Interim report

Telefónica Czech Republic – January to March 2014 Financial Results

May 14, 2014

Telefónica Czech Republic, a. s. announces its unaudited financial results for January to March 2014. 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

- **We maintain our leading market position on the market that is showing worsening year-on-year dynamics:**
  - **95%** of contract customers in consumer segment already on **FREE Tariffs**
  - Modest mobile **contract base growth +3.7%** year-on-year, remaining flat[1] in Q1 2014, with total mobile base reaching 5.1 million.
  - **Smartphone penetration growing above 36%**, up by 7.6 percentage points year-on-year
  - **VDSL accesses growing** by 31.5% year-on-year in Q1 2014, helping to manage fixed broad band ARPU dilution and maintain churn
  - **O_2 TV customer base growth continues**, driven by our new innovative IPTV platform reaching more than 163 thousands customers (15.8% year-on-year growth and 7 thousands net adds) in Q1 2014
  - **Fixed accesses disconnections in line with previous quarters**, down by 7.4% year-on year in Q1 2014.
  - O2 MVNO partners are leading the virtual operators market, covering together approx. 65% of this market segment
- **Consolidated operating revenues** reaching CZK 10,764 million in Q1 2014, down by 9.6% year-on-year (-6.5% year-on-year excluding the impact of MTR cuts).
- **OIBDA** went down by 15.9% year-on-year, impacted by top-line pressure in the Czech Republic, partly offset by OPEX reduction, with OIBDA margin[2] reaching 32% in Q1 2014, down 2.4 pp year-on-year on the back of continuous efficiency agenda (Group OPEX: -6.2% year-on-year) as well as growing profitability in Slovakia.
- **Consolidated underlying[3] free cash flow** in Q1 2014 down by 14.3% year-on-year, less than OIBDA decline of 15.9%. Total cash flow dominated by the strategic acquisition of LTE spectrum in both countries.
- **Telefónica Slovakia** maintained its strong commercial momentum reporting 13.1% year-on-year subscribers' growth (+41 thousand).
- **Successful acquisition of LTE spectrum** in both Czech and Slovakia auctions.

[1] +18 thousand net additions, excluding the estimated one-off impact of the Open door policy adopted in Q1 2014
[2] OIBDA/Operating revenues
[3] Excluding the acquisition of LTE spectrum

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@telefonica.com

<u>Consolidated Financial Statements</u>

Consolidated operating revenues[4] reached CZK 10,764 million, down by 9.6% year-on-year in Q1 2014. They would have declined by 6.5% **excluding the MTR cuts impact** (from CZK 1.08 in 1H 2012, down to CZK 0.55 in Q3 2012, to CZK 0.41 in Q2 2013, and CZK 0.27 per minute in Q3 2013 in Czech Republic, and EURc 3.18 in Q3 2012 to EURc 1.22 per minute in Q3 2013 in Slovakia).

Fixed operating revenues in the Czech Republic reached CZK 4,763 million, declining by 5.2% year-on-year, showing decline deceleration compared to previous quarter.

Mobile operating revenues in the Czech Republic were CZK 4,713 million, reporting 16.7% year-on-year decline in Q1 2014, largely driven by MTR cuts and intensified competitive pressures with decline in traditional voice and messaging revenues. **Excluding the MTR cuts impact**, mobile operating revenues would go down by 13.3% year-on-year. Company nevertheless continues to benefit from its data-centric proposition, with **non-messaging data revenues** (excluding CDMA) growth of 33.6% year-on-year harvesting the benefits of the introduction of data centric tariffs in 2013.

Revenues in Slovakia reached EUR 50 million, growing +12.1% year-on-year excluding MTR impact, and denominated in CZK currency showing 7% year-on-year growth.

The Group has continued in its effort to deliver efficiencies in both commercial and non-commercial areas of its operations. **Total consolidated operating expenses** went down by 6.2% year-on-year to CZK 7,120 million in Q1 2014. Personnel expenses (excluding restructuring costs) declined by 12.3% year-on-year as the Group continued in its restructuring program focused on building leaner and efficient organizational structure. The total Group headcount[5] has been further optimised to reach 5,186 personnel at the end of March 2014, representing 13.4% year-on-year reduction. Moreover, launch of FREE Tariffs is helping the Company to benefit from further simplification of its business model and eliminate handsets subsidies in consumer segment.

Comparable Operating income before depreciation and amortization (OIBDA)[6] decreased by 14.7% year-on-year, when the **Comparable OIBDA margin** reached 35.3% in Q1 2014, down by 2.1 pp year-on-year. **Reported OIBDA** reached CZK 3,447 million.

Depreciation and amortization charges went down by 1.8% year-on-year reaching CZK 2,689 million in Q1 2014. **Consolidated net income** excluding restructuring costs declined by 35.2% year-on-year, while the reported **net income** amounted to CZK 558 million.

Consolidated CapEx reached CZK 4,533 million in Q1 2014. This amount includes acquisition costs of LTE spectrum in both Czech Republic and Slovakia. Excluding LTE spectrum acquisition costs, consolidated CapEx reached CZK 624 million, down by 28.7% 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. Additionally, the Company focused its investments into the capacity enhancement in its fixed broadband networks by VDSL expansion.

---

[4] Figures are shown net of inter-segment charges between fixed and mobile businesses
[5] Excluding the headcount of Bonerix, the Group subsidiary
[6] OIBDA excluding restructuring costs

Consolidated underlying[7] **free cash flow** was positive at CZK 2,077 million, representing 14.3% year-on-year decline in Q1 2014, less than OIBDA year-on-year decline 15.9%. Total cash flow in the quarter was dominated by the payment for the strategic acquisition of LTE spectrum in Czech Republic and Slovakia to the amount of CZK 3,355 million[8]. Net cash from operating activities recorded negative development (-26.1% year-on-year) due to top-line pressure, one-off changes in the phasing of payments to some suppliers, and also due to increased down payments for income tax. Net cash used in investing activities increased by 187% year-on-year in light of payment for LTE spectrum.

The consolidated long-term financial debt amounted to CZK 3,000 million at the end of March 2014, with no change to the end of 2013. At the same time, **cash and cash equivalents** reached CZK 2,606 million at the end of the period, following payment for LTE spectrum.

---

[7] Excluding the acquisition of LTE spectrum

[8] 50% of payment for LTE spectrum in Slovakia remains to be paid in Q2 2014.

CZ Mobile Business Overview

The Company continues to build on the FREE Tariffs platform, launched in April 2013. These simple and price transparent tariffs bring the customers more value via unlimited on-net calls and SMS in each package, while the FREE CZ tariff offers unlimited all-net calls and SMS together with a data package, recently increased to 1.5GB[9]. As at March 31, more than 95% of the consumer contract base has migrated to new tariffs; the Company aims to reach 100% before the end of Q2 2014. The Company is also addressing the needs of its business customers with Vario Tariffs and thus continues in its commitment to be the innovation leader in the Czech mobile market.

Demand for mobile internet continued to grow largely thanks to improved proposition in the Company's FREE Tariffs with extended data package, and the Company's ongoing support of smartphone sales via introduction of instalment model, and keeping the best price guarantee proposition for the bestselling smartphones. As a result, **non-messaging data revenues** (excluding CDMA) went up year-on-year by 33.6% in Q1 2014. **Revenues from internet in handsets** increased year-on-year by 137.6%. **Small screen base**[10] at the end of March 2014 grew by more than 69% year-on-year. **Smartphone penetration**[11] grew further, reaching 36.4% at the end of March 2014, up by 7.6 percentage point year-on-year, and smartphone sales represented close to 65% of total handset sales in Q1 2014.

The total **mobile customer base** reached 5,065 thousand at the end of March 2014. Total net additions amounted to negative 37 thousand, driven by the movements in the prepaid base. **Contract customers** grew by 3.7% year-on-year, reaching 3,232 thousand. The number of **prepaid customers** reached 1,830 thousand at the end of March 2014, down by 5% year-on-year as a result of ongoing migration to contract segment and transition to MVNO's.

The blended monthly average **churn rate** reached 2.4% in Q1 2014. Contract churn was at 1.5%. Higher rates of churn show a **one-off impact** from legislation newly implemented in Q1 2014 (also known as Open door policy, or Husák's novel), together with the effect of the migration of the remaining customers to FREE Tariffs, mainly in the lowest spend categories. Monthly average churn rate in prepaid was 4% in Q1 2014.

In terms of usage, total **mobile traffic**[12] carried by our customers in the Czech Republic reached 2,818 million minutes in Q1 2014, up by 17% year-on-year, supported by successful adoption of unlimited voice in FREE and Vario tariffs.

Total mobile ARPU in Q1 2014 was CZK 282, down by 16.6% year-on-year, impacted largely by the MTR cuts and price pressures in the market. Excluding the impact of MTR cuts, total ARPU would have declined by 12.8%. **Contract ARPU** went down by 15.8% year-on-year reaching CZK 379 in Q1 2014. **Prepaid ARPU** decreased by 25.1% year-on-year to CZK 114.

Total **mobile operating revenues** were CZK 4,713 million in the Czech Republic, representing year-on-year decline of 16.7% in Q1 2014. At the same time, **mobile gross service revenues** went down by 16.1% year-on-year to reach CZK 4,351 million. Continuous competitive pressures mainly in business segment leading to lower spend together with MTR cuts were the key drivers

---

[9] Proposition valid in Q1 2014
[10] Customer base using mobile internet in handsets
[11] Smartphones as % of total handsets base
[12] Inbound and outbound, including roaming abroad, excluding inbound roaming

for the decline. Excluding the impact of mobile termination rate cuts, mobile gross service revenues would decline by 12.4% year-on-year. **Mobile originated voice revenues** declined by 23.1% year-on-year to CZK 2,502 million, while **messaging (SMS & MMS) revenues** were 39.6% lower due to lower effective per unit price. **Terminated revenues** went down by 16.5% year-on-year to CZK 485 million, largely impacted by MTR cuts not fully compensated by higher incoming traffic.

CZ Fixed Business Overview

The Company continued to report solid commercial and financial performance on the back of successful proposition of its VDSL service and O_2 TV to the broadband customer base in highly competitive and slowing market in Czech Republic, as well as via healthy growth of voice wholesale revenues. Continuous migrations of existing ADSL customers to the VDSL service and new IPTV platform for O_2 TV are both helping the Company to manage fixed broadband ARPU dilution and sustain low churn.

The total number of **fixed accesses** declined by 7.4% year-on-year reaching 1,360 thousand at the end of March 2014, with 29 thousand net losses during the period.

The number of **xDSL accesses** reached 918 thousand at the end of March 2014, with further improvement in xDSL accesses composition. In respect of VDSL, 379 thousand customers (+31.5% year-on-year) have already subscribed for the upgraded service. VDSL reported 18 thousand net additions in Q1 2014, out of which 12 thousand are net additions in residential base. 41% of the total xDSL base and 82% of the total addressable existing base (approx. 50% of households) has upgraded the service. The total number of **O_2 TV customers** exceeded 163 thousand at the end of period, +15.8% year-on-year thanks to new innovative IPTV platform launched in 2013 that is appreciated by the customers.

Total **fixed operating revenues** in Czech Republic reached CZK 4,763 million in Q1 2014, down by 5.2% year-on-year. **Revenues from voice retail services** continued in trend and fell by 21.8% year-on-year, in line with the performance of previous quarter, reaching CZK 950 million, due to continuing fixed telephony line losses. **Voice wholesale revenues** improved by 18.7% year-on-year to CZK 1,243 million. **Internet & broadband revenues (incl. Pay TV)** declined by 8.5% year-on-year to CZK 1,438 million, resulting from competitive ARPU pressures and slight decline in xDSL customer growth, compensated by the combination of migration of customers to VDSL, as well as growing Pay TV customer base thanks to the new IPTV platform. Although **total ICT revenues** went down by 11.6% year-on-year in Q1 2014 to CZK 393 million, **managed services revenues** grew by 7.3% year-on-year. Growth in managed services is in line with the Company's strategy to focus on proposition of innovative ICT solutions to mitigate dependency on one-off projects for the public sector and thus increasing share of recurring ICT revenues.

Slovakia

Telefónica Slovakia achieved strong commercial and financial performance in Q1 2014. **Total number of customers** exceeded 1,580 thousand at the end of March 2014, posting a 13.1% year-on-year growth. Their number increased by nearly 41 thousand in Q1 2014, with majority of net adds in contract customers. The **number of contract customers** grew by 17.6% year-on-year reaching 803 thousand at the end of March 2014 (29 thousand net adds in Q1 2014), while the **number of prepaid customers** increased by 8.7% year-on-year ending up at 778 thousand. Share of contract customers in Slovakia was 50.8% of the total customer base at the end of March 2014, up by 2 percentage point year-on-year.

In terms of financial performance, the **total operating revenues** of Telefónica Slovakia in local currency was flat year-on-year reaching EUR 50 million in Q1 2014. Excluding the impact of MTR cuts, the growth rate would be 12.1%, fuelled by customer growth, refreshed proposition, improving customer mix and the focus on acquiring higher value customers. At the same time, **OIBDA** of Telefónica Slovakia went up by 7.4% year-on-year to EUR 16 million, resulting in healthy 32.8% OIBDA margin. **Total ARPU** in Slovakia reached EUR 9.7 in Q1 2014 (EUR 11 when excluding the impact of MTR cuts). **Contract ARPU** reached EUR 13.4, while **prepaid ARPU** was at EUR 5.3 in Q1 2014.

<u>Attachment:</u>
The consolidated balance sheet and income statement of Telefónica Czech Republic prepared in accordance with International Financial Reporting Standards.

Contacts

Investor Relations
Telefónica Czech Republic, a.s.
investor_relations@telefonica.com
t +420 271 462 076

About Telefónica Czech Republic

Telefónica Czech Republic is the largest integrated telecommunications provider in the Czech market, trading under the O2 brand. At present the Company operates close to eight million mobile and fixed accesses, which places it among the market leaders in fully converged services in Europe. To the users of mobile services in the Czech Republic O2 offers state-of-the-art HSPA+ and LTE technology. O2 has the most comprehensive proposition of voice and data services in the Czech Republic, and actively exploits the growth potential of its various business lines, especially ICT. O2 data centres, with total floor area of 7,300 square metres, rank O2 among the leaders in hosting, cloud and managed services. O2 data centres are the only centres in the Czech Republic and in Central Europe with TIER III certification. With the O2 TV the Company is also the largest IPTV service provider in the Czech Republic. The Company is present on the mobile market in Slovakia ince 2007, through its 100% subsidiary Telefónica Slovakia. In January 2014, Telefónica Czech Republic became a member of the Czech investment group PPF.

About PPF Group

PPF Group invests into multiple market segments such as banking and financial services, insurance, real estate, energy, metal mining, agriculture, retail and biotechnology. PPF's reach spans from Central and Eastern Europe to Russia and across Asia. PPF Group owns assets of EUR 22.113 billion (as at 30 June 2013).

All amounts in CZK million

CONSOLIDATED INCOME STATEMENT	**Jan – Mar 2014**	**Jan – Mar 2013**
Operating revenues	10,764	11,902
Other recurring revenues	28	23
Revenues	**10,792**	**11,925**
Internal expenses capitalized in fixed assets	139	127
Operating expenses	(7,120)	(7,594)
Other operating income/(expenses)	(373)	(372)
Gain on sale of fixed assets	11	15
Impairment reversal/(loss)	(2)	(2)
OIBDA	**3,447**	**4,099**
OIBDA margin	**32,0%**	**34,4%**
Depreciation and amortization	(2,689)	(2,737)
Operating Income	**758**	**1,361**
Net financial income (expense)	(30)	(30)
Income before tax	**728**	**1,331**
Income tax	(170)	(285)
Net Income	**558**	**1,047**

All amounts in CZK million

CONSOLIDATED BALANCE SHEET	**31.3.2014**	**31.12.2013**
Non-current assets	**64,266**	**62,460**
- Intangible assets	10,053	6,509
- Goodwill	13,496	13,499
- Property, plant and equipment and investment property	40,149	41,857
- Long-term financial assets and other non-current assets	168	178
- Deferred tax assets	400	417
Current assets	**9,392**	**11,489**
- Inventories	377	536
- Trade and other receivables	6,307	7,001
- Current tax receivable	73	1
- Short-term financial investments	29	62
- Cash and cash equivalents	2,606	3,890
Total assets	**73,658**	**73,950**
Equity	**56,272**	**55,749**
Non-current Liabilities	**5,678**	**5,825**
- Long-term financial debt	3,000	3,000
- Deferred tax liabilities	2,597	2,735
- Long-term Provisions	25	26
- Other long-term liabilities	56	65
Current Liabilities	**11,708**	**12,376**
- Short-term financial debt	6	4
- Trade and Other payables	9,909	10,328
- Current income tax payable	49	155
- Short-term provisions and other liabilities	1,744	1,889
Total Equity and Liabilities	**73,658**	**73,950**