

Telefónica Czech Republic – January to June 2012 Financial Results

July 25, 2012

Telefónica Czech Republic, a.s. announces its unaudited financial results for January to June 2012. These results are consolidated and prepared according to International Financial Reporting Standards and fully include the results of Telefónica Slovakia, Telefónica O2 Business Solutions, Internethome and other smaller operating companies.

Operational Highlights

- **Strong commercial momentum** in focused areas **sustained** despite continued intense competition:
 - **Strong contract mobile customers' growth: +5.3% year-on-year**, with 36.8 thousand net additions in Q2 2012 (up from 27.5 thousand in Q1), driven by continued **sound trading** and **declining churn**.
 - **Smartphone penetration growing to 23%** (+1.6 p.p. q-o-q, +7.3 p.p. y-o-y)
 - **xDSL accesses grew by 6.3% year-on-year reaching 894 thousand**, with VDSL (already 23% of total FBB base) helping to prevent fixed BB ARPU dilution and improve churn.
 - **Decline in fixed accesses continued to decelerate: accesses down 4.4% year-on-year**, with 15.6 thousand net losses in Q2 2012 (45.2% deceleration year-on-year).
- **Consolidated business revenues** went **down 2.4% year-on-year** reaching CZK 12,715 million in Q2 2012 (-2.8% to CZK 25,165 million in H1), **showing improvement for the 4th consecutive quarter** on the back of **sustained better mobile service revenue performance** and **increasing positive contribution of revenue from Slovakia**.
- **Guided OIBDA¹ margin reaching healthy 40.5% in Q2 and H1 2012**, on the back of **continuous efficiency agenda in CZ, growing OIBDA in SK and investments in future growth**. Reported OIBDA reached CZK 9,682 million and CZK 4,907 million in H1 and Q2 2012, -5.8% year-on-year in H1.
- **Telefónica Slovakia** maintained its **strong commercial momentum** reporting 24.7% year-on-year subscribers' growth (+33.4 thousand in Q2) and further **improving its financial performance**.
- **2012 full year guidance reiterated for all metrics²**.

¹ OIBDA before brand fees & management fees (CZK 551 million in H1 2011 and CZK 513 million H1 2012) Over Business revenues; 2012 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2011

² Business Revenues: improving trends compared to 2011 (2011 base: -5.7% year-on-year), OIBDA margin: limited margin erosion year-on-year (2011 base: 43.7%), CapEx: up to CZK 6.2 billion (excluding business acquisitions).

"I am pleased with steady improving trends seen in our commercial and financial performance in the second quarter. We sustained solid customers' growth in key areas, which is a relevant achievement in highly competitive market environment. Positive results of our customer care and retention initiatives led to further enhancement in contract base churn. Our VDSL proposition continues to attract more customers, which helps us to better manage fixed broadband ARPU and improve churn. Our new smart mobile tariffs which include internet in handset service in every package, responded to the increasing demand from customers for mobile internet, positively impacting respective revenues. In Slovakia, we sustained strong commercial momentum and improved financial performance." 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. "We continued to see stabilisation of spend in the mobile Residential segment. In addition, decelerating spend dilution in Corporate segment helped by value management initiatives and our O₂ Exclusive proposition resulted in a lower decline in our mobile revenues. Consequently, our consolidated business revenues reported improvement for the third consecutive quarter. Our margin reached solid 40.5% driven by permanent focus on operational efficiency and growing profitability in Slovakia", he adds.

Consolidated Financial Statements

Consolidated **business revenues** went down by 2.8% year-on-year to CZK 25,165 million in H1 2012, while in Q2 the decline rate slowed down further to -2.4% reporting total business revenues of CZK 12,715 million in the quarter. Thus, the Company reported the 4th consecutive quarter of improving revenues trend (-5.4% year-on-year in Q3 2011, -4.0% year-on-year in Q4 2011 and -3.2% year-on-year in Q1 2012). This improvement continues to come a result of stabilisation in mobile residential spend, better performance in mobile data revenues and continuing sound revenue growth in Slovakia. At the same time, revenues continued to be impacted by prevailing competitive pressure largely in Corporate and SMB mobile segments and lower MTR year-on-year. Fixed business revenues in the Czech Republic declined by 6.3% year-on-year reaching CZK 10,584 million in H1 2012, while in Q2 they went down 6.5% year-on-year to CZK 5,292 million. Mobile revenues in the Czech Republic continued to improve, confirming positive trends seen in the second half of 2011 and Q1 2012. In Q2 2012, they declined by 4.0% year-on-year to CZK 6,244 million, while in H1 2012 they went down 4.5% year-on-year reaching CZK 12,345 million. Excluding the impact of MTR cuts, the decline rate would have been -1.8% year-on-year in Q2 2012, the best quarterly performance since Q4 2010, due to already mentioned better spend in the Residential segment and mobile data revenue growth. At the same time, revenues in Slovakia continued with solid growth and recorded a 26.9% year-on-year increase reaching EUR 92.8 million in H1 2012 with a 26.8% year-on-year growth to EUR 48.9 million in Q2 (+35.9% and +37.1% year-on-year in H1 and Q2 2012, excluding MTR impact).

In H1 2012, the Company has continued in its effort to deliver efficiencies in all areas of its operations via further transformation of its organisation. As a result of the restructuring program, the Company booked restructuring costs of CZK 223 million in H1 2012 (CZK 54 million in Q2 2012) in comparison with CZK 158 million in H1 2011. In Q2 2012, the total Group headcount has been further optimised with a reduction of 335. Consequently, headcount reached 6,376 at the end of June 2012, representing a 13.0% year-on-year reduction. In addition, restructuring programs executed in 2011 and H1 2012 had a positive impact on personnel expenses, which went down by 9.2% year-on-year in H1 2012 (-9.4% in Q2). Despite the above mentioned efficiencies in non-commercial areas, total consolidated **operating costs** increased slightly by 0.4% year-on-year reaching CZK 15,925 million in H1 2012 (however declining by 0.3% year-on-year in Q2) largely due to increased commercial investments to secure future growth, different phasing of ICT projects and higher network & IT costs.

Guided Operating income before depreciation and amortization (OIBDA)³ decreased by 5.8% year-on-year, reaching CZK 5,146 million in Q2 2012, while in H1 it amounted to CZK 10,195 million. At the same time **guided OIBDA margin** reported marginal 1.3 p.p. decline year-on-year, reaching a solid 40.5% in H1 and Q2 2012, on the back of already mentioned focus on cost efficiency, improving profitability in Slovakia and helped by sale of non-core business in Q1 (80% stake in subsidiary Informační linky, a.s.), not fully compensating higher commercial costs for investments in future growth. **Reported OIBDA** reached CZK 4,907 million in Q2 2012 and CZK 9,682 million in H1, -5.7% and -5.8% year-on-year respectively.

³ In terms of the 2012 guidance calculation, OIBDA excludes brand fees and management fees (CZK 551 million in H1 2011 and CZK 513 million H1 2012), 2012 guidance excludes changes in consolidation, includes potential capital gains from sales of non-core asset, assuming constant FX rates of 2011.

Depreciation and amortization charges went down 1.8% year-on-year in H1 2012 (-3.4% in Q2). Consolidated **net income** amounted to CZK 3,254 million and CZK 1,632 million in H1 and Q2 2012, down by 9.9% year-on-year in H1, largely due to the decline in OIBDA, which was not fully offset by lower income tax expenses.

Consolidated **CapEx** (excluding business acquisitions) reached CZK 2,173 million in H1 2012, down by 9.7% year-on-year. The Company continued to direct investments into further capacity expansion and improvement of the quality of its 3G network, including backhaul. In addition, CapEx was spent on further expansion of 3G network coverage, including coverage of currently unserved areas on the basis of the network sharing contract with T-Mobile. At the end of June 2012, the Company's 3G network covered more than 76% of the population. Additionally, the Company focused its investments into upgrading its fixed broadband networks including selective fibre investments aiming at strengthening its position in the highly competitive fixed broadband market in the Czech Republic and improving customer experience. In Slovakia, CapEx was largely spent on additional 3G network expansion, where it targets 50% population coverage by October 2012.

Group free cash flows decreased by 28.5% year-on-year reaching CZK 4,308 million in H1 2012, as a combination of 20.3% decline in cash from operating activities, due to a decrease in OIBDA and different phasing in working capital cash movements, and a 5.8% decrease in cash used in investing activities, largely driven by proceeds on disposal of 80% of shares of its subsidiary Informační linky, a.s. in Q1 2012.

The consolidated **financial debt** amounted to CZK 3,146 million at 30 June 2012, broadly in line with the end of 2011. At the same time, **cash and cash equivalents** reached CZK 10,886 million.

CZ Mobile Business Overview⁴

In Q2 2012, the dynamics of the mobile business continued to improve on the back of sustained sound commercial momentum, stabilisation in residential spend and better data performance, while tough competition in SMB and Corporate segments continued to dilute revenue performance. Nevertheless, the spend dilution in these two segments continues to decelerate helped by value management initiatives and the O₂ Exclusive proposition. In addition, MTR cuts (-21.2% year-on-year⁵) impacted mobile revenues during this period. In the commercial area, the Company maintained solid subscribers' growth in the contract segment and further improving churn, despite intense competitive pressure. In June, it launched new structure of its mobile tariffs (O₂ Smart NEON) which bundles voice, unlimited on-net SMS and Internet in handset services in one package. The new proposition reflects increasing demand for mobile internet and is aimed at protection of the revenues and customer base. In the mobile internet area, the Company continued in its support of smartphone sales via best price guarantee proposition for bestselling smartphones. As a result, smartphone sales represented 65% of total handset sales in Q2 2012

⁴ Figures are shown net of inter-segment charges between fixed and mobile businesses

⁵ From CZK 1.37 to CZK 1.08 in July 2011

and smartphone penetration grew further reaching 23% at the end of June 2012, up by 1.6 percentage points quarter-on-quarter.

The total **mobile customer base** reached 4,968 thousand at the end of June 2012, a 2.0% year-on-year increase. This performance has been driven by **contract customers**, whose number went up 5.3% year-on-year reaching 3,114 thousand with 36.8 thousand net additions during the quarter (compared to +27.5 thousand in Q1). This growth continued to be supported by customers migrating from the prepaid to the contract segment, strong customers' increase in Corporate segment, increasing smartphone penetration and enhanced churn. At the end of June 2012, contract customers accounted already for 62.7% of the base (+2.0 percentage points year-on-year), the highest figure ever. The number of **prepaid customers** reached 1,854 thousand at the end of March 2012, down by 3.0% year-on-year, with decelerated net losses of 7.2 thousand in Q2, compared to -31.1 thousand in Q1).

The blended monthly average **churn rate** reached 1.74% in Q2 2012. This is a result of continuous improvement in contract churn, which reached 0.87% in Q2 2012, down 0.2 percentage points year-on-year. Prepaid churn stood at 3.19% in Q2 2012.

In terms of usage, total **mobile traffic**⁶ carried by customers in the Czech Republic reached 4,723 million minutes in H1 2012, up by 6.6% year-on-year, supported by a successful contract proposition.

In H1 2012, mobile **blended ARPU**⁷ was CZK 396.5, down by 7.0% year-on-year, while in Q2 it went down 6.8% year-on-year, the lowest year-on-year decline since Q4 2010, reaching CZK 399.5. ARPU continued to be impacted by MTR cuts and competition. Excluding the impact of MTR cuts, total ARPU would have declined by 4.9% year-on-year in H1 2012 and by 4.6% year-on-year in Q2. Continuous voice ARPU dilution driven by persisting competitive pressures remains the key driver for the majority of the decline. **Contract ARPU** reached CZK 530.3 in H1 2012, down by 9.6% year-on-year and CZK 530.4 in Q2, down 9.4% year-on-year (-7.7% year-on-year and -7.3% year-on-year in H1 and Q2 2012 excluding the impact from MTR cuts). **Prepaid ARPU** decreased by 5.2% year-on-year and 4.6% year-on-year in H1 and Q2 2012 reaching CZK 176.1 and CZK 181.4 respectively. **Data ARPU** declined by 2.6% year-on-year reaching CZK 111.8 in H1 2012 (-2.0% year-on-year to CZK 112.3 in Q2) largely due to mobile internet bundling with voice tariffs and continuous SMS/MMS bundling in monthly fees. However pure data ARPU⁸ improved 8.1% year-on-year in Q2 better compared to +3.3% year-on-year in Q1.

Total **mobile business revenues** in the Czech Republic declined by 4.5% year-on-year to CZK 12,345 million in H1 2012, with a lower rate of decline in Q2 (-4.0% year-on-year to CZK 6,246 million). At the same time mobile service revenues went down by 4.8% and 4.7% year-on-year in H1 and Q2 2012 respectively. Already mentioned competitive pressures leading to lower spend in SMB and Corporate segments, and MTR cuts continued to be the key drivers for the decline. Excluding the impact of mobile termination rate cuts, mobile service revenues would decline by

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

⁷ Including inter segment revenues

⁸ Big screens, small screens, M2M, time/usage based, push email, data roaming

2.5% year-on-year in Q2 2012, compared to -2.8% in Q1 2012, -4.5% in Q4 2011 and -5.8% in Q3 2011. Despite fierce competitive pressures, continued growth in the contract customer base and better spend dynamics helped to reach 1.5% year-on-year growth in revenues from monthly fees, reaching CZK 4,070 million in H1 2012. Stabilisation in residential spend dynamics and lower spend dilution in SMB and Corporate segments are reflected in a lower decline in traffic revenues, which decreased by 11.8% year-on-year in H1 2012 to CZK 3,092 million, while it declined by 10.3% year-on-year in Q2 2012. Interconnection revenues went down by 17.2% year-on-year in H1 2012, largely impacted by MTR cuts not fully compensated by higher incoming traffic. Other revenues (including SMS & MMS, data and other business revenues) reached in total CZK 3,510 million and CZK 1,763 million in H1 and Q2 2012 and were broadly flat compared to the same periods in the previous year with more SMS/MMS bundling putting pressure on them, while revenues from mobile internet remain the key growth driver and accelerated its growth (non-SMS data revenues: +10.5% year-on-year in Q2, up from +5.8% year-on-year in Q1).

CZ Fixed Business Overview⁹

In Q2 2012, the Company successfully continued addressing the demand for fixed broadband services which led to solid commercial performance of the broadband customer base and a continuing deceleration in fixed access losses. At the same time, revenues showed similar year-on-year dynamics like in Q1 helped by modest improvement in traditional voice revenues and better ICT revenue performance. Continuous migration of existing ADSL customers to the VDSL service helped the company to manage fixed broadband ARPU dilution and improve churn, which is relevant in a highly competitive and slowing fixed broadband market environment.

The total number of **fixed accesses** declined by 4.4% year-on-year reaching 1,539 thousand at the end of June 2012, with 15.6 thousand net losses during the quarter. This represents a 45.2% reduction compared to Q2 2011 and is largely a result of lower traditional telephony line losses (-35.8 thousand in Q2 2012, -22.3% year-on-year) and solid 32.9% year-on-year growth of naked accesses.

The number of **xDSL accesses** reached 894 thousand at the end of June 2012, up 6.3% year-on-year. In respect of VDSL, 207 thousand customers have already subscribed for the upgraded service, which represents 26% of the total xDSL residential base and close to 55% of the total addressable existing base (~ 50% of households). In Q2 2012, the number of VDSL customers grew by 45.6 thousand. The total number of **O2 TV customers** reached 139 thousand at the end of Q2 2012, +7.3% year-on-year, a relevant achievement in stagnant Pay TV market in the Czech Republic.

Voice traffic generated in the fixed network went down by 12.8% year-on-year in H1 2012 to 693 million minutes, still impacted by fixed telephony line losses and the fixed to mobile substitution effect.

In H1 2012, total **fixed business revenues** went down by 6.3% year-on-year reaching CZK 10,584 million, while in Q2 they reached CZK 5,292 million, - 6.5% year-on-year. Revenues

⁹ Figures are shown net of inter-segment charges between fixed and mobile businesses

from traditional accesses fell by 15.5% year-on-year reaching CZK 1,829 million in H1 2012 due to continuing fixed telephony line losses, while revenues from traditional voice revenues went down by 7.0% year-on-year to CZK 3,159 million, largely due to lower revenues from communication traffic (in line with lower voice traffic). Internet & broadband revenues increased in total by 0.5% year-on-year reaching CZK 3,027 million in H1 2012, as a result of xDSL customer growth, migration of higher value customers to VDSL and ARPU pressures. IT services and business solutions revenues went up 2.6% year-on-year reaching CZK 984 million in H1 2012, while in Q2 they improved by 4.3% year-on-year. The Company continues with penetration of standard and recurring ICT services for business customers (Managed Services/Cloud/Security /Virtual Desktop) to mitigate dependence on one-off projects, which shall help it to generate sustainable revenues.

Slovakia

Telefónica Slovakia delivered another strong set of commercial and financial results in Q2, which resulted in the further strengthening of its position in the Slovak mobile market. At the same time its results continue to increase their contribution to the Group's financial performance. At the end of June 2012, the total **number of customers** reached 1,250 thousand, posting 24.7% year-on-year growth. In Q2 2012, their number increased by 33.4 thousand driven largely by strong performance in the contract base supported by the successful launch of the new tariff O₂ Paušál targeting higher value customers. The number of **contract customers** grew by 40.0% year-on-year reaching 575 thousand at the end of June 2012 (+35.8 thousand in Q2, 18.6% more compared to Q2 2011), while the number of **prepaid customers** increased by 14.1% year-on-year ending up at 676 thousand. Consequently, the customer mix in Slovakia further improved and contract customers represented an already significant 46.0% of the total customer base, up 5.0 percentage points year-on-year. In terms of financial performance, the **total revenues** of Telefónica Slovakia in local currency increased by 26.9% year-on-year reaching EUR 92.8 million in H1 2012 (+26.8% year-on-year in Q2). Excluding the impact of MTR cuts, the growth rates would be 35.9% and 37.1% in H1 and Q2 2012 respectively, fuelled by customer growth, improving customer mix and the company's focus on acquiring higher value customers. Thus revenues in Slovakia represented nearly 10% of total Group revenues in H1 2012. In H1 2012, OIBDA for Telefónica Slovakia went up 89.8% year-on-year with further growth in Q2 (+21.1% quarter-on-quarter and +78.1% year-on-year), thus helping to support the Group's profitability. In Q2 2012, **contract ARPU** reached EUR 17.1, while **prepaid ARPU** was at EUR 8.6.

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 eight 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

Telefónica is one of the largest telecommunications companies in the world in terms of market capitalisation and number of customers. From this outstanding position in the industry, and with its mobile, fixed and broadband businesses as the key drivers of its growth, Telefonica has focused its strategy on becoming a leading company in the digital world. The company has a significant presence in 25 countries and a customer base that amounts more than 300 million accesses around the world. Telefonica has a strong presence in Spain, Europe and Latin America, where the company focuses an important part of its growth strategy. Telefonica is a 100% listed company, with more than 1.5 million direct shareholders.

INCOME STATEMENT	Jan – Jun 2012	Jan – Jun 2011
Business revenues	25,165	25,898
Other recurring revenues	53	39
Revenues	25,218	25,937
Internal expenses capitalized in fixed assets	331	317
Operating expenses	(15,925)	(15,867)
Other operating income/(expenses)	(163)	(135)
Gain on sale of fixed assets	238	28
Impairment reversal/(loss)	(18)	(5)
OIBDA	9,681	10,275
Depreciation and amortization	(5,688)	(5,792)
Operating Income	3,993	4,483
Net financial income (expense)	(107)	(36)
Income before tax	3,886	4,447
Income tax	(632)	(836)
Net Income	3,254	3,611
BALANCE SHEET	30.06.2012	31.12.2011
Non-current assets	69,474	73,100
- Intangible assets	6,508	7,205
- Goodwill	13,462	13,453
- Property, plant and equipment and investment property	48,713	51,525
- Long-term financial assets and other non-current assets	125	171
- Deferred tax assets	666	746
Current assets	19,032	15,881
- Inventories	495	488
- Trade and other receivables	7,569	8,166
- Current tax receivable	39	165
- Short-term financial investments	43	106
- Cash and cash equivalents	10,886	6,956
Non-current assets classified as held for sale	-	1
Total assets	88,506	88,982
Equity	63,255	69,097
Non-current Liabilities	3,423	3,870
- Long-term financial debt	-	-
- Deferred tax liabilities	3,321	3,737
- Long/Term Provisions	28	26
- Other long/term liabilities	74	107
Current Liabilities	21,828	16,015
- Short-term financial debt	3,146	3,061
- Trade and Other payables	7,949	10,495
- Current income tax payable	4	5
- Short-term provisions and other liabilities	10,728	2,454
Liabilities assoc. with non-current assets classified as held for sale	-	-
Total Equity and Liabilities	88,506	88,982