Telefónica Czech Republic, a.s.

CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

Content

GENERAL INFORMATION

Telefónica Czech Republic, a.s., Group (Group) consists of Telefónica Czech Republic, a.s., (Company) and its subsidiaries: Telefónica Slovakia, s.r.o., Bonerix s.r.o., Internethome, s.r.o., CZECH TELECOM Germany GmbH and CZECH TELECOM Austria GmbH. The Group operates a joint venture Tesco Mobile ČR s.r.o. with Tesco Stores ČR a.s.

The Company has the form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

The Group was a member of the Telefónica Group of companies (Telefónica Group) with the parent company, Telefónica, S.A. (Telefónica) as at 31 December 2013.

The Company is the largest integrated telecommunications provider in the Czech market providing fully converged services.

The number of employees employed by the Group amounted in average to 5,876 in 2013 (2012: 6,502).

The Company's shares are traded on the Prague Stock Exchange.

The consolidated financial statements were approved for issue by the Company's Board of Directors on 25 February 2014.

Sale to PPF Group

In November 2013 Telefónica reached an agreement with PPF Group (through PPF Arena 2 B.V.) to sell 65.9% of the Company's shares. The transaction involves all the Company's interests including Telefónica Slovakia, s.r.o. Both companies are allowed to trade under the O2 brand for a maximum of four years. They may also join Telefónica's Partners Programme, an initiative offering partner operators the opportunity to benefit from Telefónica's scale and cooperate on key business areas.

Reduction of the Company's share capital

In accordance with the resolution on reduction of the Company's share capital adopted by the Annual General Meeting of the Company held on 22 April 2013, the reduction of the Company's share capital was recorded into the Commercial Register on 15 November 2013. The Company's share capital was reduced by way of cancellation of 6,441,798 own ordinary shares with nominal value of CZK 87 (i.e. by CZK 560,436,426). Subsequently, the cancelled own ordinary shares were deleted from the statutory register. As at 31 December 2013, the amount of the Company's share capital equaled to CZK 27,461,384,874.

Share buyback

Following the resolution of the Annual General Meeting held on 19 April 2012 regarding the share buyback programme (up to 10% of ordinary shares within 5 years), the Board of Directors adopted on 26 February 2013 a resolution to continue with the acquisition of own ordinary shares (share buyback) to the extent of 6,441,798 of ordinary shares (i.e. up to 2% of the total ordinary shares issued by the Company as of that date). The Board of Directors adopted the decision to stop the acquisition of its own shares with effect from 29 October 2013.

LTE broadband mobile data network

In the year 2013 the auction part of the tender for the awarding the rights to use radio frequencies in the 800 MHz, 1800 MHz and 2600 MHz spectrum bands ended for both the Czech Republic and the Slovak Rebublic. These bands are necessary for the development of a new generation LTE network (4G). Telefónica Czech Republic, a.s. succeeded in the tender in above mentioned bands. Telefónica Slovakia, s.r.o. auctioned off frequency allotments in the 800 MHz and 1800 MHz bands.

This spectrum combination will allow the Company to build the highest speed and quality network in the Czech Republic. The Company has already covered a significant part of Prague and Brno with the LTE network. The Company will start rolling out the 4G network in new locations in the Czech Republic in the first half of year 2014.

Frequency allotments auctioned by Telefónica Slovakia, s.r.o will simplify the deployment of 4G networks in the country and enable the high-speed mobile internet will also be available in remote areas where broadband access is currently limited.

Agreement to share 2G and 3G networks

In October 2013 the Company has signed an agreement with T-Mobile Czech Republic a.s. to share their current 2G and 3G mobile networks. The deal has been made in order to achieve the optimal coverage in the Czech Republic and efficiencies in 2G and 3G networks and technologies. The transaction will bring tangible benefits to the customers, especially in the form of better services and coverage. The deal builds upon the very successful 3G network sharing scheme, which both companies already implemented in 2011-2012.

Restructuring

Over the course of 2013, the Group continued to implement its restructuring and cost-optimization activities aimed at further improving its operating efficiency. The Group launched new projects in various areas of its operations. These projects focused on the streamlining of the organisation structure including the reduction of duplicate positions; call centres consolidation and optimization; reduction of the number of applications and systems in use including optimisation of the related processes. Some restructuring projects have led to a transfer of the activities to outsourcing partners. More than 800 employees were made redundant during the restructuring process, and the Group incurred restructuring costs of CZK 368 million (see Note 2).

Building a better working world

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Telefónica Czech Republic, a.s.:

We have audited the accompanying consolidated financial statements of Telefónica Czech Republic, a.s. and its subsidiaries ("the Group") which comprise the consolidated balance sheet as at 31 December 2013, and the consolidated statement of total comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

Management of Telefónica Czech Republic, a.s. is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2013, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Ernst & Young

Ernst & Young Audit, s.r.o.
License No. 401
Represented by partner

Radek Pav
Auditor, License No. 2042

25 February 2014
Prague, Czech Republic

CONSOLIDATED STATEMENT OF TOTAL COMPREHENSIVE INCOME

For the year ended 31 December 2013

In CZK million	Notes	Year ended 31 December 2013	Year ended 31 December 2012
Revenues	2	47,895	50,534
Other income	2	867	1,127
Expenses	2	(30,274)	(31,852)
Impairment loss		(11)	(28)
Operating income before depreciation and amortization (OIBDA)		**18,477**	**19,781**
Depreciation and amortisation	7, 8	(11,032)	(11,437)
Operating profit		7,445	8,344
Finance income	3	148	103
Finance costs	3	(323)	(291)
Results attributed to joint venture		(6)	-
Profit before tax		7,264	8,156
Corporate income tax	4	(1,569)	(1,380)
Profit for the year		**5,695**	**6,776**
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Translation differences		373	(65)
Other comprehensive income, net of tax		373	(65)
Total comprehensive income, net of tax		**6,068**	**6,711**
Profit attributable to:			
Equity holders of the Company	5	5,695	6,776
Total comprehensive income attributable to:			
Equity holders of the Company		6,068	6,711
Earnings per share (CZK) – basic*	5	18	21

*There is no dilution of earnings as no convertible instruments have been issued by the Company.

CONSOLIDATED BALANCE SHEET

As at 31 December 2013

In CZK million	Notes	31 December 2013	31 December 2012
ASSETS			
Property, plant and equipment	7	41,857	46,691
Intangible assets	8	20,008	20,330
Investment in associate	21	9	29
Other financial assets	10	169	112
Deferred tax asset	14	417	673
Non-current assets		**62,460**	**67,835**
Inventories	9	536	487
Receivables	10	7,062	7,732
Income tax receivable	4	1	101
Cash and cash equivalents	11	3,890	3,044
Current assets		**11,489**	**11,364**
Total assets		**73,949**	**79,199**
EQUITY AND LIABILITIES			
Ordinary shares	19	27,461	28,022
Treasury shares	19	(1,596)	(2,483)
Share premium		19,349	24,374
Retained earnings, funds and reserves		10,535	10,661
Total equity		**55,749**	**60,574**
Long-term financial debts	13	3,000	3,000
Deferred tax liability	14	2,735	3,206
Non-current provisions for liabilities and charges	15	26	29
Non-current other liabilities	12	64	87
Non-current liabilities		**5,825**	**6,322**
Short-term financial debts	13	4	31
Trade and other payables	12	12,199	12,235
Income tax liability	4	155	5
Provisions for liabilities and charges	15	17	32
Current liabilities		**12,375**	**12,303**
Total liabilities		**18,200**	**18,625**
Total equity and liabilities		**73,949**	**79,199**

The consolidated financial statements were approved by the Board of Directors on 25 February 2014 and were signed on its behalf by:

Luis Antonio Malvido
Chairman
of the Board of Directors
Chief Executive Officer

Martin Bek
Member
of the Board of Directors

David Melcon Sanchez-Friera
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2013

In CZK million	Notes	Share capital	Share premium	Treasury shares	Foreign exchange translation reserve	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2012		**32,209**	**24,374**	**-**	**(52)**	**56**	**6,452**	**6,058**	**69,097**
Currency translation differences – amount arising in period		-	-	-	(65)	-	-	-	(65)
Profit for the year		-	-	-	-	-	-	6,776	6,776
Total comprehensive income		-	-	-	**(65)**	-	-	**6,776**	**6,711**
Capital contribution and other transfers		-	-	-	-	(25)	47	(53)	(31)
Distribution declared in 2012	6	-	-	-	-	-	-	(8,696)	(8,696)
Treasury share transactions	19	-	-	(2,483)	-	-	-	91	(2,392)
Share capital increase/(decrease)	19	(4,187)	-	-	-	-	-	72	(4,115)
At 31 December 2012		**28,022**	**24,374**	**(2,483)**	**(117)**	**31**	**6,499**	**4,248**	**60,574**
At 1 January 2013		**28,022**	**24,374**	**(2,483)**	**(117)**	**31**	**6,499**	**4,248**	**60,574**
Currency translation differences – amount arising in period		-	-	-	373	-	-	-	373
Profit for the year		-	-	-	-	-	-	5,695	5,695
Total comprehensive income		-	-	-	373	-	-	**5,695**	**6,068**
Capital contribution and other transfers		-	-	-	-	7	43	(36)	14
Distribution declared in 2013	6	-	(3,221)	-	-	-	-	(6,442)	(9,663)
Treasury share transactions	19	-	118	(1,596)	-	-	-	234	(1,244)
Cancellation of treasury shares	19	(561)	(1,922)	2,483	-	-	-	-	-
At 31 December 2013		**27,461**	**19,349**	**(1,596)**	**256**	**38**	**6,542**	**3,699**	**55,749**

* Refer to Note 19 regarding amounts not available for distribution.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2013

In CZK million	Notes	Year ended 31 December 2013	Year ended 31 December 2012
Cash flow from operating activities			
Cash received from operations		53,719	54,592
Cash paid to suppliers and employees		(34,936)	(35,428)
Dividends received		5	5
Net interest and other financial income/expenses paid	11	(23)	(150)
Taxes paid		(1,463)	(1,783)
Net cash from operating activities		**17,302**	**17,236**
Cash flow from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets		72	322
Payments on investments in property, plant and equipment and intangible assets		(5,584)	(5,921)
Payments on investments in WiFi acquisition		(53)	(148)
Payments made on financial investments		(10)	(18)
Returned warranty deposit for spectrum auction		250	-
Paid warranty deposit for spectrum auction		(375)	(250)
Repayments of loans made to joint ventures		12	-
Provisions of loans made to joint ventures		(30)	-
Net cash used in investing activities		**(5,718)**	**(6,015)**
Cash flow from financing activities			
Dividends paid		(6,191)	(8,598)
Capital decrease	19	(3,104)	(4,115)
Cash payments to owners for acquisition of treasury shares	19	(1,596)	(2,483)
Proceeds from loans		-	3,000
Repayments of loans, borrowings and promissory notes	13	-	(2,912)
Net cash used in financing activities		**(10,891)**	**(15,108)**
Effect of foreign exchange rate changes on collections and payments		**153**	**(24)**
Net increase / (decrease) in cash and cash equivalents during the period		**846**	**(3,911)**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		**3,044**	**6,955**
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	11	**3,890**	**3,044**
BALANCE AT THE BEGINNING OF THE PERIOD		**3,044**	**6,955**
Cash on hand and at banks		3,025	6,932
Other cash equivalents		19	23
BALANCE AT THE END OF THE PERIOD	11	**3,890**	**3,044**
Cash on hand and at banks		3,874	3,025
Other cash equivalents		16	19

ACCOUNTING POLICIES

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A Basis of preparation

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below. The policies have been consistently applied to all years presented, unless otherwise stated.

The consolidated financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) and all applicable IFRSs adopted by the EU. IFRS comprise standards and interpretations approved by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC).

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll. requires the Group to prepare its consolidated financial statements in accordance with IFRS adopted by the EU (Regulation (EC) No 1606/2002). At the balance sheet date, there are no differences in the IFRS policies applied by the Group, and IFRS adopted by the EU.

The consolidated financial statements were prepared under the historical cost convention except for non-current assets held for sale, inventory held at net realizable value, financial derivatives, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of consolidated financial statements in conformity with IFRS required the Group to use certain critical accounting estimates. It also required estimates be used in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note V.

The amounts shown in the consolidated financial statements are presented in millions Czech crowns (CZK), if not stated otherwise.

In order to clarify and enhance quality of presented information, without changing accounting policies, the Group decided to simplify certain parts of the financial statements. Simplifications mainly concern statement of total comprehensive income, notes concerning revenues and costs and property, plant and equipment.

Adoption of new or revised IFRS standards and interpretations (includes standards and interpretations applicable for the Group)

In 2013, the Group adopted the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Group.

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities

The Group has applied the amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities for the first time in the current year. The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements for financial instruments under an enforceable master netting agreement or similar arrangement.

The amendments have been reflected in notes to the financial statements.

IFRS 13 Fair Value Measurement

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes disclosure requirements.

The application of IFRS 13 has not had any material impact on the amounts recognised in the financial statements.

Amendments to IAS 1 Presentation of Items of Other Comprehensive Income

The amendments introduce new terminology, whose use is not mandatory, for the statement of comprehensive income and income statement. The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met.

Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

New IFRS not effective as at 31 December 2013 (includes standards applicable for the Group)

At the date of preparation of the accompanying consolidated financial statements, the following IFRS had been published, but their application was not mandatory. The Group intends to adopt those standards when they become effective.

Standards and amendments	**Mandatory application: annual periods beginning on or after**
IFRS 9 Financial Instruments	1 January 2015
IFRS 10 Consolidated Financial Statements	1 January 2014
IFRS 11 Joint Arrangements	1 January 2014
IFRS 12 Disclosure of Interests in Other Entities	1 January 2014