

Press release

Telefónica O2 Czech Republic – January to March 2011 Financial Results

May 12, 2011

Telefónica O2 Czech Republic, a.s. announces its unaudited financial results for the first quarter of 2011. 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 focused areas despite continuous intense competition in the first quarter of 2011:
 - 36 thousand net additions of contract mobile customers, continued to be helped by mobile broadband customers growth.
 - ADSL accesses grew by 11.5% year-on-year to reach 829 thousand (23 thousand net additions in 1Q 2011, +29.2% year-on-year).
 - Fixed accesses' disconnections continued to decelerate with 30 thousand net losses in 1Q 2011 (-9.7% year-on-year).
- Consolidated business revenues went down 6.3% year-on-year in 1Q 2011 largely due to additional MTR cuts, prevailing competitive pressure, slow recovery of customers' spend patterns in mobile segment, while fixed business remained under pressure due to lower ICT revenues.
- Guided OIBDA¹ decreased by 4.1% year-on-year in 1Q 2011. Consequently, OIBDA margin improved by 0.9 percentage point reaching 41.3% in 1Q 2011 on the back of continuous OpEx efficiencies and positive OIBDA in Slovakia.
- Telefónica O2 Slovakia maintained its good commercial momentum seen already in the previous quarters reaching 948 thousand customers at the end of March 2011 (67.3 thousand net adds in 1Q 2011) and further improved its financial performance, reporting third consecutive positive quarterly OIBDA in 1Q 2011.
- 2011 full year guidance² confirmed for OIBDA and CapEx.

¹ OIBDA excludes brand fees and management fees (CZK 210 million in 1Q 2010 and CZK 249 million in 1Q 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 results for the first quarter of 2011 clearly reflect challenging operating conditions seen already last year. We continue to face intense competitive pressures in our business, while regulatory measures and slow recovery of spend patterns impact largely our mobile revenues. Nevertheless, our value proposition helped us to maintain solid commercial momentum in mobile contract, fixed and mobile broadband areas. In Slovakia, we again outperformed the market growth and further improved financial performance. Our continuous efficiency agenda and a positive OIBDA in Slovakia resulted in very healthy margin reaching above 41%," says Jesús Pérez de Uríguen, 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 6.3% year-on-year to CZK 12,866 million in 1Q 2011. The financial performance of the Group was impacted by additional MTR cuts, continuous competitive pressure largely in mobile segment, still slow recovery of customers' spend in all segments and lower ICT revenues. Fixed business revenues in the Czech Republic declined by 8.3% year-on-year (better than in 4Q 2010: -11.6%) reaching CZK 5,643 million in 1Q 2011. At the same time, mobile revenues in the Czech Republic declined by 8.6% to CZK 6,422 million (-5.0% year-on-year excluding the impact of MTR cuts). Moreover, revenues in Slovakia continued to grow steady and recorded a 53.5% year-on-year increase reaching EUR 34.6 million in 1Q 2011.

In 1Q 2011, 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. Despite increased commercial activities largely in mobile broadband area, consolidated **operating costs** decreased by 4.9% year-on-year reaching CZK 7,835 million in 1Q 2011. It is worth highlighting a 10.3% year-on-year reduction in personnel expenses in 1Q 2011 confirming a positive impact of restructuring program realized in the last year. Also in 2011, the Company will continue in optimization of its headcount delivering further efficiencies in this area. In relation with the restructuring program, it booked a restructuring provision reaching CZK 158 million in 1Q 2011, lower compared to the one booked in 1Q 2010 (CZK 381 million).

Group **Operating income before depreciation and amortization (OIBDA)** reached CZK 5,070 million in 1Q 2011, -5.2% year-on-year, which is less than revenues decline. **OIBDA margin** improved by 0.5 percentage point year-on-year reaching 39.4% in 1Q 2011. Similarly to 3Q and 4Q 2010, Telefónica O2 Slovakia recorded a positive OIBDA in 1Q 2011, reaching individual millions of EUR in the period. At the same time, **guided OIBDA**³ decreased by 4.1% year-on-year (within guidance range of -1% to -5%) to reach CZK 5,330 million in 1Q 2011, while margin improved by close to 1 percentage point reaching 41.3%, on the back of already mentioned focus on cost efficiency and improvement in Slovakia.

As a result of impairment reversal booked in 3Q 2010, the gross value of non-current assets increased, leading to a 4.2% year-on-year growth in depreciation and amortization charges in 1Q

³ In terms of 2011 guidance calculation, OIBDA excludes brand fees and management fees (CZK 210 million in 1Q 2010 and CZK 249 million in 1Q 2011), assuming constant FX rates of 2010.

2011. Consolidated **net income** amounted to CZK 1,740 million in 1Q 2011, down by 13.5% year-on-year, as a result of the decline in OIBDA and higher depreciation and amortization.

Consolidated **CapEx** reached CZK 1,128 million in 1Q 2011, up by 3.9% year-on-year. In line with its strategy to focus its investments into growth areas, the Company continued to direct investments into the capacity expansion and quality improvement of its 3G network. As already communicated at the beginning of the year, the Company signed a network share agreement with T-Mobile. This arrangement will focus on rollout of 3G coverage to currently unserved areas to offer more customers access to data services, while improving network investment efficiency. Moreover, in 1Q 2011, the investments into the upgrade of the fixed broadband network were accelerated, launching new VDSL based customer proposition on 9th May 2011, with the aim to strengthen Company's position on highly competitive fixed broadband market in the Czech Republic. The new technology will offer the customers considerably higher speeds and will be available to about one half of Czech households, i.e. about two million households. In addition, the Group recorded higher year-on-year CapEx in Slovakia due to additional network investment related to the planned launch of 3G based services at the end of second quarter.

Group **free cash flows** decreased slightly by 1.9 year-on-year reaching CZK 2,819 million in 1Q 2011, as a combination of 3.0% growth in cash flow from operation, lower income tax payments not fully compensating higher CapEx related cash payments.

The consolidated **financial debt** amounted to CZK 3,067 million at 31 March 2011 resulting into 1.4% growth compared to the end of 2010. **Cash and cash equivalents** reached CZK 7,644 million, up from CZK 4,798 million at the end of 2010, resulting from continuous strong cash flow generated by the Group.

CZ Mobile Business Overview⁴

In 1Q 2011, despite intense competitive pressure, mobile business continued to deliver solid commercial performance in mobile contract segment supported by customers' demand for mobile broadband proposition. The financial performance continued to be negatively impacted by MTR cuts (-30.1% year-on-year⁵), tough competition and slow recovery of customers' spend patterns.

Total **mobile customer base** reached 4,827 thousand at the end of March 2011, a 2.5% year-on-year decrease, due to further decline in prepaid customer base and impacted also by the disconnection of 111 thousand inactive contract customers in 2Q 2010. Excluding this, the customer base would have decreased slightly by 0.3% year-on-year. Net disconnections in the quarter stood at 12 thousand, improving quarter on quarter. The number of **contract customers** went up 1.5% year-on-year reaching 2,899 thousand at the end of 1Q 2011 (+5.3% year-on-year excluding the impact of inactive customers' disconnections in 2010) with 35.9 thousand net adds in the quarter. This performance was driven by customers migrating from the prepaid to the contract segment and positive contribution of mobile broadband customers' growth. At the end of March 2011, contract customers accounted already for 60.1% of the base (+2.4 percentage points

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

year-on-year). The number of **prepaid active customers** reached 1,927 thousand at the end of 1Q 2011, down by 8.0% year-on-year, with 47.9 thousand net losses in the quarter (improvement compared to 62.6 thousand in 4Q 2010).

The blended monthly average **churn rate** reached 1.99% in 1Q 2011 posting a 0.2 percentage point year-on-year decrease largely due to improvement in prepaid churn as a result of increased focus on higher quality customers' acquisition and success of loyalty activities awarding customers for regular top-ups.

In terms of usage, growth in **mobile traffic**⁶ carried by the customers in the Czech Republic slowed down in 1Q 2011 reaching 2,159 million, up by 1.5% year-on-year.

In 1Q 2011, mobile **blended ARPU**⁷ reached CZK 424.5, down 7.6% year-on-year, impacted by MTR cuts. Excluding the impact of MTR cuts, total ARPU would have declined 3.8% year-on-year. Voice erosion driven by persisting competition and slow recovery of customers' spend patterns was the key driver for the majority of the decline. **Contract ARPU** reached CZK 588.8 in 1Q 2011, down by 10.1% year-on-year (-6.6% year-on-year excluding the MTR cuts impact). **Prepaid ARPU** decreased by 7.8% year-on-year reaching CZK 181.9 in 1Q 2011 (-2.7% year-on-year excluding the MTR cuts impact). For **data ARPU**, it declined 1.3% year-on-year reaching CZK 115.2 in 1Q 2011, due to a decrease in data roaming prices and more SMS/MMS bundling. Nevertheless, excluding these two items, data ARPU would improve 5.8% year-on-year with growing mobile broadband customer base remaining the key driver for that improvement.

Total mobile **business revenues** in the Czech Republic declined by 8.6% to CZK 6,422 million in 1Q 2011, while mobile service revenues went down by 9.3% year-on-year due to above mentioned MTR cuts, competitive pressure, slow recovery in spend and lower data roaming prices. Mobile termination rate cuts diluted mobile service revenues by 3.8 percentage points in 1Q 2011. Despite a 1.5% year-on-year growth in mobile outbound voice traffic, traffic revenues decreased by 15.0% year-on-year to CZK 1,733 million in 1Q 2011, due to higher number of traffic bundling and competitive pressure. Interconnection revenues went down by 27.1% year-on-year to CZK 683 million, largely impacted by MTR cuts and lower incoming traffic. Other revenues (including SMS & MMS, data and other business revenues) declined in total by 2.6% year-on-year reaching CZK 1,753 million in 1Q 2011 largely due to lower data roaming prices and more SMS/MMS bundling. However, excluding SMS, MMS and data roaming, data revenues would report 5% year-on-year growth.

CZ Fixed Business Overview⁸

In 1Q 2011, the fixed business continued to maintain solid commercial performance in broadband customer base and fixed accesses. Similarly to the previous quarters, revenues from traditional

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

⁷ Including inter segment revenues

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

voice revenues recorded further decline, which has not been fully offset by broadband revenues growth. Additionally, financial performance in 1Q 2011 was impacted by lower ICT revenues.

The total number of **fixed accesses** declined by 5.7% year-on-year reaching 1,639 thousand at the end of March 2011, with 29.9 thousand net losses in the quarter (-9.7% year-on-year) helped by continuous solid uptake of naked accesses and VoIP lines for corporate customers.

The number of **ADSL accesses** reached 829 thousand at the end of 1Q 2011, up 11.5% year-on-year with 22.7 thousand net additions in the quarter, which is by 29.2% more than in the same period of 2010. The total number of **O₂ TV customers** reached 129 thousand at the end of March 2011.

Voice traffic generated in the fixed network went down 13.6% in 1Q 2011 to 414 million minutes as a result of continued fixed telephony lines losses and fixed to mobile substitution effect.

In 1Q 2011, total fixed **business revenues** went down 8.3% year-on-year (improvement compared to -11.6% in 4Q 2010) to CZK 5,643 million. Revenues from traditional accesses fell by 16.6% year-on-year reaching CZK 1,148 million due to continuous fixed telephony lines losses, while Internet & broadband revenues increased in total by 0.8% year-on-year to CZK 1,496 million, positively impacted by ADSL customer growth, which is relevant in a highly competitive fixed broadband market. IT services and business solutions revenues decreased by 6.3% year-on-year reaching CZK 465 million due to lower number of projects realized in public office sector as mentioned already in 2H 2011, while being fuelled solidly by revenues from an e-Government project (Data boxes).

Slovakia

In 1Q 2011, Telefónica O2 Slovakia continued to deliver strong set of commercial and financial results. The total **number of active customers** increased by 46.8% year-on-year reaching 948 thousand at the end of March 2011. In 1Q 2011, the total subscribers net adds reached 67.3 thousand, driven by contract customer base growth. The number of **contract customers** grew by 67.1% year-on-year reaching 380 thousand (+45.8 thousand in the quarter, 43.4% up year-on-year), while the number of **prepaid active customers** increased by 35.7% year-on-year ending up at 567 thousand at the end 1Q 2011. Consequently, the customer mix in Slovakia improved further and contract customers represented 40.1% of total customer base, up 4.9 percentage points year-on-year. In terms of financial performance, **total revenues** of Telefónica O2 Slovakia in local currency increased by 53.5% year-on-year reaching EUR 34.6 million in 1Q 2011, fuelled by the strong base growth and also year-on-year ARPU growth. In 1Q 2011, Telefónica O2 Slovakia reported third consecutive positive **OIBDA** reaching individual millions of EUR in the period. **Contract ARPU** reached EUR 17.5, while **prepaid ARPU** improved 2.8% year-on-year reaching EUR 8.3 in 1Q 2011.

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 almost six and half 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, 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 55.3 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 287 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	Jan – March 2011	Jan – March 2010
Business revenues	12,866	13,727
Other recurring revenues	23	102
Revenues	12,889	13,829
Internal expenses capitalized in fixed assets	163	155
Operating expenses	(7,835)	(8,239)
Other operating income/(expenses)	(154)	(377)
Gain on sale of fixed assets	8	(13)
Impairment of fixed assets	(2)	(10)
OIBDA	5,070	5,346
Depreciation and amortization	(2,874)	(2,759)
Operating Income	2,195	2,587
Net financial income (expense)	(27)	(65)
Income before tax	2,168	2,522
Income tax	(428)	(510)
Net Income	1,740	2,012
BALANCE SHEET	31.03.2011	31.12.2010
Non-current assets	76,487	78,285
- Intangible assets	7,682	7,989
- Goodwill	13,448	13,448
- Property, plant and equipment and investment property	55,173	56,651
- Long-term financial assets and other non-current assets	184	192
- Deferred tax assets	-	5
Current assets	17,165	14,495
- Inventories	680	606
- Trade and other receivables	8,188	8,626
- Current tax receivable	640	453
- Short-term financial investments	13	12
- Cash and cash equivalents	7,644	4,798
Non-current assets classified as held for sale	12	12
Total assets	93,664	92,792
Equity	74,891	73,176
Non-current Liabilities	6,658	6,896
- Long-term financial debt	2,823	2,883
- Deferred tax liabilities	3,748	3,936
- Long/Term Provisions	61	52
- Other long/term liabilities	26	25
Current Liabilities	12,115	12,720
- Short-term financial debt	244	141
- Trade and Other payables	9,545	9,978
- Current tax payable	-	-
- Short-term provisions and other liabilities	2,326	2,601
Liabilities assoc. with non-current assets classified as held for sale	-	-
Total Equity and Liabilities	93,664	92,792