Press release

Telefónica Czech Republic – January to June 2011 Financial Results

July 27, 2011

Telefónica Czech Republic, a.s. announces its unaudited financial results for January to June 2011. These results are consolidated and prepared according to International Financial Reporting Standards and fully include the results of Telefónica Slovakia, Telefónica O2 Business Solutions and other smaller operating companies.

Operational Highlights

- **Solid commercial momentum** in focused areas maintained despite continuous intense competition:
  - **Strong contract mobile customers growth** with 57 thousand net additions in 2Q 2011 (+62.7% year-on-year), helped by mobile broadband customers growth.
  - **xDSL accesses grew** by 11.1% year-on-year reaching 841 thousand (35 thousand net adds in 1H 2011, +11.3% year-on-year), and VDSL launch helping to protect existing base and sustain fixed BB ARPU.
  - **Fixed accesses' disconnections continued to decelerate** with 58 thousand net losses in 1H 2011 (-6.2% year-on-year).
- **Consolidated business revenues** went down 6.7% year-on-year in 1H 2011 impacted by prevailing competitive pressure, MTR cuts and slow recovery of customers' spend patterns in mobile segment.
- **Guided OIBDA**[1] decreased by 6.8% year-on-year in 1H 2011, while OIBDA margin remained broadly flat year-on-year reaching solid 41.7% in 1H 2011 on the back of continuous OpEx efficiencies and positive OIBDA in Slovakia.
- **Telefónica Slovakia** maintained its **good commercial momentum** seen already in the previous quarters reaching 1,003 thousand customers at the end of June 2011 (55 thousand net adds in 2Q 2011) and further improved its financial performance, reporting **positive OIBDA** in 1H 2011.
- **2011 full year guidance**[2] **confirmed** for OIBDA and CapEx.

"I am pleased that in highly competitive mobile market we delivered strong commercial performance in contract customers area, thus outperforming our competitors. In fixed broadband,

[1] OIBDA excludes brand fees and management fees (CZK 423 million in 1H 2010 and CZK 551 million in 1H 2011), assuming constant FX rates of 2010

[2] OIBDA decline of -1% to -5%, CapEx around CZK 5.7 billion. 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. 2011 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2010

our recently launched VDSL proposition shows promising result as current ADSL customers gradually migrate to the enhanced service, helping us to sustain value and improve churn. Our educative marketing campaign showing the customers benefits of mobile internet is reflected in accelerated growth of small screen customers. Telefónica Slovakia continued delivering solid commercial momentum reaching 1 million customers in June," says Jesús Pérez de Uriguen, the Chief Financial Officer and the First Vice-Chairman of the Board of Directors of Telefónica Czech Republic when commenting on the operator's financial results. *"Our revenues continued to be impacted largely by still intense competition in some segments, regulatory measures and gradual recovery of household consumption. In this tough environment, we kept focusing on cost efficiencies which together with improved financial performance in Slovakia helped us to maintain guided OIBDA margin broadly flat year-on-year reaching close to 42%"*, he adds.

<u>Consolidated Financial Statements</u>

Consolidated **business revenues** went down 6.7% year-on-year to CZK 25,898 million in 1H 2011 (-7.2% year-on-year in 2Q to CZK 13,033 million). Similarly to the first quarter, financial performance of the Group in the second quarter continued to be impacted by prevailing competitive pressure largely in corporate and SMB mobile segments, MTR cuts, and lower ICT revenues. Fixed business revenues in the Czech Republic declined by 7.9% year-on-year reaching CZK 11,300 million in 1H 2011(-7.6% year-on-year in 2Q 2011 to CZK 5,657 million). At the same time, mobile revenues in the Czech Republic declined by 9.7% to CZK 12,925 million in 1H 2011 and by 10.7% year-on-year reaching CZK 6,504 million in 2Q. Excluding the impact of MTR cuts, the growth rates would be at -7.0% and -5.0% in 1H and 2Q 2011 respectively. On the other hand, revenues in Slovakia continued to grow steady and recorded a 49.8% year-on-year increase reaching EUR 73.1 million in 1H 2011 (+46.7% year-on-year to EUR 38.5 million in 2Q 2011 alone).

In 2Q 2011, the Company has continued in its effort to deliver cost efficiencies in both commercial and non-commercial areas, to compensate for pressure in revenues. Despite higher commercial activities largely in fixed and mobile broadband areas, total consolidated **operating costs** decreased by 4.1% year-on-year reaching CZK 15,867 million in 1H 2011 (-5.0% excluding brand fees and management fees), also positively impacted by MTR cuts. Positive impact coming from 2010 and 2011 restructuring programs led to a 9.7% year-on-year reduction in personnel expenses in 1H 2011. The total Group headcount reached 7,329 at the end of June 2011, down by 11.7% year-on-year and 1.9 % quarter-over-quarter. In 2Q 2011 alone, the headcount has been reduced by additional 143 employees.

Group **Operating income before depreciation and amortization (OIBDA)** reached CZK 10,275 million in 1H 2011, -8.3% year-on-year (-11.2% to CZK 5,205 million in 2Q 2011 alone). In 2Q 2011, Telefónica Slovakia recorded a positive OIBDA again, reaching individual millions of EUR in the period. At the same time, **guided OIBDA**[3] decreased by 6.8% year-on-year reaching CZK 10,845 million in 1H 2011, while margin remained almost flat at 41.7%, on the back of already mentioned focus on cost efficiency and profitability improvement in Slovakia.

[3] In terms of 2011 guidance calculation, OIBDA excludes brand fees and management fees (CZK 423 million in 1H 2010 and CZK 551 million in 1H 2011), assuming constant FX rates of 2010.

Depreciation and amortization charges went up by 1.0% in 1H 2011, impacted by an impairment reversal booked in 3Q 2010 (higher gross value of fixed assets), as commented in the previous quarters. Consolidated **net income** amounted to CZK 3,611 million and CZK 1,871 million in 1H and 2Q 2011, down by 17.1% and 20.1% year-on-year respectively, as a result of the decline in OIBDA and higher depreciation and amortization, not fully compensated by lower financial expenses and lower income tax expense.

Consolidated **CapEx** reached CZK 2,554 million in 1H 2011, up by 7.4% year-on-year. In line with the strategy to focus its investments into growth areas, the Company continued to direct investments into the capacity expansion and quality improvement of 3G network. In addition, CapEx was spent on further expansion of 3G network coverage, including coverage of currently unserved areas on the basis of network sharing contract with T-Mobile. By the end of June 2011, the Company increased the 3G population coverage to ~ 55%. As mentioned already in 1Q 2011, the Company focused its investments into the upgrade of the fixed broadband network in relation to the launch of a new VDSL based customer proposition on 9th May 2011 aiming at strengthening its position on highly competitive fixed broadband market in the Czech Republic. In Slovakia, CapEx was largely spent on additional network investment related to the planned launch of 3G based services in mid July.

Group free cash flows decreased 15.2% year-on-year reaching CZK 6 billion in 1H 2011, as a combination of 6.1% decline in **cash from operating activities**, better than recurring OIBDA decline and 15.5% higher CapEx related cash payments due to different Capex phasing in 2011 compared 2010.

The consolidated **financial debt** amounted to CZK 3,111 million at 30 June 2011 resulting into 2.9% growth compared to the end of 2010. **Cash and cash equivalents** reached CZK 10,820 million, up from CZK 4,798 million at the end of 2010, due to accumulation of cash for dividend payment in October 2011.

CZ Mobile Business Overview[4]

In 2Q 2011, mobile business continued to deliver solid commercial performance in mobile contract segment supported by customers' demand for mobile broadband proposition, despite intense competitive pressure. The financial performance continued to be negatively impacted by tough competition, MTR cuts (-30.1% year-on-year[5]) and slow recovery of customers' spend patterns.

Total **mobile customer base** reached 4,869 thousand at the end of June 2011, a 0.5% year-on-year increase. In 2Q, the Company recorded 42.1 thousand net additions in its mobile customer base, the best figure in last seven quarters, on the back of continuous strong contract base growth and significant improvement in prepaid base. The number of **contract customers** went up 6.3% year-on-year reaching 2,956 thousand at the end of 2Q 2011 with 56.9 thousand net adds in the quarter (+62.7% year-on-year, excluding the disconnection of 111 thousand inactive contract customers in 2Q 2010). This performance continued to be driven by customers migrating from the prepaid to the contract segment and positive contribution of mobile broadband customers' growth. At the end of June 2011, contract customers accounted already for 60.7% of the base

[4] Figures are shown net of inter-segment charges between fixed and mobile businesses
[5] From CZK 2.37 to CZK 1.96 in January 2010, to CZK 1.66 in July 2010 and to CZK 1.37 in January 2011

(+3.3 percentage points year-on-year). The number of **prepaid active customers** reached 1,912 thousand at the end of 2Q 2011, down by 7.2% year-on-year, with only 14.8 thousand net losses in the quarter, down from 47.9 thousand in 1Q 2011 and 62.6 thousand in 4Q 2010.

The blended monthly average **churn rate** reached 1.72% in 2Q 2011 posting a 1.1 percentage point year-on-year decrease (-0.3 percentage point excluding the impact of inactive customers' disconnections in 2Q 2010) and a 0.3 percentage point decline compared to 1Q 2011. This is a result of improvement in prepaid churn (-0.6 percentage point year-on-year and -0.5 percentage points quarter-on-quarter) on the back of increased focus on higher quality customers' acquisition and success of the customer loyalty scheme activities awarding them for regular top-ups. Contract churn declined by 0.1 percentage points year-on-year as well as compared to 1Q 2011.

In terms of usage, total **mobile traffic**[6] carried by the customers in the Czech Republic reached 4,433 million minutes in 1H 2011, up by 1.0% year-on-year.

In 1H 2011, mobile **blended ARPU**[7] reached CZK 426.4, down 8.9% year-on-year (-10.2% year-on-year to CZK 428.7 in 2Q alone), impacted by MTR cuts. Excluding the impact of MTR cuts, total ARPU in 2Q 2011 would have declined 6.3% year-on-year. Voice ARPU dilution driven by persisting competition and slow recovery of customers' spend patterns were the key drivers for the majority of the decline. **Contract ARPU** reached CZK 586.9 and CZK 585.1 in 1H and 2Q 2011, down by 11.6% and 13.1% year-on-year respectively (-9.6% year-on-year in 2Q 2011 excluding the MTR cuts impact). **Prepaid ARPU** decreased by 8.6% and 9.2% year-on-year in 1H and 2Q 2011 reaching CZK 185.8 and CZK 190.1 in these periods (-4.3% year-on-year in 2Q 2011 excluding the MTR cuts impact). **Data ARPU** declined 1.9% and 2.5% year-on-year in 1H and 2Q 2011 reaching CZK 114.8 and CZK 114.5. Similarly to 1Q 2011, decrease in data roaming prices and continuous SMS/MMS bundling were the key drivers behind data ARPU dilution. Nevertheless, excluding these two items, data ARPU would improve 5.4% year-on-year with mobile broadband customer base uptake remaining the key driver for that improvement.

Total mobile **business revenues** in the Czech Republic declined by 9.7% to CZK 12,925 million in 1H 2011 and by 10.7% year-on-year reaching CZK 6,504 million in 2Q alone, while mobile service revenues went down by 10.4% and 11.5% year-on-year in these periods due to above mentioned competitive pressure, MTR cuts, slow recovery in spend and lower data roaming prices. Mobile termination rate cuts diluted mobile service revenues by 3.8 percentage points in 1H as well as in 2Q 2011. Despite a 1.0% year-on-year growth in mobile outbound voice traffic, traffic revenues decreased by 16.8% year-on-year to CZK 3,505 million in 1H 2011 (-18.5% year-on-year in 2Q), due to higher number of traffic bundling and competitive pressure. Interconnection revenues went down by 28.2% year-on-year to CZK 1,400 million in 1H 2011, largely impacted by MTR cuts and lower incoming traffic. Other revenues (including SMS & MMS, data and other business revues) declined in total by 2.7% year-on-year reaching CZK 3,517 million in 1H 2011 (-2.7% year-on-year in 2Q) largely due to lower data roaming prices and more SMS/MMS bundling. However, excluding SMS, MMS and data roaming, data revenues would report 5.6% year-on-year growth in 1H 2011, confirming positive impact of the growth in mobile broadband revenues contribution.

[6] Inbound and outbound, including roaming abroad, excluding inbound roaming

[7] Including inter segment revenues

CZ Fixed Business Overview[8]

In 2Q 2011, the fixed business continued to report solid commercial performance in broadband customer base and fixed accesses. Similarly to the previous quarters, revenues from traditional voice revenues recorded further decline, however the decline rate slightly decelerated in 2Q helped by better performance of transit revenues. Broadband revenues sustained the growth seen in the previous quarter, which is relevant in highly competitive fixed broadband environment. Additionally, financial performance in 2Q 2011 continued to be impacted by lower ICT revenues.

The total number of **fixed accesses** declined by 5.7% year-on-year reaching 1,611 thousand at the end of June 2011, with 58.4 thousand net losses in 1H 2011 (-6.2% year-on-year) helped by continuous solid uptake of naked accesses and VoIP lines for corporate customers.

The number of **xDSL accesses** reached 841 thousand at the end of 2Q 2011, up 11.1% year-on-year. In 1H 2011, their number increased by 34.7 thousand, posting a 11.3% year-on-year growth. As it was communicated already in 1Q, on 9th May 2011, Telefónica Czech Republic launched its VDSL based proposition, which offers the customers considerably higher speeds, thus enhancing their experience. By the end of June, already 41 thousand customers subscribed for the new service. The total number of **O_2 TV customers** reached 130 thousand at the end of 2Q 2011.

Voice traffic generated in the fixed network went down 13.8% in 1H 2011 to 795 million minutes as a result of continued fixed telephony lines losses and fixed to mobile substitution effect.

In 1H 2011, total fixed **business revenues** went down 7.9% year-on-year reaching CZK 11,300 million. However, in 2Q alone, the decline rate decelerated to 7.6% year-on-year (-8.3% year-on-year in 1Q 2011 and -11.6% year-on-year in 4Q 2010). Revenues from traditional accesses fell by 16.6% year-on-year in 1H as well as in 2Q 2011 reaching CZK 2,239 million in 1H 2011 due to continuous fixed telephony lines losses, while revenues from traditional voice revenues went down by 9.0% year-on-year to CZK 3,398 million in 1H 2011. However, in 2Q alone, they declined just by 7.6% year-on-year, helped by higher transit revenues in the quarter. Internet & broadband revenues increased in total by 0.8% year-on-year in 2Q and 1H 2011 to reach CZK 3,012 million in 1H 2011, positively impacted by xDSL customer growth, which is relevant in a highly competitive fixed broadband market. IT services and business solutions revenues decreased by 6.8% year-on-year reaching CZK 959 million in 1H 2011 (-7.3% year-on-year in 2Q 2011) due to lower number of projects realized in public sector.

Slovakia

In 2Q 2011, Telefónica Slovakia continued to report strong set of commercial and financial results, thus further strengthening its position on Slovak mobile market. By the end of June 2011 the total **number of active customers** increased by 41.5% year-on-year reaching 1,003 thousand on 30th June 2011. In 2Q 2011 alone, the total subscribers net additions reached 55.0 thousand, driven by contract customer base growth. The number of **contract customers** grew by as much as 59.1% year-on-year reaching 411 thousand, which represents 30.2 thousand net additions in the quarter, while the number of **prepaid active customers** increased by 31.4% year-on-year ending up at

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

592 thousand at the end 2Q 2011 (+24.8 thousand in the quarter). Consequently, the customer mix in Slovakia improved further and contract customers represented already significant 40.9% of total customer base, up 4.5 percentage point year-on-year. In terms of financial performance, **total revenues** of Telefónica Slovakia in local currency increased by 49.8% year-on-year reaching EUR 73.1 million in 1H 2011 (+46.7% year-on-year in the quarter to EUR 38.5 million, up from EUR 34.6 million in 1Q 2011), fuelled by the strong base growth and also year-on-year ARPU growth. In 2Q 2011, Telefónica Slovakia recorded positive **OIBDA** again reaching individual millions of EUR in the period. In 2Q 2011, **contract ARPU** reached EUR 18.2 (EUR 17.5 in 1Q), while **prepaid ARPU** improved 2.4% year-on-year reaching EUR 8.7 (EUR 8.3 in 1Q).

Attachment:

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

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About Telefónica Czech Republic

Telefónica Czech Republic is a major integrated operator in the Czech Republic. It is now operating almost seven 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 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 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.

About Telefónica

Telefónica is one of the world's largest telecommunications operators by market capitalisation. Its activities are centred mainly on the fixed and mobile telephony businesses, while its broadband business is the key growth driver underpinning both. It operates in 25 countries and has a global customer base of 260 million. Telefónica's growth strategy is focused on the markets in which it has a strong foothold: Spain, Europe and Latin America. Telefónica is a 100% private sector company with its shares listed in Madrid and other stock exchanges and more than 1.5 million individual shareholders.

INCOME STATEMENT	January – June 2011	January –June 2010
Business revenues	25,898	27,765
Other recurring revenues	39	124
Revenues	**25,937**	**27,889**
Internal expenses capitalized in fixed assets	317	310
Operating expenses	(15,867)	(16,552)
Other operating income/(expenses)	(135)	(422)
Gain on sale of fixed assets	28	(3)
Impairment of fixed assets	(5)	(13)
OIBDA	**10,275**	**11,209**
Depreciation and amortization	(5,792)	(5,733)
Operating Income	**4,483**	**5,476**
Net financial income (expense)	(36)	(122)
Income before tax	**4,447**	**5,355**
Income tax	(836)	(1,001)
Net Income	**3,611**	**4,354**

BALANCE SHEET	30.06.2011	31.12.2010
Non-current assets	**74,988**	**78,285**
- Intangible assets	7,437	7,989
- Goodwill	13,456	13,448
- Property, plant and equipment and investment property	53,901	56,651
- Long-term financial assets and other non-current assets	194	192
- Deferred tax assets	-	5
Current assets	**20,244**	**14,495**
- Inventories	592	606
- Trade and other receivables	7,920	8,626
- Current tax receivable	896	453
- Short-term financial investments	17	12
- Cash and cash equivalents	10,820	4,798
Non-current assets classified as held for sale	**4**	**12**
Total assets	**95,238**	**92,792**
Equity	**63,880**	**73,176**
Non-current Liabilities	**6,566**	**6,896**
- Long-term financial debt	2,801	2,883
- Deferred tax liabilities	3,615	3,936
- Long/Term Provisions	64	52
- Other long/term liabilities	86	25
Current Liabilities	**24,792**	**12,720**
- Short-term financial debt	310	141
- Trade and Other payables	9,150	9,978
- Current tax payable	-	-
- Short-term provisions and other liabilities	15,332	2,601
Liabilities assoc. with non-current assets classified as held for sale	**-**	**-**
Total Equity and Liabilities	**95,238**	**92,792**