Press release

Telefónica O2 Czech Republic – 2010 First Quarter Financial Results

May 12, 2010

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

- In 1Q 2010, Telefónica O2 Czech Republic maintained solid commercial momentum in fixed broadband and contract mobile segments.
- Mobile customer base in the Czech Republic increased by 8 thousand in 1Q 2010 driven by contract customers (+44 thousand) resulting in 3.6% year-on-year growth.
- ADSL retail accesses grew by 12.9% year-on-year to 691 thousand (+14.1 thousand in 1Q 2010).
- Telefónica O2 Slovakia improved its financial performance (revenues: +51.0% year-on-year in 1Q 2010) and further increased its customer base.
- Consolidated business revenues declined 9.1% year-on-year in 1Q 2010 still impacted by challenging economic environment, universal service and MTR cuts, while OIBDA went down 19.2% year-on-year in 1Q 2010, impacted by lower revenues and restructuring costs. On fully comparable basis[1], OIBDA declined by 7.0% year-on-year.
- Continuous efficiency agenda allowed the Group to cut the operating expenses by 9.0% year-on-year and to improve comparable OIBDA margin by 0.5 p.p. year-on-year to 43.2% in 1Q 2010.

"I am glad that in the first quarter of 2010 we have maintained a healthy customer growth in our focused areas, retail ADSL and mobile contract customers. Also in Slovakia we kept commercial momentum and improved financial performance. Our revenues performance continued to be negatively impacted by customers' optimization behavior and additional MTR cuts. Thus we further aimed at compensating, to the maximum extent possible, the pressure on revenues via continuous delivery of the efficiency agenda to sustain healthy operational profitability. As a result, our recurring OIBDA margin improved by 0.5 p.p. in the first quarter 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 (gain from real estate sale and universal service totaling CZK 429 million in 1Q 2009, universal service and restructuring costs totaling CZK minus 374 million in 1Q 2010).

Consolidated Financial Statements

The financial performance of Telefónica O2 Czech Republic Group in 1Q 2010 continued to be negatively impacted by challenging environment and MTR cuts. In addition, revenues from Universal Service (USO) negatively impacted year-on-year revenues comparison in 1Q 2010. Consolidated **business revenues** went down 9.1% yoy to CZK 13,727 million in 1Q 2010. Excluding the impact of USO[2], Group business revenues would have declined 8.1% yoy in 1Q 2010. In the same period, fixed business revenues in the Czech Republic declined by 9.6% yoy to CZK 6,152 million (-7.3% yoy excluding the USO impact). Mobile revenues in the Czech Republic declined by 11.2% to CZK 7,028 million in 1Q 2010 (-6.8 % yoy excluding the impact of MTR cuts). On the other hand, revenues in Slovakia continued to grow healthy and recorded a 51% yoy growth in local currency in 1Q 2010.

In 2010, the Company continues in its effort to further improve its operational efficiency. Hence, it set an ambitious restructuring program, aspiring to establish more effective organisational structure by reducing the number of organizational layers across the whole organization. In addition it aims at making its processes as efficient as possible via further integration of fixed and mobile platforms and systems, with a special focus on Network transformation, including outsourcing of some activities. As a result of the restructuring program, the Company booked restructuring costs of CZK 381 million in 1Q 2010.

The Company continued in efficiency enhancement via strict financial discipline seen already in 2009 to compensate for drop in revenues. This resulted in 9.0% yoy decrease in consolidated **operating costs** to reach CZK 8,239 million in 1Q 2010. Reductions have been reported in majority of cost categories (both commercial and non-commercial). Cost of goods sold decreased by 35.9% to CZK 430 million, while marketing and sales expenses dropped 9.8% due to more efficient use of external commissions in sales channels and lower negotiated commissions charges. For non-commercial expenses, it is worth highlighting a 5.0% decline in network &IT repairs and maintenance expenses to CZK 630 million in 2010 coming mainly from maintenance contracts consolidation and re-negotiation on local and group level in the second half of 2009.

Group **Operating income before depreciation and amortization (OIBDA)** went down 19.2% yoy to CZK 5,346 million in 1Q 2010 largely due to revenues decline, non-recurring gain from real estate sale booked in 1Q 2009 (CZK 341 million) and negative impact of above mentioned restructuring costs (CZK 381 million) booked in 1Q 2010. **OIBDA margin** thus decreased by 4.8 p.p. yoy to reach 38.9% in 1Q 2010. **Comparable OIBDA**[3] decreased by 7.0% yoy to CZK 5,930 million, while **comparable OIBDA margin**[4] improved by 0.5 p.p. to reach 43.2% in 1Q 2010.

Consolidated **net income** amounted to CZK 2,012 million, down by 23.9% yoy, 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 1,086 million in 1Q 2010, up by 5.9% yoy. 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.

The consolidated **financial debt** amounted to CZK 3,069 million at 31 March 2010, in line with December 2009, while **cash and cash equivalents** and short term financial investments reached CZK 4,150 million at the end of March 2010.

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[2] CZK 179 million in 1Q 2009 and CZK 13 million in 1Q 2010

[3] OIBDA excluding brand fees and non-recurring items (1Q 2009: universal service and gain from real estate totaling CZK 429 million; 1Q 2010: universal service and restructuring costs totaling CZK minus 374 million).

[4] Comparable OIBDA over Comparable business revenues (business revenues excluding universal service: CZK 179 million in 1Q 2009 and CZK 13 million in 1Q 2010).

CZ Mobile Business Overview[5]

Mobile business maintained solid commercial performance in mobile contract segment leveraging on successful customer proposition around O_2 NEON tariffs. The financial performance continued to be negatively impacted by customers' optimization of their usage and by MTR cuts (-34.4% between January 2009 and January 2010[6]).

In the highly penetrated mobile market in the Czech Republic, total **mobile customer base** increased by 3.6% yoy and reached 4,953 thousand at the end of March 2010. Number of **contract customers** went up 10.1% yoy reaching 2,858 thousand at the end of 1Q 2010 with 43.5 thousand net adds in the quarter. This solid performance was driven by continuous uptake of O_2 NEON tariffs and by customers migrating from the prepaid to the contract segment. Number of **prepaid active customers** reached 2,095 thousand at the end of 1Q 2010, down by 4.2% yoy. The Company kept up seeing a continuous improvement in prepaid customer base with 35.4 thousand net losses in 1Q 2010, 63.2% less compared to the same period of 2009. At the end of 1Q 2010, contract customers represented 57.7% of the base (+3.4 p.p. yoy).

The blended monthly average **churn rate** reached 2.2% in 1Q 2010, virtually stable compared with the same period in 2009, but improved by 0.2 p.p. compared to 4Q 2009 largely due to lower prepaid customers' churn.

In terms of usage, **mobile traffic[7]** carried by the customers in the Czech Republic grew by 9.6% yoy to 2,127 million minutes in 1Q 2010 due to higher contract base and successful proposition of O_2 NEON tariffs.

In 1Q 2010, **blended ARPU**[8] reached CZK 459.4, down 11.2% yoy largely due to customers optimizing their behaviour and MTR cuts. **Contract ARPU** reached CZK 655.0 in the quarter, down by 15.7% yoy. Continuous customer migration from prepaid to the contract tariffs contributed to contract ARPU dilution on top of MTR cuts and economy impact. **Prepaid ARPU** decreased by 10.2% yoy to CZK 197.2 in 1Q 2010 impacted by customers optimizing their behaviour in the current environment and migration of high value prepaid customers to contracts.

Total mobile **business revenues** in the Czech Republic declined by 11.2% to CZK 7,028 million in 1Q 2010, while mobile service revenues went down by 11.3% yoy. Mobile termination rate cuts diluted mobile business revenues by 4.4 p.p. in 1Q 2010. Despite 9.2% yoy growth in mobile outbound voice traffic in 1Q 2010, traffic revenues decreased by 11.9% yoy to CZK 2,039 million, due to higher number of customers opting for semi-flat rate tariffs (O_2 NEON). Interconnection revenues went down by 20.9% yoy to CZK 936 million, largely impacted by MTR cuts, which has not been compensated by higher inbound traffic.

CZ Fixed Business Overview[9]

The fixed business reported solid commercial performance in broadband customer base and fixed accesses. The financial performance was negatively impacted by already mentioned universal service, while ICT revenues reported good growth in 1Q 2010.

Total number of **fixed accesses** declined by 6.1% yoy to reach 1,738 thousand at the end of March 2010, with 33.1 thousand net losses in the quarter (by 21.9% less compared to 1Q 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 proved in household performance. Their number decreased by 6.1% yoy to 1,182 thousand at the end of March 2010, while it went down by 10.3% in the year ending 31 March 2009.

Voice traffic generated in the fixed network went down 14.5% in 1Q 2010 to 480 million minutes as a result of continued fixed telephony lines losses and fixed to mobile substitution effect.

Retail ADSL accesses reached 691 thousand at the end of 1Q 2010, up 12.9% yoy, while total number of **O_2 TV customers** reached 138 thousand, up by 7.8% yoy.

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[5] Figures are shown net of inter-segment charges between fixed and mobile businesses
[6] 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).
[7] Inbound and outbound, including roaming abroad, excluding inbound roaming
[8] Including inter segment revenues
[9] Figures are shown net of inter-segment charges between fixed and mobile businesses

Total fixed **business revenues** went down 9.6% yoy to CZK 6,152 million in 1Q 2010 (-7.3% yoy excluding the USO impact). **Revenues from traditional access** fell by 33.2% yoy to reach CZK 1,376 million in 1Q 2010 due to continuous fixed telephony lines losses and introduction of broadband centric customer proposition in 2009, while **Internet & broadband revenues** increased in total by 44.0% yoy to CZK 1,485 million in 1Q 2010. **IT services and business solutions revenues** increased by solid 31.2% yoy to reach CZK 496 million in 1Q 2010.

Slovakia

In 1Q 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 (O_2 Fér). Total **number of active customers** reached 646 thousand at the end of March 2010, up by 76.8% yoy, with 92.8 thousand net adds in the quarter. Number of **contract customers** almost doubled (+93.5% yoy) and reached 228 thousand, while number of **prepaid active customers** increased by 68.8% yoy to reach 418 thousand at the end 1Q 2010. Contract customers represented 35.3% of total customer base at the end of 1Q 2010, up 3.0 p.p. yoy. **Total revenues** of Telefónica O2 Slovakia increased by 51.0% yoy in local currency in 1Q 2010. **Contract ARPU** reached EUR 18.4 and **prepaid ARPU** was EUR 8.1.

On its meeting held on 4 May 2010, the Board of Directors of Telefónica O2 Czech Republic agreed to increase the registered capital of Telefónica O2 Slovakia, s.r.o. by a monetary investment in the amount of EUR 40,000,000. Thus, the registered capital increased from the current amount of EUR 200,000,000 to the new amount of EUR 240,000,000.

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).

For more information, please contact:

Martin Žabka
Spokesperson
Telefónica O2 Czech Republic, a.s.
public.relations.cz@o2.com
tel: 800 163 342 (800 1 media)

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 - Mar 2010	Jan – Mar 2009
Business revenues	13,727	15,106
Other recurring revenues	102	25
Revenues	**13,829**	**15,131**
Internal expenses capitalized in fixed assets	155	196
Operating expenses	(8,239)	(9,058)
Other operating income/(expenses)	(377)	3
Gain on sale of fixed assets	(13)	354
Impairment of fixed assets	(10)	(11)
OIBDA	**5,346**	**6,614**
Depreciation and amortization	(2,759)	(3,114)
Operating Income	**2,587**	**3,501**
Net financial income (expense)	(65)	(87)
Income before tax	**2,522**	**3,413**
Income tax	(510)	(769)
Net Income	**2,012**	**2,645**

BALANCE SHEET	31.3.2010	31.12.2009
Non-current assets	**78,538**	**80,316**
- Intangible assets	8,804	9,029
- Goodwill	13,448	13,448
- Property, plant and equipment and investment property	55,940	57,545
- Long-term financial assets and other non-current assets	346	294
- Deferred tax assets	-	-
Current assets	**14,863**	**12,357**
- Inventories	517	618
- Trade and other receivables	9,017	9,664
- Current tax receivable	1,178	697
- Short-term financial investments	10	109
- Cash and cash equivalents	4,141	1,269
Non-current assets classified as held for sale	**137**	**95**
Total assets	**93,538**	**92,768**
Equity	**75,822**	**73,879**
Non-current Liabilities	**6,196**	**6,422**
- Long-term financial debt	2,927	3,044
- Deferred tax liabilities	3,223	3,333
- Long/Term Provisions	26	24
- Other long/term liabilities	19	21
Current Liabilities	**11,521**	**12,467**
- Short-term financial debt	142	87
- Trade and Other payables	8,791	9,384
- Current tax payable	8	(1)
- Short-term provisions and other liabilities	2,580	2,997
Liabilities assoc. with non-current assets classified as held for sale	**-**	**-**
Total Equity and Liabilities	**93,538**	**92,768**