

An aerial photograph of a city street, likely in a university town, showing a mix of residential and institutional buildings, parking lots, and large green spaces with trees. The street runs vertically through the center of the image. A dark teal banner is overlaid on the top right corner, containing the page title and number.

Board of Directors' Report on Business Activity

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The Czech telecommunications market in the first half of 2012

The telecommunications market in the Czech Republic witnessed a slight decline in the first six months of 2012; the gradual recovery of the market demand, continuous competitive pressures and regulatory impact were the key reasons.

The mobile market was dominated by new and innovative services – mainly data, but also voice.

For the overview of the key new services and products of Telefónica CR, please refer to Section 3.2.2.

Effective from 28 May 2012, MobilKom, a.s. introduced 'Calling for One Crown', a tariff which, for CZK 200 per month, gave customers calls for CZK 1 to the U:fon network, to other fixed and mobile networks, 100 minutes of calls to all networks in the Czech Republic and to selected international fixed line numbers.

UPC Česká republika, a.s. (UPC) ran promotions for all internet access services from the beginning of the year until the end of April 2012. The 10 Mbit/s service sold for CZK 299 for the first 12 months, instead of the listed price of CZK 494 per month. The 25 Mbit/s service could be subscribed for CZK 399 per month for the first 12 months, instead of the regular price of CZK 599 per month. The 50 and 100 Mbit/s services were offered by UPC at a 50% discount for the first 4 months of usage.

T-Mobile Czech Republic a.s. (T-Mobile) began to market a new edition of prepaid cards Twist Přátelé Extra. A regular monthly top-up of at least CZK 300 gave the customer calls to all numbers for CZK 3.50 per minute and SMS for CZK 1.50.

Vodafone Czech Republic a.s. (Vodafone) overhauled its data tariff proposition. Its mobile data tariffs charged on a per-day basis increased the daily data limit from 5 MB per day to 25 MB per day; the price went up from CZK 17 to CZK 25 per day. The Connection tariffs were expanded with Weekly Connection for CZK 49 per week and FUP 60 MB per week. The monthly Internet in Mobile tariffs welcomed a new Mobile Connection Super for CZK 249 per month with FUP 300 MB per month.

As part of the so-called 'Eurotariff' regulated by the European Union executive authority, customers were charged CZK 8.60 for a minute of an outgoing call (CZK 10.30 previously), CZK 2.38 for an incoming call, CZK 2.68 per SMS and CZK 20.84 per 1 MB of data, charged at the rate of 1kB.

T-Mobile started offering Travel&Surf, a new roaming mobile internet tariff; the service could be activated on a daily, weekly or a monthly basis.

Vodafone communicated its new 'roaming per day' proposition, which could be subscribed by customers of Vodafone's Tailor-made tariffs. The roaming offer allowed customers to use free units from their national tariffs in 41 countries of Europe.

Regulation

Several changes occurred in the first half of 2012 in the regulatory environment which governs the field of electronic communications in the Czech Republic. The most material changes included the following:

- 1) changes in the legislation;
- 2) changes in the areas of markets analysis and product regulation;
- 3) changes in the Universal Service provision and in the government's policy and support of broadband internet access.

The following are the most significant changes in the area of legislation governing electronic communications:

- Promulgation of the Act No. 341/2011 Coll. on General Inspection of Security Forces, and on the amendment to related acts,
- Promulgation of the Act No. 19/2012 Coll., amending the Act No. 216/1994 Coll., on arbitration and enforcement of the arbitration award, as amended, and other related laws, including the Act No. 127/2005 Coll., on electronic communications, and on the amendment to some related acts (Electronic Communications Act), as amended,
- Completion of the implementation of the revised regulatory framework for electronic communications networks in the Czech law:
 - Directive 2009/136/EC of the European Parliament and of the Council amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services; Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) No 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws;
 - Directive 2009/140/EC of the European Parliament and of the Council amending Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and Directive 2002/20/EC on the authorisation of electronic communications networks and services;

- Regulation (EC) No 1211/2009 of the European Parliament and of the Council establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office, through the Act No. 468/2011 Coll., amending the Act No. 127/2005 Coll., on electronic communications, and on the amendment to some related acts (Electronic Communications Act), as amended, and some other laws, which came into effect on 1 January 2012.

Telefónica CR was involved in the preparation of the above legislation by providing consultation either directly or on the platform of industry associations of telecommunications operators or through its parent company Telefónica.

Relevant markets analysis and product regulation

Telefónica CR continued to meet its duties with which it was tasked based on the relevant markets analysis undertaken by the Czech Telecommunication Office (CTO) in previous periods.

On commission from the CTO, Ernst & Young, s.r.o., continued the development of the LRIC methodology, including a model for call termination in public fixed networks. The outputs of this model are expected to be used by the CTO to set the maximum call termination rates in fixed public networks in 2013 and beyond.

The LRIC methodology for call termination in public mobile networks was drawn up for the CTO by PricewaterhouseCoopers Česká republika, s.r.o., and the result of the cost price calculation of mobile termination rates based on the new model will apply most likely from 2013.

The CTO continued the third round of the analysis of the relevant market no. 5 – wholesale broadband access in electronic communications networks. The draft paper was notified to the European Commission, which chose to exercise its veto and commenced the so-called second phase of the relevant market analysis; the publication date for the final version of the analysis has thus been postponed. Telefónica CR expects that the analysis will be published in the form of a general measure by the end of the year.

In the middle of 2012, the CTO also commenced the analysis of the relevant market no. 2 – call origination in the public telephone network provided at a fixed location, market no. 4 – wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location, and market no. 8 – access and call origination in public mobile telephone networks.

Regulation of international roaming

A new regulatory framework for international roaming services, which defines the regulated services and the related prices for the period until 2022, was approved by the European Parliament and the Council of Ministers in the second quarter of 2012. In line with the roaming regulation, regulated prices of international roaming voice and SMS services were cut further with effect from 1 July 2012, and the scope of the regulation was expanded to include also mobile data roaming services.

With effect from 1 July 2012, the retail price for incoming calls went down to EUR 0.08 per minute; the price of an outgoing call was cut to EUR 0.29 per minute. The price of an outgoing SMS went down to 0.09, and the new maximum price of EUR 0.70 per 1MB of data now applies. The prices in Czech crowns were adjusted using the applicable exchange rate conversion.

Imposition of duties related to the provision of the Universal Service

Telefónica CR provided the following services during the first half of 2012 as part of meeting its duties imposed by the CTO in relation to the Universal Service provision:

- (a) the public payphone service;
- (b) access to the public telephone service, of the same quality as for other end users, for people with disabilities, namely by means of special terminal equipment;
- (c) special price plans for persons with disabilities, which are different from the regular price plans provided under the standard commercial terms and conditions.

As to the service under (a), a CTO decision tasked Telefónica CR with the duty to operate the service in municipalities with 4,999 or more residents until the end of 2013; and in municipalities with a population under 1,999, until the end of 2014.

As to the service under (b), the CTO passed a decision which obliges Telefónica CR to provide the service as part of the Universal Service for a period of three years commencing from 15 July 2012.

Compensation for Universal Service provision

Telefónica CR is presently working to prepare its claim for compensation for the loss incurred as a result of Universal Service provision (including the loss incurred as a result of offering special price plans for people with disabilities) in 2011.

State policy and support in the area of broadband internet

In March 2012, the CTO released working draft terms of reference for the tender for 800 MHz, 1800 MHz and 2.6 GHz frequencies for public consultation. Using the aforementioned frequencies to develop mobile broadband internet access represents one of the tools to meet the objectives set out in the State Policy in the Area of Electronic Communications – Digital Czech Republic. Telefónica CR submitted its comments to the CTO. After the CTO processes all the comments, it invited tender in July 2012. On 12 July 2012, the CTO published on its electronic bulletin board and in the Telecommunications Journal the details of a tender for the use of radio frequencies for the operation of a public communication network in the 800 MHz, 1800 MHz and 2600 MHz bands.

Structural funding from the EU continued to support various projects in the area of ICT development in public institutions. The support went in the direction of mainly regional networks connecting public institutions, as well as the private sector.

In April the European Commission invited comments on the EU Initiative to Reduce the Cost of Rolling Out High Speed Communication Infrastructure in Europe, and, in July 2012, on the Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks.

The Government of the Czech Republic started the process of programming the EU Structural Funds for the period 2014–2020. With regard to the overall objectives of the EU, as expressed in the policy paper Digital Agenda for Europe 2020, we can expect that support will focus also on the field of ICT.

The Company is constantly monitoring options offered to customers by structural funds, and modifies its products and services so that they are eligible for subsidies. A special attention was paid to Call 8 under the Integrated Operational Programme for the development of eGovernment services in the regions. Telefónica CR successfully participated in tenders for projects co-funded from the Structural Funds.

Telefónica Czech Republic Group in the first half of 2012

Several changes occurred in the ownership structure of the Telefónica CR Group in the first half of 2012, which were made in order to make the management of the Group more effective, and to focus on its core businesses. As part of the consolidation of activities in the field of ICT services, the subsidiary Telefónica O2 Business Solutions, spol. s r.o., was merged through consolidation with another subsidiary, Internethome, s.r.o.; after the merger, all WiFi services were 'under one roof'. With regard to the market trend of the demand for broadband internet access growing at the expense of voice services, Telefónica CR decided to spin off a part of its assets – the organisation unit Information and Assistance Services – into a newly incorporated subsidiary Informační linky, a.s. An 80% stake in this company was subsequently sold. For more details about the changes in the subsidiary and affiliate companies, please refer to Section 4 Corporate Governance.

In the context of the highly competitive telecommunications marketplace, Telefónica CR continued also in the first half of 2012 to focus on the improvement of its existing services, customer experience and on the development and marketing of new products and services in areas with a growth potential. Its strategy focused on paying the utmost attention to what the customer requires and on meeting the growing demand for fixed and mobile broadband internet access and for mobile voice. The efforts brought a result in the form of a continued growth in the number of customers and maintaining, or increasing, as the case may be, Telefónica CR's market share.

Activities which focused on customer retention and improving the customer experience delivered a net increase of 64 thousand in the number of mobile contract customers over the half-year, which cemented the Company's leadership in this respect. Telefónica CR continued the roll-out of its 3G mobile network, including some parts in collaboration with T-Mobile. As at the end of June, the 3G network was available to more than 76% of the population. The Company also invested in improving the quality and carrying capacity of the 3G network.

The growing 3G coverage and the related marketing initiatives to support smartphone sales led to an increase of the customers' interest in small- and large-screen mobile internet. The smartphone penetration in the customer base was approximately 23% at the end of June, which is a 7 p.p. increase year on year. The share of smartphones sold in the total handset sales was close to 65% in the half-year. The growing number of mobile internet customers reflected positively on the increased revenues from data services, excluding SMS.

In the area of fixed broadband internet access, the Company, in line with its strategy to offer the best internet access service to the market and thus cement its competitive position, focused its attention on marketing VDSL services. The ongoing migration of customers from ADSL to the VDSL service

helped the Company retain higher net worth customers and reduce the price pressure from the largest cable internet provider. Moreover, the churn rate also went down. By the end of June, the number of customers using the VDSL service went up to 207 thousand, which is 55% of all customers within the reach of the service. In the fiercely competitive environment, Telefónica CR secured a more than six percent year-on-year growth in the number of xDSL customers.

As one of the largest ICT service providers in the Czech Republic, Telefónica CR focused on marketing its broad portfolio of services in the first half of 2012. In addition to the more traditional, often one-off solutions for the government segment, the Company started promoting standard ICT services for the corporate clientele. The Company believes that this strategy will help it secure a revenue growth in the future.

In Slovakia, the Group continued to successfully offer its O2 Fér tariffs and O2 Moja Firma (My Business) for the self-employed, small and medium business customers. During the first six months of 2012, the company included in its portfolio a new tariff for residential customers – O2 Paušál – which, for the first time included a bonus for a purchase of a new handset. This offer targeted higher-spend customers, with the aim to increase the average revenue per user. The attractive offer helped Telefónica Slovakia retain its dynamic rate of growth, which in turn cemented its position at the Slovak mobile market. The company believes that its market share was close to 20% at the end of June. The continued strong revenue growth and improved financial performance produced a result in almost twice the level of OIBDA in the first half of 2012, compared to the same period of the year 2011.

All the above activities manifested in the very good operating performance in terms of customer additions. The number of xDSL customers reached 883 thousand at the end of the half-year, which is a year-on-year growth of 6.3%. The number of O2 TV customers was 139 thousand at the end of June, which is a pronounced success given the reality of the stagnant pay TV market in the Czech Republic. As at the same date, the number of fixed lines operated by Telefónica CR was 1.5 million. During the first six months of 2012, their number went down 42 thousand, which is 28.5% less than in the same period of the year 2011. The number of mobile customers increased 2.0% year on year, to almost 5 million, at the highly saturated mobile market. The growth was driven mainly by the increase in the number of contract customers, which at the end of June stood at 3.1 million, up 5.3% on the previous year. The rate of decline in the number of prepaid customers slowed down in the first half of the year to 38 thousand – compared to 63 thousand in the first half of 2011. The number of mobile customers in Slovakia went up 86 thousand in the first half-year, and stood at 1,250 thousand at the end of June.

During the first half of 2012, the Company continued its journey of transformation, following the goal of operating efficiency improvement and operating cost reduction. It implemented the next phase of the restructuring programme, which sought to implement a more effective and efficient organisation thorough a reduction of the number of management levels across the Company. The transformation also served the goal of making processes more effective and streamlined. The transformation also looked at the consolidation and optimisation of call centre operation, and the outsourcing of activities associated with non-core functions. In the first half of the year, the financial accounting function was outsourced to an external company outside the structure of Telefónica CR, which achieved a Group headcount reduction of 214 down to 6,376 in the half-year.

The total headcount of the Telefónica CR Group, broken down by region, as at 30 June 2012 (shown in comparison to 30 June 2011) as follows:

| | as at 30 June 2011 | as at 30 June 2012 |
|--|--------------------|--------------------|
| Telefónica Czech Republic, a.s. | 6,767 | 5,825 |
| Telefónica O2 Business Solutions, spol. s r.o. | 162 | 143 |
| Employees in the Czech Republic | 6,929 | 5,968 |
| Telefónica Slovakia, s.r.o. | 400 | 408 |
| Employees in Slovakia | 400 | 408 |
| Group employees total | 7,329 | 6,376 |

Telefónica Slovakia

In the first half of the year 2012, Telefónica Slovakia offered a new no-commitment product to residential customers. The new tariff O2 Paušál gave customers the benefit of unlimited free SMS, a bonus redeemable against a handset purchase, and a flat rate of EUR 0.10 on calls to all local networks and to all networks in six other European countries. The tariff came in four price point variants (Blue, Silver, Gold, Platinum), each with a different bonus for the purchase of a new phone. The highest Platinum O2 Paušál gave customers unlimited calls to all networks in Slovakia, and unlimited calls from Slovakia to the Czech Republic, Hungary, Poland, Austria, United Kingdom and Ireland. Moreover, each customer received a data allowance of 1,000 MB already included in his tariff.

In the first half-year, Telefónica Slovakia also pursued the second phase of the 3G network roll-out; in the second quarter of 2012 alone, the company added 39 new locations to the 3G coverage map. The goal is to have 50% coverage of the population with the proprietary 3G network by autumn 2012.

According to a survey conducted by an independent agency Ipsos Tambor in collaboration with Telefónica Slovakia, the company again topped the leader board of Slovak mobile operators when it comes to customer satisfaction.

As at 30 June 2012, Telefónica Slovakia recorded a total of 1,250 thousand customers, of which almost 575 thousand were contract customers. This represents an increase of 24.7% in the total customer base. The share of contract customers in the total customer base was up 5 p.p. and reached 46% at the end of the half-year. The company's revenues for the first six months of the year reached EUR 92.8 million, up 26.9% year on year. In the same period, the OIBDA (Operating Income before Depreciation and Amortization) almost doubled compared to the same period of the year 2011.

New products and services

Also in 2012, Telefónica CR continued its Smart Network campaign. From February, it offered a smartphone for CZK 1 with the subscription of any O2 NEON tariff with Internet on A Mobile.

From March, Telefónica CR started to guarantee the lowest price on the most popular mobile handsets on the market and thus gave customers yet another reason why O2 is the best place to go for a smartphone.

It is the Company's long-term strategy to transform O2 brand stores into a place where people can go for inspiration or consultation – and to heed this, it launched teams of specialist consultants and O2 Guru. In April, Telefónica CR opened its largest and most modern brand store O2 Experience Centre in Chodov, Prague.

Telefónica CR secured a certification from Apple for use with the new iPad. The latest model of iPad went on sale in the Czech Republic in March. Together with the new iPad, customers could buy O2 Mobile Internet micro SIM card with three months' worth of internet access for free.

Between the beginning of June and the end of July, customers could activate a new Internet Active tariff, which offers the speed of up to 25/2 Mbps, in all 28 O2 brand stores in Prague, and claim a reduced-rate public transport annual pass for CZK 600, instead of the listed price of CZK 1,480.

From June, Telefónica CR offers an expanded range of mobile data tariffs; it also came out with a special Facebook data tariff. For CZK 75 per month or CZK 19 per week, prepaid customers could access the global social network Facebook from their mobile handset.

Customers who call from a fixed line from Telefónica CR still had a choice of tariffs and bundled services, which came with calls to all mobile networks in the Czech Republic starting from CZK 2 per minute. Those who need to call international could benefit from a new proposition of calling fixed line numbers in 47 countries of the world, again with prices as low as CZK 2 per minute. The new tariffs and bundles O2 Calling Mobile and O2 Calling International could be combined by the customers themselves – depending on which destinations they call most often. The bundled services could be combined with fixed voice tariffs that come with free call minutes to fixed line numbers in the Czech Republic.

Customers of mobile prepaid services could, starting from March, top up their credit using their payment card directly from their telephone by calling an automated voice system at *19, without needing to register. The service facilitates buying credit for people who do not have regular internet access. The customer calls the secure number, enters the number for which the credit is intended, the amount and the card number. The system promptly despatches a message confirming the credit top-up.

For new and existing customers of mobile prepaid services, Telefónica CR prepared an innovated service, from February, which offers free calls and SMS on weekends to the O2 network. All users of prepaid cards with the tariff O2 NA!HLAS and O2 NA!PIŠTE could, with the 'Reward for Top-up' loyalty scheme and in addition to the guaranteed reward, also win a special prize of 2 years' worth of telecommunications services for CZK 2 per month.

As part of the summer campaign, which ran from July until September, customers could find CZK 25 worth of credit in each half-litre bottle of Coca-Cola. A registration – by entering the code found under the screw top at www.25kredit.cz or via a mobile web or application – activated the credit. Owners of the prepaid O2 cards had the credit automatically added to their SIM card balance; others could request a new O2 card free of charge or donate the credit.

In February, Telefónica CR also expanded its portfolio of post-paid tariffs for young people. The popular O2 [:kúl:] was joined by O2 Pohoda. After the free minutes are used up, the calls are charged at CZK 4.60 per minute, SMS and MMS costs CZK 1.60 and CZK 5.90, respectively.

O2 [kúl:] was offered for CZK 205 per month (incl. VAT), and came with 60 free minutes and unlimited on-net SMS.

Both 'young' tariffs could be combined with O2 Internet on A Mobile Start for the reduced price of CZK 100 per month; the regular listed price with FUP 150 MB was CZK 150 per month. Another attraction was the possibility to subscribe O2 Mobile Internet for CZK 200 per month (FUP 500MB), instead of the full-price CZK 300.

In March, Telefónica CR came out with Internet Guard, a comprehensive service that protects children, the family and the family computer against the threats from the digital world. It was developed in partnership with F-Secure, a global leader in online security, and customers could subscribe it for CZK 59 per month.

In July, all new O2 customers started automatically receiving their bill in an electronic format – delivered free to an email of their choice. The e-bill could come with a free itemised bill (normally for CZK 90), to give the customer a full control of their mobile phone usage. The e-bill is distributed via email with a notification via SMS. The online self-service My O2 gives a full history of the customer's bills and payments.

Telefónica CR was the first operator in the Czech Republic to go live with its LTE (Long Term Evolution) fourth generation mobile communication network, offering its customers the fastest internet they can presently experience anywhere. The technology allows for data transmission speeds which are up to ten times higher than those afforded by 3G networks.

The proposition to residential customers could also be enjoyed by business and self-employed customers.

To corporate customers, Telefónica CR continued to offer the option to become an 'Exclusive Customer' – a scheme which offers premium benefits in the form of better care, proactive usage optimisation, special handset pricing, personal treatment in a call centre, and many more. The goal is to reward the customer for his loyalty, improve customer experience and create an up-sell potential for other services from Telefónica CR.

Commented financial results

In this section we present and comment on the unaudited consolidated financial results of the Telefónica CR Group including the results of Telefónica CR (the parent company), Telefónica Slovakia, Telefónica O2 Business Solutions, Internethome and other smaller operating companies. The results were prepared according to International Financial Reporting Standards (IFRS).

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%. 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 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. Mobile revenues in the Czech Republic continued to improve, confirming positive trends seen in the second half of 2011. In H1 2012 they went down 4.5% year-on-year reaching CZK 12,345 million, while in Q2 2012, they declined by 4.0% year-on-year. 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.

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. Hence it executed additional phase of its restructuring program, focused on establishment of a more effective organisational structure by reducing the number of organizational layers across the whole company. In addition the transformation aims at further streamlining and simplifying processes. As a result of this restructuring program, the Company booked restructuring costs of CZK 223 million in H1 2012 in comparison with CZK 158 million in H1 2011. In H1 2012, the total Group headcount has been further optimised with a reduction of 514. 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. 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 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)¹ decreased by 5.8% year-on-year, reaching CZK 10,195 million in H1 2012. At the same time guided OIBDA margin reported marginal 1.3 p.p. decline year-on-year, reaching a solid 40.5% in H1, on the back of already mentioned focus on cost efficiency, improving profitability in Slovakia and helped by sale of non-core business (80% stake in subsidiary Informační linky, a.s.), not fully compensating higher commercial costs for investments in future growth. Reported OIBDA reached CZK 9,682 million in H1, -5.8% year-on-year.

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

Consolidated Capital Expenditures (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

¹ 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.

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 Overview²

In H1 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-year³) 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 64% of total handset sales in H1 2012 and smartphone penetration grew further reaching 23% at the end of June 2012, up by 7 percentage points year-on-year.

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 1.80% in H1 2012, while in Q2 2012 it was only 1.74%. 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.

² Figures are shown net of inter-segment charges between fixed and mobile businesses

³ From CZK 1.37 to CZK 1.08 in July 2011

In terms of usage, total mobile traffic⁴ 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 ARPU⁵ 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 ARPU⁶ 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% year-on-year in H1 2012. 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 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. 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 Overview⁷

In H1 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. 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.

⁴ Inbound and outbound, including roaming abroad, excluding inbound roaming

⁵ Including inter segment revenues

⁶ Big screens, small screens, M2M, time/usage based, push email, data roaming

⁷ Figures are shown net of inter-segment charges between fixed and mobile businesses

The total number of fixed accesses declined by 4.4% year-on-year reaching 1,539 thousand at the end of June 2012, with 41.8 thousand net losses during the quarter. This represents a 28.5% reduction compared to H1 2011 and is largely a result of lower traditional telephony line losses (-83.0 thousand in H1 2012, -18.0% 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 H1 2012, the number of VDSL customers grew by 104.1 thousand. The total number of O2 TV customers reached 139 thousand at the end of H1 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. Revenues 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 H1 2012, 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 H1 2012, their number increased by 86.2 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 (+76.6 thousand in H1), 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% in H1 and 37.1% in 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, thus helping to support the Group's profitability. In H1 2012, contract ARPU reached EUR 16.7 (EUR 17.1 in Q2), while prepaid ARPU was at EUR 8.3 (EUR 8.6 in Q2).

Outlook for the second half of 2012

Based on the results delivered in the first half of 2012 and outlook for the second half, Telefónica CR Group confirms its full year guidance in all levels:

| | 2011 base | 2012 guidance |
|---------------------------|--------------------|--|
| Business revenues | -5.7% year-on-year | improving trends vs. 2011 |
| OIBDA margin ¹ | 43.7% | limited margin erosion y-o-y |
| CapEx ² | CZK 5.6 billion | up to CZK 6.2 billion (flexibility to manage CapEx/ Revenue evolution) |

¹ OIBDA before brand fees & management fees; 2012 guidance excludes changes in consolidation, includes potential capital gains from non-core asset sales, assuming constant FX rates of 2011.

² Excluding business acquisitions