



Telefónica O2 Czech Republic – 2010 First Half Financial Results

July 28, 2010

Telefónica O2 Czech Republic, a.s. announces its unaudited financial results for the first half 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

- Mobile customers' performance in the Czech Republic in the first half of 2010 remained solid on the back of 4.5% year-on-year contract customers' growth.
- ADSL accesses grew by 11.0% year-on-year to reach 756 thousand at the end of 2Q.
- Fixed accesses' decline continues to decelerate with 29 thousand net losses in 2Q.
- Telefónica O2 Slovakia maintained its sound financial performance (revenues: +51.0% year-on-year in 1H 2010) and further increased its customer base.
- Consolidated business revenues declined 6.6% year-on-year in 1H 2010, but improved in 2Q (-4.1% year-on-year) still impacted by universal service and MTR cuts, while the customers' spend stabilized. OIBDA went down 18.1% year-on-year in 1H 2010, impacted by lower revenues, restructuring costs and non-recurring items in 2009. On fully comparable basis¹, OIBDA declined by 4.5% year-on-year in 1H 2010.
- Continuous efficiency agenda and MTR cuts allowed the Group to decrease the operating expenses by 7.3% year-on-year (excl. T-Mobile settlement) and to improve comparable OIBDA margin² by 0.7 p.p. year-on-year to 43.4% in 1H 2010.
- Full year guidance³ confirmed for OIBDA and CAPEX.

"I am pleased to confirm our solid commercial performance in the second quarter of 2010 with additional customer growth in retail ADSL and mobile contract customers. Our broadband centric proposition helped us to further slowdown decline of our fixed accesses. Also in Slovakia we kept sound commercial momentum and further improved financial performance. We have recorded improving trends in consumption of our mobile customers on the back of decreasing optimization, while MTR cuts continued to dilute mobile revenues. Fixed business revenues were positively contributed by ICT revenues growth. Despite some revenues enhancement, we continued focusing on delivery of our efficiency agenda to sustain healthy operational profitability. As a result, our recurring OIBDA margin improved by 0.7 p.p. in the first half of 2010 compared to the same period in 2009." 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.

¹ OIBDA excluding brand fees and non-recurring items (1H 2009: universal service, gain from real estate and settlement agreement with T-Mobile totaling CZK 1,456 million; 1H 2010: universal service and restructuring costs totaling CZK minus 414 million).

² Comparable OIBDA over Comparable business revenues (business revenues excluding universal service: CZK 179 million in 1H 2009 and CZK 27 million in 1H 2010).

³ OIBDA decline of -5% to -9%, CapEx around CZK 6 billion. In terms of 2010 guidance calculation, OIBDA excludes brand fees (CZK 754 million in 2009). 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; 2010 guidance excludes changes in consolidation, assuming constant FX rates of 2009.

A *Telefónica* company

Consolidated Financial Statements

The financial performance of Telefónica O2 Czech Republic Group in 2Q 2010 showed improving trends both in fixed and mobile segments compared to the 1Q with less customers' optimization and stabilization in spend. Consolidated **business revenues** went down 6.6% yoy to CZK 27,765 million in 1H 2010 with a 4.1% yoy decline to CZK 14,038 million in 2Q alone. Excluding the impact of USO⁴, Group business revenues would have declined 6.2% yoy in 1H 2010, and 4.1% yoy in 2Q 2010. Fixed business revenues in the Czech Republic declined by 7.5% yoy to CZK 12,273 million in 1H 2010 (-6.5% yoy excluding the USO impact) and by 5.3% to 6,121 million in 2Q 2010 (-5.5% yoy excluding the USO impact, an improvement compared to a 7.3% decline in 1Q). Mobile revenues in the Czech Republic declined by 8.5% to CZK 14,310 million in 1H 2010 (-4.2 % yoy excluding the impact of MTR cuts) and by 5.8% to CZK 7,282 million in 2Q 2010, (-1.6 % yoy excluding the impact of MTR cuts, an improvement compared to 1Q: -6.8%). On the other hand, revenues in Slovakia continued in the sound growth and recorded a 51.0% yoy increase to reach EUR 48.8 million in 1H 2010 (+51.0% in 2Q).

In the first quarter of 2010, the Company announced an ambitious restructuring program with a special focus on Network transformation, aiming at further improvement of its operational efficiency. As a result, the restructuring provision of CZK 381 million has been booked in 1Q, while in 2Q, the Company charged additional CZK 46 million coming from further management structure simplification. In addition, the Company continued in efficiency enhancement via strict financial discipline seen already in previous quarters to compensate for drop in revenues. Consolidated **operating costs** reached CZK 16,552 million in 1H 2010, down 1.6% yoy, while in 2Q they reached CZK 8,313 million, up 7.1% yoy. 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, group consolidated costs would decline by 7.3% and 5.4% in 1H and 2Q respectively helped also by MTR cuts.

Group **Operating income before depreciation and amortization (OIBDA)** went down 18.1% yoy to CZK 11,209 million in 1H 2010 (-17.2% yoy to 5,864 million in 2Q alone) largely due to revenues decline, non-recurring gain from real estate sale booked in 1Q 2009 (CZK 341 million), settlement agreement with T-Mobile in 2Q 2009 (CZK 1,027 million) and negative impact of restructuring costs (CZK 427 million) booked in 1H 2010. **OIBDA margin** thus decreased by 5.7 p.p. yoy to reach 40.4% in 1H 2010 and by 6.6 p.p. yoy to 41.8% in 2Q 2010. **Comparable OIBDA**⁵ decreased by 4.5% yoy to CZK 12,047 million in 1H 2010 (-2.0% yoy to 6,116 million in 2Q 2010), while **comparable OIBDA margin**⁶ improved by 0.7 p.p. to reach 43.4% in 1H 2010 (+1.0 p.p. to 43.6% in 2Q 2010).

Consolidated **net income** amounted to CZK 4,354 million in 1H 2010, down by 23.9% yoy (-23.9% yoy in 2Q to CZK 2,342 million), largely as a result of the decline in OIBDA, which has not been fully compensated by lower depreciation & amortization, financial expenses and income tax.

Consolidated **CAPEX** reached CZK 2,379 million in 1H 2010, down by 18.1% yoy (-31.2% yoy in 2Q). The Company continued to invest in expansion of its mobile broadband networks (EDGE and UMTS), fixed broadband network (ADSL and IPTV) as well as development of IT systems. During the 1H 2010, the Company expanded its 3G coverage to additional district towns resulting in 29 towns in the Czech Republic covered by mid-July, which represents some 32% of the population. Investment in EDGE network expansion also continued and by the end of June 2010, 60% of the population has been covered. Group **free cash flows** increased 15.2% yoy to reach CZK 7,103 million in 1H 2009, largely due to lower paid income tax and less cash paid for CAPEX.

The consolidated **financial debt** amounted to CZK 3,147 million at 30 June 2010, flat compared to the end of 2009, while **cash and cash equivalents** and short term financial investments reached CZK 8,397 million at the end of June 2010.

⁴ CZK 179 million in 1H 2009 and CZK 27 million in 1H 2010

⁵ OIBDA excluding brand fees and non-recurring items (1H 2009: universal service, gain from real estate and settlement agreement with T-Mobile totaling CZK 1,456 million; 1H 2010: universal service and restructuring costs totaling CZK minus 414 million).

⁶ Comparable OIBDA over Comparable business revenues (business revenues excluding universal service: CZK 179 million in 1H 2009 and CZK 27 million in 1H 2010).



CZ Mobile Business Overview⁷

Mobile business continued to maintain solid commercial performance in mobile contract segment leveraging on successful customer proposition around O₂ NEON tariffs. The financial performance in the second quarter improved compared to 1Q with less customers' optimization and some stabilization seen in spend, while MTR cuts (-34.4% between January 2009 and January 2010⁸) continued to dilute mobile revenues in 1H 2010.

Simultaneously with expansion of mobile broadband networks the Company introduced new mobile broadband services for its prepaid customers, who access the Internet irregularly. From 1st June, all customers can opt for the O₂ Prepaid Mobile Internet. This service allows them to browse the net easily anywhere and anytime they wish without any commitments. The prepaid service is offered in four options depending on the number of purchased daily packages. Additionally, for smartphone users who want to use the internet on their mobiles Telefónica O₂ came with the O₂ Internet on Your Mobile Plus tariff. For contract customers, the new mobile broadband tariffs O₂ Mobile internet Start and O₂ Mobile internet Standard have been introduced during the first half of 2010.

In Q3 2009, for its contract customers the Company launched a tariff with no monthly fee (O₂ ZERO) to address the customers' demand for a strict cost control. In line with prudent principle, the Company decided to apply 3 months' activity criteria to those contract customers and to customers who subscribed for similar tariffs launched in the past years, as it applies to prepaid customers. As a result, in June 2010, the contract customer base has been reduced by 111,000 one-off corresponding to customers with low activity level. However, this adjustment has no impact on the financial performance of the mobile business.

Consequently, total **mobile customer base** increased by 0.1% yoy to reach 4,842 thousand at the end of June 2010 (+2.4% yoy to 4,953 thousand excluding the adjustment). Number of **contract customers** went up 4.5% yoy reaching 2,782 thousand at the end of 2Q 2010 (+8.6% yoy to 2,893 thousand excluding the adjustment). Excluding the adjustment, the contract net adds reached 78 thousand in 1H 2010. This solid performance was driven by continuous uptake of O₂ NEON tariffs and by customers migrating from the prepaid to the contract segment. Number of **prepaid active customers** reached 2,060 thousand at the end of 2Q 2010, down by 5.2% yoy. The Company kept up seeing a continuous improvement in prepaid customer base with 70 thousand net losses in 1H 2010, 36.7% less compared to the same period in 2009. At the end of 2Q 2010, contract customers represented 57.4% of the base (+2.4 p.p. yoy).

The blended monthly average **churn rate** totaled 2.5% in 1H 2010 and 2.8% in 2Q, posting a 0.6 p.p. yoy increase in 1H 2010 and 1.1 p. yoy in 2Q, mainly due to the disconnections made in the contract base in the period. Excluding the one-off adjustment, churn would stand at 2.1% in 2Q, which is 0.1 p.p. lower compared to 1Q.

In terms of usage, **mobile traffic**⁹ carried by the customers in the Czech Republic grew by 9.0% yoy to 4,387 million minutes in 1H 2010.

In 1H 2010, **blended ARPU**¹⁰ reached CZK 468.3, down 9.5% yoy, largely due to MTR cuts and customers' optimizing their behavior. However, in 2Q the ARPU (CZK 477.1) improved to -7.9% yoy. **Contract ARPU** reached CZK 664.0 in 1H 2010, down by 13.5% yoy, while in 2Q its decline slowed down to -11.2% yoy to reach CZK 673.0. This was the result of decreasing customers' optimization, stabilization in spend and seasonality patterns. In addition, customer migration from prepaid to the contract tariffs and MTR cuts continued to contribute to contract ARPU dilution. **Prepaid ARPU** decreased by 9.2% yoy to reach CZK 203.3 in 1H 2010 with an improvement to CZK 209.4 in 2Q compared to CZK 197.2 in 1Q due to positive impact of propositions focused on traffic stimulation and regular top-ups.

Total mobile **business revenues** in the Czech Republic declined by 8.5% to CZK 14,310 million in 1H 2010 with a 5.8% decline in 2Q 2010, while mobile service revenues went down by 8.5% yoy and 5.6% yoy in 1H and 2Q respectively. Mobile termination rate cuts diluted mobile service revenues by 4.4 p.p. and 4.3 p.p. in 1H and 2Q

⁷ Figures are shown net of inter-segment charges between fixed and mobile businesses

⁸ MTR dropped from CZK 2.99 to CZK 2.65 (February 1, 2009), to CZK 2.31 (July 1, 2009) and to CZK 1.96 (January 1, 2010).

⁹ Inbound and outbound, including roaming abroad, excluding inbound roaming

¹⁰ Including inter segment revenues



2010. Despite 9.0% yoy growth in mobile outbound voice traffic in 1H 2010, traffic revenues decreased by 10.6% yoy to CZK 4,214 million (-9.3% in 2Q), due to higher number of customers opting for semi-flat rate tariffs (O₂ NEON). Interconnection revenues went down by 19.6% yoy to CZK 1,951 million in 1H (-18.3% in 2Q), largely impacted by MTR cuts, which have not been compensated by higher inbound traffic. Other revenues (including SMS & MMS, data and other business revenues) declined by 7.2% yoy in 1H 2010, while in 2Q, they improved by 2.2% driven by better performance of SMS, MMS as well as mobile data revenues.

CZ Fixed Business Overview¹¹

The fixed business reported solid commercial performance in broadband customer base and fixed accesses in 1H 2010. The financial performance continued to be negatively impacted by already mentioned universal service (1Q), while ICT revenues continued in growing trend experienced already in 1Q.

Total number of **fixed accesses** declined by 5.3% yoy to reach 1,708 thousand at the end of June 2010, with 29 thousand net losses in the quarter (by 37.9% less compared to 2Q 2009) helped by solid uptake of naked accesses following the introduction of new broadband centric proposition in 2009. The positive impact of the broadband strategy has been also proven by household access performance. Their decline slowed down further to -5.6% yoy in 2Q 2010 to reach 1,159 thousand at the end of June 2010, while their number decreased by 6.1% yoy in 1Q 2010 and by 9.1% yoy in 2Q 2009.

Voice traffic generated in the fixed network went down 13.2% in 1H 2010 to 923 million minutes as a result of continued fixed telephony lines losses and fixed to mobile substitution effect.

Retail ADSL accesses reached 702 thousand at the end of 2Q 2010, up 10.8% yoy, while total number of **O₂ TV customers** reached 133 thousand, up by 0.4% yoy.

Total fixed **business revenues** went down 7.5% yoy to CZK 12,273 million in 1H 2010 (-6.5% yoy excluding the USO impact), while they decreased by 5.3% to CZK 6,121 million in 2Q (-5.5% excluding the USO impact). **Revenues from traditional accesses** fell by 31.5% yoy to reach CZK 2,684 million in 1H 2010 (-29.6% in 2Q) due to continuous fixed telephony lines losses and introduction of broadband centric customer proposition in 2009, while **Internet & broadband revenues** increased in total by 35.8% yoy to CZK 2,989 million in 1H 2010. **IT services and business solutions revenues** increased by still solid 25.4% yoy to reach CZK 1,030 million in 1H 2010 (+20.5% yoy in 2Q alone).

Slovakia

In 1H 2010, Telefónica O2 Slovakia kept its sound commercial performance and deliver strong financial performance leveraging on successful customer proposition based on value and simplicity strategy (O₂ Fér). Total **number of active customers** reached 709 thousand at the end of June 2010, up by 69.9% yoy, with 63 thousand net adds in the second quarter. Number of **contract customers** grew by 89.9% yoy to reached 258 thousand, while number of **prepaid active customers** increased by 60.3% yoy to reach 451 thousand at the end 2Q 2010. Contract customers represented 36.4% of total customer base at the end of 2Q 2010, up 3.8 p.p. yoy. **Total revenues** of Telefónica O2 Slovakia in local currency increased by 51.0% yoy to reach EUR 48.8 million in 1H 2010, with a 51.0% yoy growth in 2Q alone to EUR 26.3 million. **Contract ARPU** reached EUR 18.8 and EUR 19.2 in 1H and 2Q respectively, while **prepaid ARPU** was at EUR 8.3 and EUR 8.5 in these periods.

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).

¹¹ Figures are shown net of inter-segment charges between fixed and mobile businesses



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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), and UMTS, 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, the Isle of Man, Germany, the Czech Republic, and Slovakia. With the exception of Isle of Man, all the operating businesses 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 49 million mobile and fixed customers.

INCOME STATEMENT	Jan – Jun 2010	Jan – Jun 2009
Business revenues	27,765	29,737
Other recurring revenues	124	52
Revenues	27,889	29,789
Internal expenses capitalized in fixed assets	310	391
Operating expenses	(16,552)	(16,823)
Other operating income/(expenses)	(422)	-
Gain on sale of fixed assets	(3)	356
Impairment of fixed assets	(13)	(20)
OIBDA	11,209	13,693
Depreciation and amortization	(5,733)	(6,234)
Operating Income	5,476	7,459
Net financial income (expense)	(122)	(132)
Income before tax	5,355	7,327
Income tax	(1,001)	(1,605)
Net Income	4,354	5,722
BALANCE SHEET	30.6.2010	31.12.2009
Non-current assets	76,846	80,316
- Intangible assets	8,532	9,029
- Goodwill	13,448	13,448
- Property, plant and equipment and investment property	54,523	57,545
- Long-term financial assets and other non-current assets	342	294
- Deferred tax assets	-	-
Current assets	18,680	12,357
- Inventories	473	618
- Trade and other receivables	8,886	9,664
- Current tax receivable	925	697
- Short-term financial investments	23	109
- Cash and cash equivalents	8,373	1,269
Non-current assets classified as held for sale	161	95
Total assets	95,688	92,768
Equity	65,304	73,879
Non-current Liabilities	6,069	6,422
- Long-term financial debt	2,956	3,044
- Deferred tax liabilities	3,060	3,333
- Long/Term Provisions	24	24
- Other long/term liabilities	30	21
Current Liabilities	24,314	12,467
- Short-term financial debt	191	87
- Trade and Other payables	8,387	9,384
- Current tax payable	(15)	(1)
- Short-term provisions and other liabilities	15,751	2,997
Liabilities assoc. with non-current assets classified as held for sale	-	-
Total Equity and Liabilities	95,688	92,768