2,054 million in 4Q 2010 as a result of the decline in OIBDA, which has not been fully compensated by lower depreciation and amortization and lower income tax expense.

[6] CZK 367 million in 2009 and CZK 47 million in 2010
[7] OIBDA excluding brand fees, management fees and non-recurring items (2009: universal service, gain from real estate and settlement agreement with T-Mobile totaling CZK 1,548 million; 2010: universal service, restructuring costs and impairment reversal totaling CZK 3,913 million).
[8] Comparable OIBDA over Comparable business revenues (business revenues excluding universal service: CZK 367 million in 2009 and CZK 47 million in 2010).
[9] In terms of 2010 guidance calculation, OIBDA excludes brand fees and management fees (CZK 754 million in 2009 and CZK 1,057 million in 2010). In addition, 2009 OIBDA base excludes non-recurring items (settlement with T-Mobile, universal service and gain from real estate sale) totaling CZK 1,548 million and 2010 OIBDA excludes non-recurring items (universal service and impairment reversal) totaling CZK 4,371 million); 2010 guidance assumes no changes in consolidation and constant FX rates of 2009.

Consolidated **CAPEX** reached CZK 5,664 million in 2010, down by 12.7% year-on-year (-0.9% year-on-year in 4Q). Similarly to the previous quarters, the Company continued to invest in expansion of its mobile broadband networks (EDGE and UMTS), in the enhancement of fixed broadband network as well as development of IT systems in 4Q 2010. At the end of December 2010, the mobile 3G network was available in 84 towns and their urban areas, what represents 42.5% of the Czech population. At the same time, advanced investment in EDGE network expansion allowed the company to reach 98% of the population coverage.

Group **free cash flows** increased by 21.0 year-on-year to reach CZK 16,42 million in 2010, largely due to lower income tax payments (-40.1% year-on-year) and less CAPEX related cash payments (-34.7% year-on-year to CZK 5,539 million).

The consolidated **financial debt** amounted to CZK 3,024 million at 31 December 2010 resulting into 3.4% decline compared to the end of 2009, largely on the back of appreciation of the Czech currency. **Cash and cash equivalents** and short term financial investments reached CZK 4,810 million, up from CZK 1,378 million at the end of 2009.

CZ Mobile Business Overview[10]

In 4Q 2010, mobile business continued to deliver solid commercial performance in mobile contract segment leveraging on successful customer proposition around O_2 NEON tariffs and new mobile broadband proposition. The financial performance continued to be negatively impacted by MTR cuts (-28.1% year-to date[11]), while underlying mobile revenues performance excluding incoming voice (MTR impact) shows continuous improving trends seen already in the previous quarters.

Total **mobile customer base** reached 4,839 thousand at the end of December 2010, a 2.1% decline year-on-year, impacted by the disconnection of 111 thousand inactive contract customers in 2Q 2010. Excluding that disconnections, the customer base would have increased by 0.1% year-on-year, solid figure in a highly competitive and penetrated mobile market in the Czech Republic. The number of **contract customers** went up 1.7% year-on-year reaching 2,864 thousand at the end of 4Q 2010 (+5.7% year-on-year excluding the impact of inactive customers' disconnections in 2Q 2010) with 45.0 thousand net adds in the quarter, while the full year net adds reached 49.2 thousand (160.2 thousand net adds in 2010 excluding the impact of disconnection of inactive customers in 2Q 2010). This performance was driven by continuous uptake of O_2 NEON tariffs, customers migrating from the prepaid to the contract segment and positive contribution of mobile broadband customers' growth. At the end of 2010, contract customers represented 59.2% of the base (+2.3 p.p. year-on-year). The number of **prepaid active customers** reached 1,975 thousand at the end of 4Q 2010, down by 7.3% year-on-year, with 62.6 thousand net losses in 4Q.

The blended monthly average **churn rate** reached 2.4% in 2010 posting a 0.3 p.p. year-on-year increase mainly due to the inactive customers disconnections made in the contract base. However, in 4Q 2010 alone, the churn rate declined by 0.2 p.p. to reach 2.2% helped by improvement in prepaid churn.

In terms of usage, **mobile traffic**[12] carried by the customers in the Czech Republic grew by 6.8% year-on-year to 8,790 million minutes in 2010.

In 2010, **blended ARPU**[13] reached CZK 468.5, down 8.1% year-on-year, impacted by MTR cuts. However, the year-on-year decrease in ARPU decelerated throughout the 2010 year from -11.2% year-on-year in 1Q to -6.0% year-on-year in 4Q 2010 as a result of continuous stabilization in customer spend. Excluding the MTR cuts impact, ARPUs would have declined -6.6% in 1Q, -3.7% in 2Q, -3.5% in 3Q and -1.9% in 4Q. **Contract ARPU** reached CZK 659.7 in 2010, down by 11.4% year-on-year, while in 4Q its decline slowed down to -8.5% year-on-year to reach CZK 643.5. Customer migration from prepaid to the contract tariffs and MTR cuts continued contributing to contract ARPU dilution. **Prepaid ARPU** decreased by 7.8% year-on-year reaching CZK 206.0 in 2010 with just a

[10] Figures are shown net of inter-segment charges between fixed and mobile businesses
[11] On July 1, 2010 MTR dropped to CZK 1.66 (after a drop from CZK 2.31 to CZK 1.96 in January 2010)
[12] Inbound and outbound, including roaming abroad, excluding inbound roaming
[13] Including inter segment revenues

5.4% decline to CZK 212.3 in 4Q. For **data ARPU**, it declined 4.1% year-on-year reaching CZK 120.1 in 2010, however improved by 2.7% year-on-year in 4Q alone to CZK 123.1.

Total mobile **business revenues** in the Czech Republic declined by 7.8% to CZK 28,592 million in 2010 and by 6.0 % in 4Q 2010 alone, while mobile service revenues went down by 8.1% year-on-year and 7.3% year-on-year in these periods due to above mentioned MTR cuts, compensated partially by stabilizing spend. Mobile termination rate cuts diluted mobile service revenues by 4.2 p.p. and 4.0 p.p. in 2010 and 4Q 2010 respectively. Despite 6.8% year-on-year growth in mobile outbound voice traffic in 2010, traffic revenues decreased by 11.0% year-on-year to CZK 8,342 million (-11.6% in 4Q), due to higher number of customers opting for semi-flat rate tariffs (O_2 NEON). Interconnection revenues went down by 22.4% year-on-year to CZK 3,631 million in 2010 (-25.6% in 4Q), largely impacted by MTR cuts and lower incoming traffic. Other revenues (including SMS & MMS, data and other business revues) declined by 3.2% year-on-year in 2010 with a 2.8% increase in 4Q 2010 confirming the promising contribution from mobile broadband revenues uptake in 2H 2010.

CZ Fixed Business Overview[14]

In 4Q 2010, the fixed business maintained solid commercial performance in broadband customer base and fixed accesses. As communicated earlier in the year, the financial performance in 2H 2010 was negatively impacted by lower ICT revenues due to lower number of projects for public office sector and already mentioned universal service.

The total number of **fixed accesses** declined by 5.7% year-on-year reaching 1,669 thousand at the end of December 2010, with 16.6 thousand net losses in the quarter (the lowest figure in 2010) helped by solid uptake of naked accesses and VoIP lines for corporate customers. For the full year 2010, the Company recorded 101.4 thousand fixed accesses' net disconnections, down from 122.8 thousand in 2009 (-17.4% year-on-year).

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

The number **of ADSL accesses** reached 806 thousand at the end of 4Q 2010, up 11.1% year-on-year with 29.4 thousand net additions in the quarter helped also by wholesale base growth, while the total number of **O_2 TV customers** reached 129 thousand at that date.

Total fixed **business revenues** went down 9.6% year-on-year to CZK 24,290 million in 2010 (-8.5% year-on-year excluding the USO impact), while they decreased by 11.6% to CZK 6,035 million in 4Q (-11.5% excluding the USO impact). **Revenues from traditional accesses** fell by 25.9% year-on-year reaching CZK 5,133 million in 2010 (-21.5% in 4Q) due to continuous fixed telephony lines losses and introduction of broadband centric customer proposition in 2009, while **Internet & broadband revenues** increased in total by 16.9% year-on-year to CZK 5,974 million in 2010 (+3.3% in 4Q alone). **IT services and business solutions revenues** decreased by 10.8% year-on-year reaching CZK 2,146 million in 2010, with a 31.9% year-on-year decline in 4Q alone due to lower number of projects realized in public office sector as mentioned already in 3Q.

Slovakia

In 4Q 2010, Telefónica O2 Slovakia continued with its robust commercial performance and delivered strong financial performance leveraging on successful customer proposition based on value and simplicity strategy (O_2 Fér). The total **number of active customers** reached 880 thousand at the end of December 2010, up by 59.2% year-on-year, with 99.3 thousand net additions in 4Q (+10.6% year-on-year). Additionally, in absolute terms, Telefónica O2 Slovakia increased its customer base by substantial figure of 327.6 thousand in 2010, posting a 44.0% year-on-year growth. The number of **contract customers** grew by 71.0% year-on-year reaching 334 thousand, while the number of **prepaid active customers** increased by 52.8% year-on-year ending up at 546 thousand at the end 4Q 2010. Consequently, contract customers represented 38.0% of total customer base at the end of 2010, up 2.6 p.p. year-on-year. **Total revenues** of Telefónica O2 Slovakia in local currency increased by

[14] Figures are shown net of inter-segment charges between fixed and mobile businesses

50.5% year-on-year reaching EUR 111.7 million in 2010, with a 42.6% year-on-year growth in 4Q alone to EUR 32.8 million on the back of increasing customer base, improving customer mix and growth in traffic. Like in 3Q, Telefónica O2 Slovakia reported positive **OIBDA** in 4Q 2010. **Contract ARPU** reached EUR 19.0 and EUR 18.6 in 2010 and 4Q respectively, while **prepaid ARPU** stood at EUR 8.5 and EUR 8.4 in these periods.

Outlook for 2011

In 2011, the Company will continue to be focused closely on its customers by further improving and strengthening customer relations via services' enhancement and new products' offers to meet their needs. The primary goal of these initiatives is to offer best-in-class customer experience and satisfaction. In particular, the Company will continue enhancing its fixed broadband value proposition where it plans to introduce VDSL based services aiming to stabilize fixed access losses and maintain competitiveness. In line with its 3G coverage expansion strategy and helped by recently signed 3G network sharing agreement with T-Mobile, the Company will focus on improved proposition of mobile broadband and data services. The Company's aim is to exploit its competitive advantage of having the widest and best-quality 3G network in further mobile broadband and data customers' growth while increasing the mobile revenues contribution.

Telefónica O2 Slovakia will continue in active marketing of its "transparency, value and simplicity" customer proposition. This will lead to further improvement of financial performance and profitability while maintaining solid customer base growth.

The Company does not have a full visibility on its revenues performance in 2011. It expects that ICT revenues could be still impacted by lower number of projects for public sector. In addition, mobile revenues will be hit by additional MTR cuts (-35% in 2011). The Company will maintain its effort to focus on efficiencies in OPEX and CAPEX while keeping investments to increase customer value and experience to maximize its cash flow generation, which remains the considerable goal also for 2011.

In 2011[15], the Group expects OIBDA[16] to decline between –1% and –5% and CAPEX to be around CZK 5.7 billion.

2010 dividend proposal

The Board of Directors approved a proposal to the Annual General Meeting for a dividend distribution of CZK 40 per share, i.e. suggestion to distribute the total amount of CZK 12,883,596 thousand of the net profit for 2010 and a part of the retained profits from previous years. The proposed relevant dividend record date is September 7, 2011, dividend payment date is proposed on October 6, 2011. The dividend proposal has been reviewed by the Supervisory Board and will be submitted to the Annual General Meeting that will be held on April 28, 2011.

[15] 2011 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2010

[16] In terms of 2011 guidance calculation, OIBDA excludes brand fees and management fees (CZK 1,057 million in 2010). In addition, 2010 OIBDA base excludes reversal of the impairment loss of CZK 4,343 million.

Attachment:
The consolidated balance sheet and income statement of Telefónica O2 Czech Republic prepared in accordance with International Financial Reporting Standards (all figures in CZK million).

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About Telefónica O2 Czech Republic

Telefónica O2 Czech Republic is a major integrated operator in the Czech Republic. It is now operating more than six million lines, both fixed and mobile, making it one of the world's leading providers of fully converged services. The organization offers the most comprehensive portfolio of voice and data services in this country. It is paying special attention to the exploitation of the growth potential, particularly in the data and Internet sector. Telefónica O2 Czech Republic operates the largest fixed and mobile network including a 3rd generation network, CDMA (for data), UMTS and EDGE, enabling voice, data and video transmission. Telefónica O2 Czech Republic is also a notable provider of ICT services.

About Telefónica Europe

Telefónica Europe is a business division of Telefónica comprising mobile, fixed and DSL operations in the UK, Ireland, Germany, the Czech Republic and Slovakia - all of which use 'O2' as their consumer brand. Telefónica Europe also has 50% ownership of the UK and Irish Tesco Mobile and German Tchibo Mobilfunk joint venture businesses. Telefónica Europe is headquartered in Slough, UK, and has some 54 million mobile and fixed customers.

INCOME STATEMENT	Jan – Dec 2010	Jan – Dec 2009
Business revenues	55,561	59,751
Other recurring revenues	94	101
Revenues	**55,655**	**59,852**
Internal expenses capitalized in fixed assets	637	787
Operating expenses	(32,889)	(33,965)
Other operating income/(expenses)	(440)	3
Gain on sale of fixed assets	92	422
Impairment of fixed assets	4,325	(23)
OIBDA	**27,380**	**27,076**
Depreciation and amortization	(11,856)	(12,001)
Operating Income	**15,524**	**15,075**
Net financial income (expense)	(206)	(198)
Income before tax	**15,318**	**14,877**
Income tax	(3,038)	(3,211)
Net Income	**12,280**	**11,666**

BALANCE SHEET	31.12.2010	31.12.2009
Non-current assets	**78,285**	**80,316**
- Intangible assets	7,989	9,029
- Goodwill	13,448	13,448
- Property, plant and equipment and investment property	56,651	57,545
- Long-term financial assets and other non-current assets	192	294
- Deferred tax assets	5	-
Current assets	**14,495**	**12,357**
- Inventories	606	618
- Trade and other receivables	8,626	9,664
- Current tax receivable	453	697
- Short-term financial investments	12	109
- Cash and cash equivalents	4,798	1,269
Non-current assets classified as held for sale	**12**	**95**
Total assets	**92,792**	**92,768**
Equity	**73,176**	**73,879**
Non-current Liabilities	**6,896**	**6,422**
- Long-term financial debt	2,883	3,044
- Deferred tax liabilities	3,936	3,333
- Long/Term Provisions	52	24
- Other long/term liabilities	25	21
Current Liabilities	**12,720**	**12,467**
- Short-term financial debt	141	87
- Trade and Other payables	9,978	9,384
- Current tax payable	-	(1)
- Short-term provisions and other liabilities	2,601	2,997
Liabilities assoc. with non-current assets classified as held for sale	**-**	**-**
Total Equity and Liabilities	**92,792**	**92,768**