

O2 increased net profit by 2.5%, despite its costs grew due to European roaming regulation

24 October 2017

- Due to European regulation, O2 recorded higher roaming costs, while it is not able to book them in relevant revenue
- In addition to the continuous customers' demand for digital television O2 TV and mobile data, successful financial services proposition is positively reflected in the financial results
- Consolidated revenue thus increased by 0.6% in the first nine months 2017 to CZK 27.9 billion; net profit grew by 2.5% to CZK 4.1 billion
- O2 Spolu (O2 Together) tariffs' offer designed to families and groups remains strategic priority for O2, which it will further develop
- O2 as the first operator in the Czech Republic developed Smart Box device, which combines the fastest modem, the most powerful Wi-Fi router and smart household centre.

"This year, as the first operator in the Czech republic, we introduced a device, which we completely developed in-house. O2 Smart Box brings to the households the most powerful Wi-Fi modem and Internet HD, which enables watching videos in HD quality. At the same time it enables connect smart household devices like security sensors, fire alarm or sockets remote control. From the beginning of its sale, O2 Smart Box accounts for more than a half of all fixed broadband sold modems. Majority of the new customers enjoys our smart household heart together with internet connection," comments Tomáš Budník, Chief Executive Officer and the Chairman of the Board of Directors of O2 Czech Republic on the results, and adds: *"Our customers transferred by 94% more mobile data compared to last year. This has been significantly supported also by O2 Spolu tariffs with large data portion and by a new product designed for a young generation - a 10 GB mobile data tariff."*

In line with the expectations the customers used mobile services abroad much more compared to previous years. *"Since June till August O2 customers, who travelled abroad within Europe, call twice more and consumed seven times more data compared to last year. Due to this growth we have to bear higher related costs in total amount of hundreds Czech koruna, which we have to pay in cash to international operators. At the same time, we are not able to fully book them into our revenue,"* explains Tomáš Kouřil, company's Chief Financial Officer and Vice-Chairman of the Board of Directors. Such a development is in line with the Czech Telecommunications Office analysis' conclusion, which states, that the new roaming regulation might have a negative impact on operators' economy, or it can lead to the future domestic price increase.

However, so far, O2 has been able to compensate higher roaming related costs. *"In addition to the traditional growth areas like mobile data or pay TV, we are successfully selling our financial services. Revenue from financial services reached already close to CZK 130 million year to date and help partially compensate negative European regulation impact,"* adds Tomáš Kouřil.

Operating overview

Mobile segment

As of 30 September 2017, total number of mobile customers reached **4.917** million, same as last year. The number of **contract customers** increased by **1.6%** year-on-year reaching **3.383 million**. In the last twelve months their number grew by 53 thousand and they represented already 68.8% of the mobile customer base, up by 1.1 percentage point. Number of prepaid customers reached 1.534 million.

O₂ Spolu tariff, which O2 has been offering as the only market operator since May 2017 as part of its strategy focused on bundles proposition designed to small customers groups, is being demanded by both, current as well as new customers. Tariff, which brings families, friends and small entrepreneurs flexible bundle of up to 4 SIMs with unlimited voice and SMS, mobile data and digital TV in one package, helped to increase number of mobile contract as well as O₂ TV customers. A big data portion included in the tariff contributed to a 94% mobile data consumption year-on-year. Number of internet in handset service went up by 29.2% year-on-year to 2.246 million.

Already 61% of handsets in O2 network is a smartphone and 42% of them supports LTE technology. Over 80% customers with LTE handset also exchanged the SIM card with a new one supporting this technology.

Fixed segment

Number of **O₂ TV** service customers provided on O2 fixed line (IPTV) as well as on internet connection from any provider (OTT) reached **230 thousand** and as at 30 September 2017, up by 4.5% year-on-year. A complementary service MULTI which enables customers watching TV on more TV sets at one time became very popular. Already **35 thousand** customers subscribed for this service and thus O2 can show off with **close to 265 thousand** active set top boxes. More and more customers also enjoy watching O₂ TV Sport with a 24 hours access. For CZK 69 fee they gain an access to the most attractive sporting events. O₂ TV Sport for a day can also subscribed anyone at the **O₂ TV Free** channel, which is available in terrestrial broadcasting via **HbbTV application**. During recent football derby Slavia – Sparta the current individual event view record has been broken with 239 thousand viewers.

Number of **xDSL fixed internet** customers reached 742 thousand at the end of September 2017. Thanks to internet speed increase through installation of remote DSLAMs, the share of customers enjoying VDSL technology on total xDSL base reached already over to 70%. For households with insufficient internet speeds over xDSL, O2 has been offering an unlimited he growth area. **Mobile operating revenue** reported a 3.5% growth to CZK 14.816 billion with European roaming regulation's negative impact since the third quarter. Excluding roaming mobile operating revenue would grow 3.9% year-on-year in the first nine months 2017. Out of other mobile services, the year on year decline of voice and SMS/MMS revenue slowed down and was more than compensated by mobile data and hardware revenue increase. Financial services (hardware & travel insurance, electronic sales recording solutions) were one of the fastest growing businesses, with overall CZK 126 million revenue in January to September 2017.

In **Slovakia**, revenue reached CZK 5.230 billion, up 6.0% year-on-year. Year on year comparison has been negatively impacted by strengthening CZK FX versus EUR. Thus **revenue** denominated in euros **improved by 7.9%** to EUR 197 million. Similarly to the Czech Republic, higher data and hardware revenue were the key growth drivers.

EBITDA decreased by **0.6%** year-on-year to **CZK 7.804 billion** in the first nine months 2017 as growth in roaming related costs driven by European regulation was not fully compensated by savings in other cost categories. In the Czech Republic, EBITDA declined by 1.9% to CZK 6.048 billion, while Slovakia reported a 3.7% increase to CZK 1.756 billion (+5.6% to EUR 66.1). Consolidated **net profit improved by 2.5%** year-on-year reaching **CZK 4.114 billion**.

KEY FINANCIAL AND OPERATING INDICATORS

Financial indicators for the Group

Financial indicators	9M 2017	9M 2016	Year-on-year change
Operating revenue	CZK 27,893 mil.	CZK 27,720 mil.	+ 0.6 %
- CZ mobile revenue	CZK 14,816 mil.	CZK 14,319 mil.	+ 3.5 %
- CZ fixed revenue	CZK 8,006 mil.	CZK 8,600 mil.	- 6.9 %
- SK revenue	CZK 5,230 mil.	CZK 4,934 mil.	+ 6.0 %
Total costs	CZK 20,141 mil.	CZK 19,926 mil.	+ 1.1 %
- of which operating costs	CZK 5,884 mil.	CZK 5,702 mil.	+ 3.2 %
EBITDA	CZK 7,804 mil.	CZK 7,855 mil.	- 0.6 %
<i>EBITDA margin</i>	28.0 %	28.3 %	- 0.3 p. p.
Net profit	CZK 4,114 mil.	CZK 4,012 mil.	+ 2.5 %

Operating indicators – Czech Republic

Number of mobile customers	30 Sept 2017	30 Sept 2016	Year-on-year change	
			Relative	Absolute
Contract customers	3.383m	3.330m	+ 1.6 %	+ 53k
Prepaid customers	1.534m	1.591m	- 3.6 %	- 57k
Total	4.917m	4.921m	- 0.1 %	- 4k
ARPU	CZK 292	CZK 288	+ 1.3 %	

Number of fixed service customers	30 Sept 2017	30 Sept 2016	Year-on-year change	
			Relative	Absolute
O ₂ TV (IPTV and OTT)	230k	220k	+4.5%	+ 10k
xDSL	742k	774k	-4.8%	- 32k
VDSL	528k	477k	+10.6%	+ 51k
Fixed voice lines	635k	727k	-12.6%	- 92k

Smartphones	30 Sept 2017	30 Sept 2016	Year-on-year change
Smartphone penetration within the O ₂ network	60.9%	53.4%	+ 7.5 p.p.
LTE smartphone penetration within the O ₂ network	41.7%	27.9 %	+ 13.8 p. p.

Operating indicators – Slovakia

Number of mobile customers	30 Sept 2017	30 Sept 2016	Year-on-year change	
			Relative	Absolute
Contract customers	1.118m	1.045m	+ 6.9%	+ 73k
Prepaid customers	798k	820k	- 2.6%	-22k
Total	1.916m	1.865m	+ 2.8%	+51k

In this section we present and comment in detail on the unaudited consolidated financial results of O2 Czech Republic a. s. for January to September 2017 prepared according to International Financial Reporting Standards. These results fully include the results of O2 Slovakia group (including O2 Business Solutions), O2 IT Services and other subsidiaries.

Consolidated Financial Results

Consolidated operating revenue reached CZK 27,893 million, up 0.6% year-on-year in the first nine months 2017, while in the third quarter they declined 1.0% to CZK 9,406 million. On top of continuous growth of mobile data and hardware & accessories revenue in both countries and higher O₂ TV revenue, success in financial services business were the key growth areas. Since the third quarter, the new European roaming regulation, which enables customers to use mobile services within European Union for same prices as at home (excluding any surcharge) has been negatively reflected both in revenue and costs.

Operating revenue in the Czech Republic reached CZK 22,822 million, marking a 0.4% year-on-year decrease (-1.6% to CZK 7,688 million in the third quarter). **Fixed operating revenue** declined by 6.9% year-on-year reaching CZK 8,006 million in the first nine months, as 10.2% growth in O₂ TV revenue did not fully compensate lower fixed voice revenue and decline in ICT revenue (with no impact on ICT gross margin). **Mobile operating revenue** were CZK 14,816 million in the first nine months, reporting a 3.5% year-on-year growth (+3.4% to CZK 5,031 million in the third quarter), as lower voice and messaging revenue were more than compensated by 13.6% growth of data revenue and 18.4% increase in hardware & accessories revenue. **Revenue in Slovakia**¹ reached CZK 5,230 million the first nine months 2017, by 6.0% higher year-on-year (+2.2% to CZK 1,764 million in the third quarter). Due to strengthening CZK FX versus EUR, revenue in euros improved 7.9% to EUR 197 million in the first nine months, and 5.8% to EUR 68 million in the third quarter.

Total consolidated expenses² went up 1.1% year-on-year to CZK 20,141 million in the first nine months. While in the Czech Republic they were flat year on year, Slovakia reported a 7.1% growth. The year on year comparison has been positively impacted by outsourcing of about 1,000 employees of call centres and franchise shops in 2016. As a result, commissions were by 19.0% (CZK 170 million) lower, costs of external call centres were reduced by 69.3% (CZK 84 million) and IT costs by 7.2% (CZK 48 million). At the same time, higher headcount led to an 8.4% (CZK 243 mil) growth in the personal costs. Costs of sales grew slightly by 0.2% year-on-year in the first nine months 2017 as above mentioned savings in commissions were slightly lower than hardware & accessories cost growth (in line with growing revenue). In addition, higher roaming costs, which the company has to pay its wholesale international partners for its customers using roaming services abroad, negatively impacted costs of sales.

Earnings before interest, depreciation and amortization (EBITDA) decreased by 0.6% year-on-year to CZK 7,804 million, while in the third quarter was by 3.2% lower and reached CZK 2 711 mil. In the Czech Republic it reached CZK 6,048 million, up by 1.9% year-on-year in the first nine months 2017 (-6.1% in the third quarter), while Slovakia reported a 3.7% growth to CZK 1,756 million and 7.6% to CZK 624 million (+5.6% to EUR 66.1 million and +11.2% to

¹ O2 Slovakia and O2 Business Services

² Costs of sales, operating expenses and Internal expenses capitalized in fixed assets

EUR 23.9). Consolidated **EBITDA margin** thus reached 28.0% in the first nine months 2017, and 28.8% in the third quarter.

Consolidated net income increased by 2.5% year-on-year to CZK 4,114 million in the first nine months 2017, while in the third quarter it grew by 1.4% to CZK 1,481 million.

Consolidated capital expenditures (CapEx) reached CZK 3,019 million in the first nine months 2017 compared to CZK 3,098 million in the same period 2016. CapEx amount in both years have been impacted by several one-off items – in 2016, it was CZK 1,472 million related to the acquisition of spectrum licences in 1,800 MHz and 2,600 MHz bands in the Czech Republic. CapEx in the first nine months 2017 include CZK 210 million for 450 MHz spectrum license renewal for additional 15 years since 8 February 2018 and CZK 782 million related to the extension of the O2 brand license agreement with Telefónica by three years on top of current period till 27 January 2019, i.e. newly until 27 January 2022. A relevant cash prepayment which will be made in the fourth quarter 2017 is the condition for O2 brand license extension. Excluding these one-off items, the total capital expenditure would amount to CZK 2,027 million, up by 24.7% year-on-year and its share of revenue was 7.3%. A 58.1% CapEx growth in Slovakia to CZK 688 million was the key driver for higher group CapEx, while in the Czech Republic it increased by 12.4% to CZK 1,339 million, where investments related to IT transformation and investments to mobile core network were the main CapEx areas. In Slovakia investments were directed into 2G network expansion, capacity and quality enhancement to reduce dependency on national roaming and consequently improve our future profitability. In addition, O2 Slovakia continued investing in 4G LTE network coverage expansion to satisfy growing customers' demand for mobile data. At the end of September 2017, this technology coverage reached already over 90% of Slovak population. In two years, the coverage improved by 65 percentage points with close to 1,400 new covered localities across Slovakia. At the same time, at the end of September 2017 O2 Slovakia covered 580 towns in all Slovak regions with broadband wireless LTE TDD internet using 3.5 GHz and 3.7 GHz spectrums, which is used mainly for digital O2 TV television and Home Internet services. At this stage, this technology is available for over 300 thousand households.

The consolidated free cash flow³ reached CZK 3,618 million in the first nine months 2017, up by 39.6% year-on-year, largely due to a 28.8% decline in net cash used in investing activities related to a CZK 1,472 million cash payment for spectrum licences in 1,800 MHz and 2,600 MHz bands in the Czech Republic in the first nine months 2016.

The consolidated financial debt amounted to CZK 10,487 million at the end September 2017. At the same time, **cash and cash equivalents** reached CZK 4,069 million. Thus, **net debt**⁴ to **EBITDA** reached 0.62.

CZ Mobile Business Overview

The total **mobile customer base** reached 4,917 thousand at the end of September 2017, flat year-on-year. The number of **contract customers** increased 1.16% year-on-year, reaching 3,383 thousand. The number of **prepaid customers** reached 1,534 thousand. The share of contract customers in total mobile customer base reached 68.8%, up by 1.1 percentage points year-on-year.

³ Net cash flow from operating activities plus Net cash used in investing activities

⁴ Gross debt less cash

The blended monthly average **churn rate** remained low and reached 1.7% in the first nine months 2017 (1.6% in the third quarter), mainly helped by contract churn, which was only 1.0% (0.9% in the third quarter), while monthly average churn rate in prepaid was 3.3%.

Despite negative impact of European roaming regulation, **total mobile** average revenue per customer (**ARPU⁵**) increased by 1.3% to CZK 292 in the first nine months 2017. In addition to lower roaming revenue, voice and SMS market pricing pressures were reflected, but have been more than compensated by growing quality of the customer base, higher data spend and positive contribution of the financial services. **Contract ARPU** improved by 0.4% year-on-year to CZK 373, while **prepaid ARPU** declined by 2.8% year-on-year to CZK 115.

Total **mobile operating revenue** in the Czech Republic were CZK 14,816 million in the first nine months 2017, representing a 3.5% year-on-year growth, while in the third quarter they went up 3.4% to CZK 5,013 million. Excluding roaming revenue (in both years), operating revenue would grow by 3.9% and 4.2% respectively. **Mobile service revenue** went up by 2.3% and 1.4% in the first nine months and third quarter (+2.7% and +2.1% excluding roaming revenue), fuelled mainly by a 13.6% growth of **data revenue**, which more than compensated lower voice and messaging revenue. Revenue from financial services (hardware and travel insurance and fiscalisation) reached CZK 126 million in the first nine months 2017. Handset and other hardware insurance is the most relevant area in the insurance business. Hardware & accessories sales revenue improved 18.4% year-on-year. More than a half of the customers buying hardware in O2 shops leaving also with an insurance contract.

CZ Fixed Business Overview

Number of **O₂ TV** service customers provided on O2 fixed line (IPTV) as well as on internet connection from any provider (OTT) reached **230 thousand** and as at 30 September 2017, up by 4.5% year-on-year. A complementary service MULTI which enables customers watching TV on more TV sets at one time became very popular. Already **35 thousand** customers subscribed for this service and thus O2 can show off with **close to 265 thousand** active set top boxes. More and more customers also enjoy watching O₂ TV Sport with a 24 hours access. For CZK 69 fee they gain an access to the most attractive sporting events. O₂ TV Sport for a day can also subscribed anyone at the **O₂ TV Free** channel, which is available in terrestrial broadcasting via **HbbTV application**. During recent football derby Slavia – Sparta the current individual event view record has been broken with 239 thousand viewers.

Number of **xDSL fixed internet** customers reached 742 thousand at the end of September 2017. Thanks to internet speed increase through installation of remote DSLAMs, the share of customers enjoying VDSL technology on total xDSL base reached already over to 70%. For households with insufficient internet speeds over xDSL, O2 has been offering an unlimited 4G LTE wireless connection since March. Combining both technologies, O2 covers 99% of all addresses in the Czech Republic. And customers like and demand Home Internet, which is confirmed by fact, that at the end of third quarter, over 770 thousand of them subscribed for this technology agnostic service.

Total number of **fixed voice lines** reached 654 thousand at the end of June 2017.

⁵ Outgoing revenue (voice, SMS & MMS, data) + termination revenue + M2M revenue over average number of customers

Total **fixed operating revenue** reached CZK 8,006 million in the nine months 2017, down by 6.9% year-on-year, while in the third quarter they were by 9.9% lower reaching CZK 2,656 million. A 10.2% growth in O₂ TV revenue did not fully compensate lower voice revenue and continuous decline in data revenue. The year on year decline in ICT revenue reflects higher base in the third quarter 2016. However thanks to selective approach of O₂ to ICT projects, gross margin dilution was limited.

Slovakia

Despite challenging competitive environment and negative impact of European roaming regulation, in the first nine months 2017, O₂ Slovakia group⁶ reported growth of customers, increase of their value and improvement of its financial performance. Thus it continues positively contributing to the group's financial results representing 19% of the consolidated revenue and 22% of EBITDA. In addition to mobile services for residential and SME customers, O₂ Slovakia has been further developing LTE TDD network on 3.5 GHz and 3.7 GHz spectrums, on which it offers wireless home internet and digital O₂ TV television. This network is currently available for over 300 thousand households in 580 towns in all Slovak regions. It also provides complete portfolio of fixed and mobile services for corporate and public sector customers via O₂ Business Services.

During 2017, O₂ Slovakia continued in intensive rollout and development of its network. In less than two years, it newly covered close to 1,400 localities across Slovakia with 4G LTE network, so the coverage improved from 25% to current over 90%, the most among all operators in Slovakia. In addition to 4G LTE network rollout, O₂ Slovakia also increased coverage of its 2G network, which is currently available to 97.9% of the population. Moreover, thanks to national roaming in Slovak Telekom network and newly also in Orange network, the total combined 2G coverage reaches 99.8%. Thus O₂ Slovakia offers its customers the widest national 2G network.

Total number of mobile customers reached 1,916 thousand at the end of September 2017, posting a 2.8% year-on-year growth. Thus O₂ Slovakia continues strengthening its market position. This growth was driven solely by **contract** additions. Their number grew by 6.9% year-on-year reaching 1,118 thousand, while the **number of prepaid customers** reached 798 thousand. The customer mix quality keeps improving and share of contract customers on total base in Slovakia reached 58.24%, up by 2.3 percentage point year-on-year.

O₂ Slovakia continues recording increasing demand for its smartphone proposition, which has supported also with new in-house instalment sales model. Customers with O₂ Paušál or O₂ Data tariffs pay a EUR 2 prepayment only and remaining handset costs in 24 monthly instalments. This is reflected in growing smartphone penetration, which reached 60.0% as of 30 September 2017. LTE handset penetration was at 43% and 36% of customers own LTE handset with LTE USIM card. Thanks to increase in 4G network coverage, LTE handset penetration and growing customers' demand for tariffs with higher data limits number of customers with internet in handset improved by 13% year-on-year to 920 thousand. Data traffic went by 64% year-on-year in the first nine months 2017, and mobile data revenue by 31% year-on-year.

⁶ including O₂ Business Services, a. s. (100% daughter company of O₂ Slovakia)

Total operating revenue in Slovakia increased by 6.0% year-on-year reaching CZK 5,230 million in the first nine months 2017 and by 2.2% to CZK 1,764 million in the third quarter. Due to strengthening CZK versus EUR the year on year growth in euros was higher. In the first nine months 2017, revenue increased by 7.9% to EUR 197 million and by 5.8% to EUR 68 million in the third quarter. **EBITDA** in Slovakia grew 3.7% year-on-year reaching CZK 1,756 million in the first nine months 2017, while in the third quarter it increased 7.6% to CZK 624 million, while in domestic currency, it grew by 5.6% to EUR 66 million in the first nine months and by 11.2% to EUR 24 million in the third quarter. Thus EBITDA margin reached 33.6% in the first three quarters (35.3% in the third quarter).

Thanks to improving customer mix and structure and customers' interest in higher data limit tariffs **total mobile ARPU** in Slovakia grew by 3.0% year-on-year to EUR 9.6 (CZK 254) in the first nine months, and by 4.7% to EUR 9.9 (CZK 257) in the quarter. **Contract ARPU** improved by 2.8% to EUR 12.8 (CZK 341) EUR 13.2 (CZK 344) in the quarter, while **prepaid ARPU** reached EUR 5.6 (CZK 150) in the first nine months and EUR 5.8 (CZK 152) in the third quarter.

Other relevant events:

In the period between publication of the [Half-Year Report](#) for the period ending on 30 June 2017 and publication of this Interim report, no relevant events occurred.

Attachment:

Interim consolidated balance sheet and income statement of O2 Czech Republic prepared in accordance with International Financial Reporting Standards (all amounts in million CZK).

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About O2 Czech Republic

O2 is the largest provider of telecommunications services in the Czech market. Currently it operates almost eight million mobile and fixed lines, which ranks it to one of the leading provider of fully convergent services in Europe. To its mobile customers O2 offers state-of-the-art HSPA+ and LTE technologies. For customers, O2 brand does not mean just telecommunications. O2 is capable to meet also the most demanding requests also in ICT area and provide them housing, hosting and cloud services in data centres with total area 7,300 square metres. These data centres are the only ones in the Czech Republic and Central Europe to have TIER III certification. The company is also, with its O2 TV, the largest IP TV provider in the Czech Republic.

All amounts in CZK million

CONSOLIDATED INCOME STATEMENT	Jan – Sep 2017	Jan – Sep 2016
Operating revenue	27,893	27,720
Non-operating revenue	49	41
Revenue	27,942	27,761
Internal expenses capitalized in fixed assets	263	223
Cost of sales	(14,258)	(14,224)
Operating expenses	(6,146)	(5,925)
Other operating income/(expenses)	3	20
EBITDA	7,804	7,855
EBITDA margin	28.0 %	28.3 %
Depreciation and amortization	(2,476)	(2,539)
Impairment reversal/(loss)	(1)	(153)
Operating profit	5,327	5,163
Net financial income (expense)	(86)	(67)
Results attributed to joint venture	(2)	(2)
Profit before tax	5,239	5,094
Income tax	(1,125)	(1,082)
Profit	4,114	4,012

All amounts in CZK million

CONSOLIDATED BALANCE SHEET	30 Sep 2017	31 Dec 2016
Non-current assets	22,751	22,071
- Intangible assets	16,816	16,515
- Property, plant and equipment and investment property	5,194	5,075
- Long-term financial assets and other non-current assets	532	231
- Deferred tax assets	209	250
Current assets	11,329	11,235
- Inventories	715	624
- Trade and other receivables	6,544	6,434
- Tax receivable	1	40
- Cash and cash equivalents	4,069	4,137
Total assets	34,080	33,306
Equity attributable to owners of the parent	14,319	17,504
Non-controlling stake	-	1
Total equity	14,319	17,505
Non-current Liabilities	10,814	7,382
- Long-term financial debt	10,455	6,976
- Deferred tax liabilities	231	170
- Non-current provisions for liabilities and charges	43	57
- Non-current other liabilities	85	179
Current Liabilities	8,947	8,419
- Short-term financial debt	32	1
- Trade and Other payables	8,700	8,254
- Current income tax payable	89	8
- Provisions for liabilities and charges	126	156
Total Equity and Liabilities	34,080	33,306