Interim report

Telefónica Czech Republic – January to March 2013 Financial Results

May 7, 2013

Telefónica Czech Republic, a. s. announces its unaudited financial results for January to March 2013. These results are consolidated and prepared according to International Financial Reporting Standards and fully include the results of Telefónica Slovakia and other smaller operating companies.

Operational Highlights

- **Continuous solid customer' growth in key areas**:
  - **Healthy total mobile customers' growth: +2.2% year-on-year to 5.0 million**, with significant 79 thousand net additions[1] in Q1 2013 (vs. negative in Q1 2012). Continued **strong contract trading** (43 thousand net adds in the quarter[1]) and **low churn** remained the drivers of the growth. **Prepaid base reported positive growth** (+36 thousand in Q1 2013).
  - **Smartphone penetration growing to 29%**, up 7.5 percentage points year-on-year.
  - **xDSL accesses grew by 4.3% year-on-year reaching 921 thousand**, with VDSL (already over 72% of total accessible base in residential segment) continues helping to manage fixed BB ARPU dilution and maintain churn.
  - **Fixed accesses disconnections in line with previous quarters: accesses down 5.6% year-on year**
- **Consolidated operating revenues** went **down by 4.4% year-on-year** reaching CZK 11,902 million in Q1 2013 (-2.3% year-on-year excluding impact of MTR cuts).
- **Guided OIBDA** (excluding brand fees and management fees) reached CZK 4,346 million in the quarter, **impacted** by **restructuring costs**. **OIBDA in comparable terms[2] went down 6.0% year-on-year**, while **comparable OIBDA margin[3]** reached solid **39.5%** on the back of **continuous efficiency agenda** (Group OpEx: -3.9% year-n-year in the quarter) and **growing profitability in Slovakia**. OIBDA including brand fees and management fees reached CZK 4,098 million in the quarter.
- **Consolidated free cash flow growing 6.4% year-on-year.**
- **Telefónica Slovakia** maintained its **strong commercial momentum** reporting 14.9% year-on-year subscribers' growth (+44 thousand in Q1).
- **2013 full year guidance[4] reiterated.**

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[1] Excluding the negative impact of disconnection of 114 thousand mobile contract customers in Q1 2013
[2] OIBDA before brand fees and management fees, excluding CZK 220 million gain from sale of 80% stake in Informační linky, a.s. in Q1 2012 and restructuring cost (CZK 169 million in Q1 2012, CZK 354 million in Q1 2013)
[3] Comparable OIBDA/Operating revenues
[4] OIBDA margin: limited margin erosion year-on-year (2012 base: 41.4%), CapEx: less than CZK 6 billion (excluding business acquisitions and excluding investments for spectrum license)

Telefónica Czech Republic, a.s.
Za Brumlovkou 266/2
Praha 4
140 22
T +420 271 462 076
http://www.telefonica.cz/en/investor-relations/
investor.relations@o2.com

Consolidated Financial Statements

In Q1 2013, consolidated **operating revenues** went down by 4.4% year-on-year to CZK 11,902 million. Excluding the MTR cut impact they would decline 2.3% year-on-year, lower decline compared to Q4 2012 (-2.7% year-on-year), largely due to better year-on-year performance in ex-MTR mobile operating revenues.

Fixed operating revenues in the Czech Republic declined by 5.4% year-on-year reaching CZK 5,004 million in Q1 2013, reporting similar trends compared to 2012.

Mobile operating revenues in the Czech Republic reported a 6.9% year-on-year decline to CZK 5,679 million in Q1 2013, largely on the back of MTR cuts and persisting competitive pressures. Excluding the MTR cut impact, mobile operating revenues would go down by 2.6% year-on-year, showing improvement from Q4 (-4.7% year-on-year), also helped by higher hardware revenues. The Company maintained solid growth in non-messaging data revenues (+12.9% year-on-year in Q1, excluding CDMA).

At the same time, revenues in Slovakia continued to post positive financial performance and recorded a 13.8% year-on-year increase to EUR 50.0 million in the quarter (+26.9% year-on-year excluding MTR impact).

In Q1 2013, the Company has continued in its effort to deliver efficiencies in both commercial and non-commercial areas of its operations. Total consolidated **operating costs** went down by 3.9% year-on-year to CZK 7,347 million in the quarter. Personnel expenses (excluding restructuring costs) declined by 4.9% year-on-year as the Group continued in its restructuring program focused on building leaner and efficient organisational structure. In Q1 2013, the total Group headcount has been optimised by 283 employees. As a result, the Group's headcount reached 5,991 at the end of March 2013, representing 10.7% year-on-year reduction.

Guided Operating income before depreciation and amortization (OIBDA)[5] reached CZK 4,346 million in Q1 2013, down 13.9% year-on-year. The year on year performance has been impacted by positive impact of the CZK 220 million gain from sale of non-core assets in Q1 2012 (80% stake in Informační linky, a.s.) and higher restructuring cost booked in Q1 2013 (CZK 354 million) compared to Q1 2012 (CZK 169 million). On **fully comparable basis** (i.e. excluding the above mentioned items), **OIBDA** would decline 6.0% year-on-year, while the **comparable OIBDA margin** would reach 39.5% in Q1 2013, down 0.7 percentage points year-on-year. At the same time guided OIBDA margin[6] reached 36.5% in Q1 2013. Reported OIBDA (including brand fees and management fees) reached CZK 4,098 million in the quarter.

[5] In terms of the 2013 guidance calculation, OIBDA excludes brand fees and management fees, 2013 guidance excludes changes in consolidation, includes potential capital gains from sales of non-core asset, assuming constant FX rates of 2012.

[6] OIBDA excluding brand fees & management fees over Operating revenues

Depreciation and amortization charges went down by 4.7% year-on-year reaching CZK 2,734 million in Q1 2013. Consolidated **net income** amounted to CZK 1,047 million, down by 35.5% year-on-year, negatively impacted by above mentioned exceptional items in Q1 2012 and Q1 2013. Excluding these items, net income would decline by 10.9% year-on-year largely due to a decline in comparable OIBDA, not fully compensated by lower depreciation & amortization charges and lower financial expenses.

Consolidated **CapEx** reached CZK 875 million in Q1 2013, down by 10.2% year-on-year. The Company continued to focus on efficient investments into growth areas. These include largely further capacity expansion and improvement of the quality of mobile broadband network, in line with growing demand for mobile data services. In Q1 2013, the Company commenced deployment of LTE network in existing 1,800 MHZ band spectrum. It will launch LTE services in selected parts of Prague since 15th May 2013 followed by LTE rollout in Brno in Q4 2013. Additionally, the Company focused its investments into the capacity enhancement in its fixed broadband networks and VDSL expansion.

Cash from operating activities was broadly flat (-0.3 % year-on-year) due to focus on working capital cash management, lower interest and income tax payments. Cash used in investing activities decreased by 9.8% year-on-year. This is a result of combination of lower proceeds on disposal of fixed assets (Q1 2012 impacted by proceeds on disposal of 80% of shares of subsidiary Informační linky, a. s. worth CZK 240 million), and a 20.9% decrease in payments for CapEx. Thus, consolidated **free cash flows** improved by 6.4% year-on-year reaching CZK 2,423 million in Q1 2013.

The consolidated **financial debt** (long-term short-term) amounted to CZK 3,011 million at the end March 2013, flat compared to the end of 2012. At the same time, **cash and cash equivalents** reached CZK 5,350 million.

CZ Mobile Business Overview

The Company continuously monitors its customers' needs and demand in changing market environment. In line with this approach and to confirm its innovative leadership position, on 15th April, the Company substantially simplified its mobile tariff portfolio and launched new O_2 FREE tariffs. These simple and price transparent tariffs bring the customers more value via unlimited on-net calls and SMS in each package, while the top tariff (O_2 FREE CZ) offers unlimited all-net calls and SMS and 1GB data package on top of that. Moreover, the Company believes that simple tariff structure and removal of handset subsidies will help it to simplify its business model and to continue with further operational transformation, bringing additional savings in operating costs.

In Q1 2013, the Company continued to report solid commercial momentum in all areas of the mobile segment. It reported sound trading in the contract segment on the back of low churn and sustained positive performance in prepaid area, which has been reported already in H2 2012. In the mobile internet area, the Company continued in its support of smartphone sales via best price guarantee proposition for bestselling smartphones and in marketing of its Smart tariffs, bundling mobile voice, internet in handset and unlimited on-net SMS. As a result, smartphone sales represented close to 70% of total handset sales in Q1 2013 and smartphone penetration[7] grew further reaching 29% at the end of March 2013, up by 7.5 percentage points year-on-year.

It should be highlighted that since the beginning of 2013, the Company has applied a more conservative activity criteria for accounting mobile customers, which has led to the disconnection of 114 thousand mobile contract customers on the reported customer base, effective since January 1 2013, with no impact on revenues.

The total **mobile customer base** reached 5,048 thousand at the end of March 2013, a 2.2% year-on-year increase, despite aforementioned disconnection of contract base. Total net additions amounted 79 thousands excluding the adjustment vs. negative net additions in Q1 last year, leveraged on both, the good traction in the contract segment and the positive performance of the prepay segment. **Contract customers** grew by 1.4% year-on-year reaching 3,121 thousand. Net additions during the quarter excluding the impact of the disconnection reached 43 thousand. This growth continued to be supported by customers migrating from the prepaid to the contract segment, solid trading and sustained low churn. The number of **prepaid customers** reached 1,927 thousand at the end of March 2013, up 3.5% year-on-year, with positive net additions of 36 thousand in the quarter, confirming turnaround seen already in H2 2012, helped also by growing wholesale base (BLESKmobil).

The blended monthly average **churn rate** reached 2.7% in Q1 2013, while contract churn was at 2.2% impacted by the commented adjustment in the customer base. Excluding the adjustment contract churn continued to be low at 1% (-0.1 percentage point year-on-year), while total churn went up 0.1 percentage point year-on-year to 1.9% due to slight increase in prepay churn.

In terms of usage, total **mobile traffic**[8] carried by customers in the Czech Republic reached 2,409 million minutes in Q1 2013, up by 3.4% year-on-year, supported by successful adoption of Smart tariffs.

In Q1 2013, mobile **total ARPU** declined 14.5% year-on-year in comparable terms (excluding the impact from disconnection made at the beginning of 2013) to CZK 338.4, impacted largely by MTR cuts and lower effective prices for outgoing traffic due to the competitive pressure and increasing adoption of new tariffs bundling voice and SMS in the package. Excluding the impact of MTR cuts, total ARPU would have declined by 9.6%. **Contract ARPU** went down 15.9% year-on-year in comparable terms reaching CZK 449.8 in the quarter. **Prepaid ARPU** decreased by 11.3% year-on-year to CZK 151.8.

Total **mobile operating revenues** in the Czech Republic declined by 6.9% year-on-year to CZK 5,679 million in Q1 2013. At the same time, mobile gross service revenues went down by 9.8% year-on-year to reach CZK 5,206 million. Already mentioned competitive pressures leading to lower spend together with MTR cuts continued to be the key drivers for the decline. Excluding the impact of mobile termination rate cuts, mobile gross service revenues would

[7] Smartphones as % of total handsets base
[8] Inbound and outbound, including roaming abroad, excluding inbound roaming

decline by 5.2% year-on-year in the quarter. Mobile originated voice revenues declined 7.8% year-on-year to CZK 3,271 million, while messaging (SMS & MSS) were 13.9% lower due to lower effective per unit price. Terminated revenues went down by 29.1% year-on-year to CZK 581 million in Q1 2013, largely impacted by MTR cuts not fully compensated by higher incoming traffic. At the same time, non-messaging revenues improved by 5.8% year-on-year (+12.9% excl. CDMA) reaching CZK 764 million, supported by growing revenues from mobile internet and remained the key growth driver of mobile revenues.

CZ Fixed Business Overview

In the first three months of 2013, the Company continued to report solid commercial performance of the broadband customer base in highly competitive and slowing market via successful proposition of its VDSL service. In addition, continuous migration of existing ADSL customers to the VDSL service keeps helping the Company to manage fixed broadband ARPU dilution and sustain low churn.

The total number of **fixed accesses** declined by 5.6% year-on-year reaching 1,468 thousand at the end of March 2013, with 31 thousand net losses during the quarter. The Company managed to further decelerate disconnections of fixed voice accesses, which reached 38 thousand in Q1 2013, down from 47 thousand last year.

The number of **xDSL accesses** reached 921 thousand at the end of Q1 2013, up by 4.3% year-on-year. In respect of VDSL, 288 thousand customers have already subscribed for the upgraded service (28 thousand net additions in the quarter), which represents 35% of the total xDSL residential base and 72% of the total addressable existing base (~ 50% of households). The total number of **O_2 TV customers** reached 141 thousand at the end of Q1 2013, +2.1% year-on-year.

Total **fixed operating revenues** went down by 5.4% year-on-year reaching CZK 5,004 million in Q1 2013. Revenues from voice retail services fell by 17.7% year-on-year, in line with performance in previous quarters, reaching CZK 1,215 million, due to continuing fixed telephony line losses, while wholesale voice revenues went up by 14.7% year-on-year to CZK 1,048 million, largely helped by higher transit revenues. Internet & broadband revenues (incl. IPTV) declined slightly by 1.3% year-on-year to CZK 1,551 million in Q1 2013, resulting from the combination of xDSL customer growth, migration of customers to VDSL and competitive ARPU pressures. ICT revenues went down by 5.9% year-on-year reaching CZK 445 million due to different phasing of projects in Q1 2013 compared to the same period in 2012.

Slovakia

In Q1 2013, Telefónica Slovakia reported solid commercial and financial performance. At the end of March 2013, the total **number of customers** reached 1,398 thousand, posting a 14.9% year-on-year growth. Their number increased by 44 thousand in the quarter, thanks to the solid performance of the contract customers as well as the prepay segment growth. The number of **contract customers** grew by 26.7% year-on-year reaching 683 thousand at the end of March 2013 (+23 thousand in Q1), while the number of **prepaid customers** increased by 5.5% year-on-year ending up at 715 thousand. Consequently, the customer mix in Slovakia further improved and contract customers represented already 48.8% of the total customer base at the end of Q1 2013, up by 4.5 percentage points year-on-year.

In terms of financial performance, the **total operating revenues** of Telefónica Slovakia in local currency increased by 13.8% year-on-year reaching EUR 50 million in Q1 2013. Excluding the impact of MTR cuts, the growth rates would be 26.9%, fuelled by customer growth, improving customer mix and the company's focus on acquiring higher value customers. At the same time, OIBDA of Telefónica Slovakia went up by 32.9% year-on-year to EUR 15.2 million, resulting in healthy 30.4% OIBDA margin. **Contract ARPU** reached EUR 15.3, while **prepaid ARPU** was at EUR 7.3.

Realisation of Share Buyback Program

The Annual General Meeting of the Company held on 19th April 2012 approved the share buyback program, based on which the Company is allowed to purchase its own ordinary shares to the extent that it does not exceed 32,208,989 shares, i.e. will not exceed 10% of total number of company ordinary shares. The period during which the Company is authorized to acquire its shares shall be 5 years from the date of the General Meeting. Based on the above-mentioned General Meeting resolution, the Board of Directors adopted, on 26th February 2013, a resolution to continue with own ordinary shares acquisition (share buyback) program in the extent of up to 6,441,798 of the ordinary shares, i.e. up to 2 % of the total ordinary shares issued by the Company. The Board of Directors also approved the intention to submit to the General Meeting of the Company a proposal to cancel the acquired shares, together with a proposal to reduce the registered capital by the amount of the nominal value of the acquired shares. Following the above resolutions, the Company commenced the purchase of its own shares on 5th March 2013. By 30th April, it repurchased in total 1,246,126 shares representing 0.39% of the total ordinary shares issued by the Company. The total purchase price amounted to CZK 376 million, resulting in average price of CZK 302 per share.

Results of Annual General Meeting

The Annual General Meeting of the Company was held on 22nd April 2013. The supreme body of the Company approved the unconsolidated and the consolidated financial statements of the company for the year 2012 prepared under the International Financial Reporting Standards (IFRS) audited by Ernst & Young, which gave both sets of financial statements its unqualified opinion.

The Company's General Meeting decided by resolution on the distribution of 2012 profit and a part of retained profits in the amount of CZK 6,442 million in the dividend. A dividend of CZK 20 before tax will be paid to each share with a nominal value of CZK 87 and dividend of CZK 200 before tax to the share with a nominal value of CZK 870. In addition, the General Meeting approved distribution of a portion of the share premium by the total amount of up to CZK 3,221 million. An amount of CZK 10 before tax shall be paid to each share with the nominal value of CZK 87 and an amount of CZK 100 before tax shall be paid to the share with the nominal value of CZK 870. In total, CZK 30 per share will be paid out to the shareholders. The conclusive day for dividend and the amount corresponding to the distribution of share premium shall be on 14th October 2013. Both amounts shall be payable on 11th November 2013.

The General Meeting also approved the reduction of the registered capital by cancellation of 2% of own shares, which the Company acquired in 2012 in the course of the share buy-back (6,441,798 shares). Company's registered capital will be reduced by the total amount of CZK 560 million. The total purchase price amount, for which the company acquired the cancelled shares, amounted to CZK 2,483 million. The share premium shall be reduced by CZK 1,922 million, which represents the difference between the purchase price and the nominal value of the cancelled shares. After the cancellation of 2% of own shares, the new number of shares will be 315,648,092.

The General Meeting also approved amendments to the Company's Articles of Association in the wording proposed by the Board of Directors and changes in the Supervisory Board and the Audit Committee.

The full wording of the press release on the results of the General Meeting and overview of adopted resolutions can be found on the Company's web page.

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).

Contacts

Investor Relations
Telefónica Czech Republic, a.s.
investor.relations@o2.com
t +420 271 462 076

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 – Mar 2013	Jan – Mar 2012
Operating revenues	11,902	12,451
Other recurring revenues	23	17
Revenues	**11,925**	**12,468**
Internal expenses capitalized in fixed assets	127	170
Operating expenses	(7,347)	(7,641)
Other operating income/(expenses)	(372)	(164)
Gain on sale of fixed assets	15	221
Impairment reversal/(loss)	(2)	(5)
OIBDA	**4,346**	**5,049**
Brand fees & management fees	(248)	(274)
OIBDA after brand fees & management fees	**4,098**	**4,775**
Depreciation and amortization	(2,737)	(2,872)
Operating Income	**1,361**	**1,903**
Net financial income (expense)	(29)	(44)
Income before tax	**1,332**	**1,859**
Income tax	(285)	(237)
Net Income	**1,047**	**1,622**

BALANCE SHEET	31.03.2013	31.12.2012
Non-current assets	**65,941**	**67,835**
- Intangible assets	6,575	6,833
- Goodwill	13,497	13,497
- Property, plant and equipment and investment property	45,126	46,691
- Long-term financial assets and other non-current assets	112	141
- Deferred tax assets	631	673
Current assets	**13,350**	**11,364**
- Inventories	476	487
- Trade and other receivables	7,453	7,730
- Current tax receivable	52	101
- Short-term financial investments	20	2
- Cash and cash equivalents	5,350	3,044
Non-current assets classified as held for sale	**-**	**-**
Total assets	**79,291**	**79,199**
Equity	**61,531**	**60,574**
Non-current Liabilities	**6,116**	**6,322**
- Long-term financial debt	3,000	3,000
- Deferred tax liabilities	3,011	3,206
- Long/Term Provisions	38	29
- Other long/term liabilities	67	87
Current Liabilities	**11,644**	**12,303**
- Short-term financial debt	11	31
- Trade and Other payables	9,606	9,982
- Current income tax payable	6	5
- Short-term provisions and other liabilities	2,021	2,285
Liabilities assoc. with non-current assets classified as held for sale	**-**	**-**
Total Equity and Liabilities	**79,291**	**79,199**