Annual Report 2006

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Annual Report 2006

Content

Auditors' report

To the Shareholders of Telefónica O2 Czech Republic, a.s.:

I. We have audited the consolidated financial statements of Telefónica O2 Czech Republic, a.s. and its subsidiaries as at 31 December 2006, presented in the Annual Report of Telefónica O2 Czech Republic, a.s. (the Company) on pages 97–136, on which we have issued an auditors' report dated 22 February 2007, presented in the Annual Report on page 99. We have also audited the separate financial statements of the Company as at 31 December 2006, which are presented in the annual report of the Company on pages 137–175 on which we have issued an auditors' report dated 22 February 2007, presented in the Annual Report of the Company on page 139 (both referred further as financial statements).

II. We have also audited the consistency of the annual report with the financial statements described above. The management of Telefónica O2 Czech Republic, a.s. is responsible for the accuracy of the Annual Report. Our responsibility is to express, based on our audit, an opinion on the consistency of the Annual Report with the financial statements.

We conducted our audit in accordance with International Standards on Auditing and the related implementation guidance issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the information presented in the annual report that describes the facts reflected in the financial statements is consistent, in all material respect, with the financial statements. We have checked that the accounting information presented in the Annual Report on pages 5–92 and 181–196 is consistent with that contained in the audited financial statements as at 31 December 2006. Our work as auditors was confined to checking the Annual Report with the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. We believe that our audit provides a reasonable basis for our opinion.

Based on our audit, the accounting information presented in the Annual Report is consistent, in all material respects, with the above-mentioned financial statements.

III. In addition, we have reviewed the accuracy of the information contained in the report on related parties of Telefónica O2 Czech Republic, a.s., for the year ended 31 December 2006, presented in the annual report of the Company on pages 207–219. The management of Telefónica O2 Czech Republic, a.s., is responsible for the preparation of the report on related parties. Our responsibility is to issue a report based on our review.

We conducted our review in accordance with applicable International Standards on Auditing and the related implementation guidance issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the review to obtain moderate assurance as to whether the report on related parties is free from material misstatement. The review is limited primarily to enquiries of company personnel, to analytical procedures applied to financial data and to examining, on a test basis, the accuracy of information, and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the report on related parties of Telefónica O2 Czech Republic, a.s., for the year ended 31 December 2006 is materially misstated.

Ernst & Young

Ernst & Young Audit & Advisory, s.r.o., člen koncernu
License No. 401
Represented by

Brian Welsh	Magdalena Souček
Partner	Auditor, Licence No. 1291

23 April 2007, Prague, Czech Republic

Financial and operational highlights

Financial data are based on audited consolidated financial statements prepared in accordance with International Financial Reporting Standards. All figures, unless otherwise stated, are in CZK millions as at 31 December of each year.

Financials	2006	2005
Revenues[1]	61,311	61,040
OIBDA – Operating income before finance costs, tax, depreciation and amortization[2]	27,906	27,240
Operating income	11,160	9,432
Income before taxes	10,940	8,748
Net income	8,020	6,248
Total assets	117,877	124,211
Property, plant and equipment	78,755	88,003
Total equity	88,481	94,975
Financial debts	9,363	9,631
Capital expenditure	6,500	6,072
Operations		
Fixed telephony accesses[3] (x 1,000)	2,402	2,908
ADSL connections (x 1,000)	470	274
Pay TV – O_2 TV (x 1,000)	16	–
Mobile customers (x 1,000)	4,864	4,676
– of which contract pre-paid	1,875	1,546
– pre-paid	2,989	3,130
Mobile data customers[4] (x 1,000)	168	137
Group headcount	9,416	10,059

Ratios (in %)	2006	2005
OIBDA/Business Revenues (OIBDA margin)[2]	45.8	44.9
Net income/Revenues	13.1	10.2
Capital expenditure/Revenues	10.6	9.9
ROA (Net income/Total assets)	6.8	5.0
ROE (Net income/Equity)	9.1	6.6
Gross gearing (Financial debts/Total equity)	10.6	10.1
Macroeconomic indicators[5]		
Population (in millions)	10.3	10.2
GDP[6] (in %)	6.1	6.1
Inflation (in %)	2.5	1.9
Unemployment (in %)	8.1	9.0
CZK/USD exchange rate – average over the period	22.6	23.9
CZK/USD exchange rate – end of period	20.9	24.5
CZK/EUR exchange rate – average over the period	28.3	29.8
CZK/EUR exchange rate – end of period	27.5	29.0

[1] Business and recurring revenues.(excluding Gains from sale of non-current assets).
[2] Including impairment charge; in 2005 the Group posted an impairment charge of CZK 1,261 million, compared to CZK 253 million in 2006.
[3] Excluding incoming-only lines.
[4] CDMA and GPRS.
[5] Sources: Czech Statistical Office, Czech National Bank, Ministry of Finance, Ministry of Labour and Social Affairs.
[6] At constant 1995 prices; the 2006 figure is an estimate.

Letter from the Chairman of the Board of Directors

To Our Shareholders,

Let me review the developments in the Telefónica O2 Czech Republic Group in 2006. The past year was a year full of memorable changes and events. The first results of these changes were already visible in 2006, but their full impact will be felt in the coming years.

At the beginning of the year there were two companies present on the Czech telecommunications market: ČESKÝ TELECOM, a.s. and Eurotel Praha, spol. s r.o. On 1 July 2006, these two companies joined forces to form Telefónica O2 Czech Republic, a.s. (Telefónica O2), the first integrated telecommunications operator in the Czech Republic. Since the beginning of September 2006, the new company has been presenting itself and all its products and services under the O_2 brand. After winning a mobile licence in Slovakia, we expanded our activities onto the market there. The launch of O_2 TV, our IPTV product, introduced us to a new market – multimedia entertainment. Our ongoing efforts to grow our broadband internet and data services yielded a significant increase in the numbers of customers of these services in both the fixed line and mobile segments. The financial results exceeded our expectations from the beginning of the year. We succeeded in reversing the trend in revenues, which increased slightly in 2006 compared to 2005. Although our costs increased, mainly due to the launch of the integration process and the re-branding project, we managed to increase our OIBDA and maintain our margins.

When, in early March, we announced our plan to merge the two companies, we presented an implementation schedule for the individual integration projects and our targets for 2006 and beyond. Our key integration targets for 2006 included integration of our distribution channels and points-of-sale, integration of business and corporate sales, including government, customer care integration, re-branding, cultural alignment and a gradual integration of key financial processes. And I am truly happy to be able to say that we have successfully delivered on the majority of the above integration targets we set for 2006.

Jaime Smith Basterra
Chairman of the Board of Directors

By the end of 2006, we had successfully integrated the fixed and mobile sides of sales for our largest accounts. In this segment, customers are attended to by a dedicated key account manager offering a full portfolio of fixed line and mobile services. Customer care was also similarly integrated; our sales lines were made completely separate from our customer care lines, and the distribution and customer care channels on the fixed line and mobile sides of the business were also integrated.

Since 1 September 2006, Telefónica O2 has been presenting all its services and products under the O_2 brand, supported in all communication by the logo of the parent company, Telefónica, acting as a champion of quality and guarantor of international backing. In the first 4 months the new brand has earned a very solid position – not only among our customers, but across the entire Czech business community.

Several other flagship integration projects were implemented. The first converged voice – internet products, combining all the benefits of fixed line and mobile services, were launched on the market. The project to integrate network operation – encompassing network construction and maintenance of the fixed and mobile network – is progressing on plan. During the year, the IT infrastructure was integrated, together with key IT systems. The integration process is set to continue in 2007. One new project is the Customer Experience Programme, which is aimed primarily at improving selected processes that have a bearing on the customer experience. The goal of the integration is to achieve considerable synergies, leading to revenue growth and savings on operating and capital costs.

In September 2006, Telefónica O2 Group secured a licence for mobile network operation in Slovakia via its subsidiary Telefónica O2 Slovakia s.r.o. (Telefónica O2 Slovakia). This step represents an organic regional expansion, leveraging on synergies in partnership with Telefónica O2. The plans to enter the Slovak market are based on innovative marketing, the O_2 brand and state-of-the-art technology. The goal of Telefónica O2 Slovakia is to contribute to the competitive environment in the Slovak telecommunications market, to be of benefit to customers and to increase the value for shareholders of Telefónica O2. Its strategy is to become a strong player on the Slovak telecommunications market in the near future.

A national roaming agreement concluded with T-Mobile Slovensko, a.s. made it possible to launch commercial operation for customers of pre-paid services as early as on 2 February 2007, i.e. less than five months after winning the licence. By the end of February 2007, Telefónica O2 Slovakia had its first 200 thousand active customers. Launch of the post-paid service is scheduled for the second quarter of 2007.

On 1 September 2006 we launched our IPTV (television over a fixed line) product, branded as O_2 TV. This marked a step into the new market of multimedia entertainment, where we want to secure a significant share. In addition to accessing films, TV and radio programmes, our customers now can rent films from a virtual video library or TV archive. That the service is attractive to customers can be clearly seen from the relatively high demand. By the end of 2006, i.e. in four months, the number of O_2 TV customers had reached 16 thousand, and at the beginning of February 2007 it exceeded the 20 thousand mark. The service is also a tangible product of our co-operation with Telefónica, which developed the product and has been marketing it in Spain.

In the field of regulation of the telecommunications market, 2006 brought several important changes. The Czech Telecommunications Office completed its analysis of 18 relevant markets as it was obliged to do by the law. Based on the analysis, the authority determined entities with significant market power, which were then encumbered with remedies such as pricing regulation. The remedies mostly concerned wholesale services, while retail pricing regulation was abolished. I can say that in large part the remedies had been expected on our part.

As in the previous years, the demand for high-speed internet, data and other value added services grew both in the fixed line and mobile segments in 2006. We also saw an ongoing trend of substitution of fixed lines by mobile services. This brought about an increase in the number of mobile customers and growing traffic in mobile networks at the expense of fixed lines, whose number continued to decline. Mobile SIM card penetration increased to more than 120% at the end of 2006, while fixed line penetration fell to 24%. The total number of mobile customers of the company increased by 4% in 2006 to 4,864 thousand while the number of fixed lines fell in the same period by 17% to 2,402 thousand. Our position as an integrated operator helped us eliminate the effect of this trend – the overall voice traffic generated by our customers grew in 2006 by 6.9% compared to 2005, mainly due to 21% growth in mobile traffic.

In line with market trends and the requirements of our customers, our activities in 2006 focused on stimulating voice traffic and revenues from voice services and on the development and marketing of new services in areas with growth potential, such as high-speed internet, data services and other value added services.

A fourfold speed upgrade for all O_2 Internet Expres products at the beginning of February 2006, with no corresponding increase in prices, and a strong marketing campaign helped increase the number of broadband internet customers in the consumer segment by 179 thousand (79%) to 405 thousand in 2006. The total number of ADSL connections was 470 thousand as at 31 December 2006. The number of mobile data customers also increased considerably in 2006. The number of GPRS and CDMA customers grew by 23% to 168 thousand, confirming our leadership in this field.

We also introduced new innovative voice services. After the lifting of pricing regulation in the fixed voice segment, we rebalanced the monthly subscription rates for voice tariffs. The rates on domestic long-distance calls to the local call rate, and the rates on calling to mobile networks were brought down. For our pre-paid mobile customers we introduced O_2 Simple, a new tariff concept that lets customers use credit calculated from their subscription for calls or SMS to suit their needs, giving them more flexibility and easy control over their spending.

The Group's financial results in 2006 in many ways exceeded our expectations. Consolidated revenues reached CZK 61.3 billion in 2006, which represents year-on-year growth of 0.4%, evidencing a reversal in trend. The key role in this growth was played by the mobile segment, where total revenues grew by 6% to CZK 30.9 billion. The fixed line segment recorded a decline of 4.7% to CZK 30.4 billion, although the rate of decline slowed as the year progressed. Despite 2.8% growth in consolidated costs, our OIBDA grew by 2.4% in 2006 on the previous year, reaching CZK 27.9 billion. OIBDA margin reached 45.8% in 2006, compared to 44.9% in 2005. The growing operating costs were driven by the costs of the integration process, including the re-branding project, and our expansion in Slovakia; the higher costs counteracted the otherwise continuing long-term efficiency improvements in the operating cost area. As a result of further decreases in the level of depreciation and amortisation and the lower financial costs, net consolidated profit showed year-on-year growth of 28.3% to CZK 8 billion. In 2006, we continued to focus our investments mainly on growth areas – ADSL, IPTV, CDMA and UMTS. Total consolidated investment was CZK 6.5 billion. Free cash flow remained high in 2006, reaching CZK 18.4 billion. This translates into a drop of 1.4%, caused by accelerated investment in growth areas.

The main priorities for 2007 include slowing the downward trend in fixed lines. To achieve that, we plan to introduce new converged products combining voice, high-speed internet and television over a fixed line. We believe that this offer will help increase the value of the fixed line and subsequently reduce the customer churn rate. We have identified strong potential for growth in the IT and integrated customer solutions area in the corporate and government segments. Our activities in the mobile business continue to focus on maintaining Average Revenue Per User (ARPU), mainly by continuing the migration of pre-paid customers to post-paid tariffs and by increasing our revenues from mobile data and mobile internet services. We remain focused on our main goal – customer experience. We will also support the gradual expansion of our Slovak operation, including the development of systems, processes, networks and distribution channels. Maintaining our leadership on the Czech telecommunications market remains one of our strategic priorities. A focus on OIBDA growth, efficient investment and strong free cash flow remain key aspects of our financial management.

Jaime Smith Basterra
Chairman of the Board of Directors

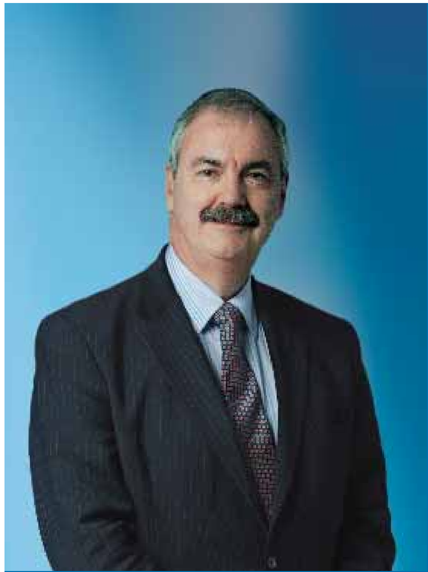
Letter from the Chairman of the Supervisory Board

To Our Shareholders,

You have surely noticed that 2006 brought many changes to our company. It was the year in which the first integrated telecommunications operator, Telefónica O2 Czech Republic, emerged on the Czech market. We were among the first few in the industry to decide to form a company offering comprehensive communication, information and entertainment solutions to customers. At the same time, the company decided to accept a new identity with the O_2 brand, which has been an immense success in the United Kingdom, Germany and Ireland. O_2 brings a wholly different way of looking at telecommunications services – one that can only be achieved by an integrated operator.

The above changes have already born fruit. Although the integration and re-branding processes began in the latter part of the year, it is already clear that they were a step in the right direction. The financial results of the Telefónica O2 Czech Republic Group in 2006 reversed some previous trends. We managed to turn around the decline in the Group's overall revenues and, for the first time, the average revenue per user (ARPU) in our mobile business. Operating profit meanwhile continued to grow, as did other key financial indicators. The good financial results fostered growth in the company's value in terms of market capitalisation, confirming its strong financial performance.

The continuing integration of the company into the global Telefónica Group, one of the world's largest telecommunications operators, also reflected positively on the business results. In terms of value added in 2006, the group is the second largest player in the global telecommunications industry. The assurance and strong backing of the global group that comes with the Telefónica brand combines well with the dynamic O_2 brand. The pledge of greater support from Telefónica O2 Europe was confirmed at the last General Meeting, when personnel changes were implemented in the Supervisory Board. The four new members from Telefónica O2 Europe



Peter Anthony Erskine
Chairman of the Supervisory Board

guarantee more direct communication and full leverage of the wealth of experience of this company.

In the second half of 2006 and particularly in early 2007, the foundations were laid for the further development of our company. Our subsidiary Telefónica O2 Slovakia won a tender for a mobile telecommunications licence in Slovakia. The company launched its pre-paid services at the beginning of February 2007 and within a month it had recorded its first 200 thousand active customers.

Finally, let me thank all of the employees of the Telefónica O2 Czech Republic Group for welcoming the changes as new opportunities. The results of their work are appreciated not only by our customers, but also by you, our shareholders. Thank you for the trust you have vested in our company.

Peter Anthony Erskine
Chairman of the Supervisory Board

Calendar of key events in 2006

January
The number of users of ADSL high-speed internet access reaches 275 thousand, an increase of 175% on the previous year.

ČESKÝ TELECOM increases the internet connection speed by up to four times. Existing customers qualify for an automatic and free speed upgrade and new customers are offered higher speeds for the same prices.

Eurotel records 4,676 thousand customers in its network at the end of 2005, thus confirming its leadership on the Czech mobile market. The fourth quarter of 2005 largely contributed to the achievement – Eurotel was the most successful operator in terms of new customer acquisition in both the post-paid and pre-paid segments.

February
ČESKÝ TELECOM published its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2005. Consolidated operating profit and consolidated profit before tax grew in 2005 to CZK 9.5 billion and CZK 8.7 billion respectively. Consolidated net profit reached CZK 6.2 billion.

The number of users of high-speed internet over a fixed line exceeds the 300 thousand mark.

ČESKÝ TELECOM launches its e-účet application for online payment for telecommunications services.

Eurotel launches Najdi na mapě on the Eurotel Live! portal; the service lets users search maps and plan their journeys in the Czech Republic.

Eurotel introduces a guarantee of the lowest mobile handset prices on the Czech market.

March
The Board of Directors and Supervisory Board of ČESKÝ TELECOM approve the plan to integrate Eurotel and ČESKÝ TELECOM into one telecommunications company, Telefónica O2 Czech Republic.

Via its subsidiary OMNICOM Praha, ČESKÝ TELECOM acquires another licence for time-limited experimental digital television broadcasting.

ČESKÝ TELECOM wins a tender to provide a component of the Universal Service and will continue to operate public payphones.

Eurotel launches Eurotel Web Video calls, a service which lets post-paid and pre-paid customers make video calls without a mobile handset and outside the UMTS network coverage.

April
An Ordinary General Meeting of shareholders of ČESKÝ TELECOM is held. The shareholders approve, among other things, a proposal of the Board of Directors for the payment of a dividend of CZK 45 per share before tax from the 2005 profit and retained earnings. The General Meeting consents to the transfer of Eurotel's equity to ČESKÝ TELECOM and approves an amendment to the Company's Articles of Association and a change of the corporate name to Telefónica O2 Czech Republic, a.s.

The Supervisory Board of ČESKÝ TELECOM makes personnel changes in the offices of its Chairman and 1st Vice-Chairman. Peter Anthony Erskine becomes Chairman and Julio Esteban Linares López is elected 1st Vice-Chairman of the Supervisory Board. The number of high-speed internet users reaches the 350 thousand mark.

ČESKÝ TELECOM publishes its unaudited consolidated financial results prepared under International Financial Reporting Standards for the first quarter of 2006.

ČESKÝ TELECOM introduces a new tariff structure with unlimited calling, one rate for local and long distance calls in the Czech Republic and cheaper calls to mobile networks.

Český Telecom launches a service that lets customers of Eurotel Go! pre-paid cards pay for credit top-ups via their monthly fixed line bill.

Eurotel launches the HSDPA technology. The Internet Speed service now has a data download speed of up to 1,024 kb/s in the UMTS 3rd generation mobile network, and not only in the Czech Republic in areas with UMTS coverage, but also in foreign destinations.

Eurotel launches Eurotel Navigace, a new service that offers a convenient and economical navigation solution for travellers.

May

CZECH TELECOM Mobile Solution is voted one of the three best IT projects in 2005.

The number of high-speed mobile internet users exceeds the 80 thousand mark. The fast mobile internet service, running on CDMA2000 1xEV-DO, is now available to more than 80% of the Czech population.

June

ČESKÝ TELECOM records 375 thousand fixed lines with ADSL internet connection. The service is now available in 1,581 locations, representing 90% of all telephone lines in the Czech Republic.

Eurotel expands the range of services available on the information and entertainment Eurotel Live! portal in the UMTS network and publishes new, lower prices for using the services of online traffic cameras and mobile TV. Customers can now subscribe to two general news channels with content compiled from the iDNES and iHNed news portals.

Eurotel decides to terminate its 450 MHz NMT voice service.

July

Telefónica O2 Czech Republic, a.s. is registered in the Commercial Register as of 1 July 2006.

Telefónica O2 publishes its unaudited consolidated financial results prepared under International Financial Reporting Standards for the first half of 2006.

More than 85 thousand customers of Telefónica O2 Czech Republic are now using fast mobile internet via the CDMA technology.

Telefónica O2 commences pilot operation of the IPTV technology.

As a part of integration process Corporate & Government Customers sales are consolidated into one unit. Each Corporate and Government customer has one Key Account manager for fix and mobile services.

August
400 thousand people are now using high-speed internet. During the first half of 2006, the number of high-speed internet users grew by close to 50%.

Telefónica O2 unveils its new O_2 brand which replaces the existing brands ČESKÝ TELECOM and Eurotel.

Telefónica O2 Slovakia wins the tender for the third mobile network licence in Slovakia. The licence confers the right to provide telecommunications services in Slovakia on GSM and UMTS frequencies for the next 20 years.

Telefónica O2 launches a new mobile tariff concept. The tariffs let customers adapt their payments for communications services to their anticipated consumption, and so get the best value for money.

September
Telefónica O2 becomes the first operator to launch an IPTV product, branded as O_2 TV.

The Board of Directors of Telefónica O2 Czech Republic approves, with the prior consent of the Supervisory Board, the appointment of Juraj Šedivý and Henrich Daubner as authorised representatives of Telefónica O2 Slovakia. Juraj Šedivý becomes Chief Executive Officer of Telefónica O2 Slovakia.

Telefónica O2 launches BlackBerry, a mobile office solution for corporate clients.

October
Telefónica O2 publishes its unaudited consolidated financial results prepared under International Financial Reporting Standards for the first three quarters of 2006.

The number of customers connected to the internet via the fast mobile data technology CDMA2000 1xEV-DO exceeds the 90 thousand mark.

Telefónica O2 becomes the first Czech operator to broadcast HDTV on the digital video broadcasting–terrestrial (DVB-T) and O_2 TV platforms.

Telefónica O_2 offers an integrated solution combining fixed and mobile connection in a single subscription and a single bill.

O_2 Navigace is awarded the Crystal Disc at the 2006 Invex/Digitex exhibition; the award recognises innovative solutions in the field of information and communication technology.

As a part of integration process Medium Enterprise Customers sales are consolidated into one unit. Each Medium Enterprise now has one Account Manager for fixed and mobile services.

November
The number of high-speed internet users in the Czech Republic reaches 450 thousand.

O_2 TV now has 10 thousand active users.

Telefónica O2 receives a Certificate of Excellence from the European Foundation for Quality Management; the company earns the premium rating in the category Recognised for Excellence in Europe.

December

O_2 TV now has 16 thousand customers.

Telefónica O2 increases the data limits for O_2 Internet Expres services while preserving the prices.

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About Telefónica

2006 Relevant Data

Telefónica Group is the third largest player in the global telecommunications industry.

Profitable Growth*
Profits +40.2% 6,233 millions of euros

	2004[1]	2005[1]	2006	05/06
Incomes (EUR Millions)	30,281	37,383	52,901	+41.5%
OIBDA (EUR Millions)	12,222	15,056	19,126	+27.0%
Free Cash Flow (EUR Millions)	8,455	9,918	11,122	+12.3%[2]

Customers +32.4% 203.2 millions of accesses

	2004	2005[3]	2006	05/06
ADSL line retailers (Accesses in thousands)	3,916	5,653	7,975	+41.1%
Mobiles (Accesses in millions)	74.4	99.1	145.1	+46.4%
Pay TV (Customers in thousands)	408	683	1,064	+55.7%

Shareholder returns
Total profitability for the shareholder 2006 +32.4%[4]

	2004	2005	2006	growth
Earnings per share (EUR)	0.62	0.91	1.304	+42.9%
Total profitability for the shareholder Telefónica				+ 32.4%
Total profitability for the shareholder DJTelco				+ 23%

*The audited consolidated financial statements of Telefónica Group are included in the annual accounts.
[1] In 2005 TPI is included in the paragraph "discontinuing operations", for what figures are not coherent with the ones in 2004.
[2] Free Cash Flow as OIBDA-CapEx (FX final period).
[3] In 2006 the criteria of access reporting was changed, for that reason the figures in 2005 have been updated in order to improve comparability.
[4] Source: Bloomberg.

Selected operating highlights

> 19 thousand suppliers
> 1.5% national GDP contribution*
> 203 millions of accesses
> 1.5 million of shareholders
> 227 thousand employees

(*) Spain, Argentina, Brazil, Chile, Colombia and Peru

Technology and innovation

4,800 millions of Euros in innovation +65%

	2004	2005	2006	growth
Innovation (EUR Thousands)	2,398	2,900	4,301	+48%
I+D	461	533	588	+10%

Community

39.7 millions of euros for community investment + 3,7 %

	2004	2005	2006	growth
Fundación Telefónica + ATAM* (EUR Thousands)	34	38	39.4	3.7%
Direct beneficiaries				
Proniño beneficiaries	8,608	11,540	25,339	+120%
Digital Inclusion				
Millions of low income fixed lines Latam	4,720	5,541	6,411	+16%

* Company contributions, which double the ones of the employees.

Telefónica 2006

Accesses

Telefónica operates in 23 countries, being the first private investor in Latin America.

To December 2006, Telefónica Group is provided with 203 million of total accesses, which means an increase of 32.4% in comparison with the previous year. The increase of cellular accesses (+46.4%), wide band (+41.1%) and pay TV (+55.7%) must be highlighted. The number of mobile phone customers increased up to 145 million and in the fixed line area we reached 42.3 million of accesses.

Telefónica is the third worldwide telecommunications company in number of customers and the first multinational; the two larger ones are Chinese.

Investment

Over the last two years Telefónica has widely expanded its operations through the acquisitions of BellSouth assets in Latin America in 2004, ČESKÝ TELECOM, 5% of China Netcom's share capital, and the European assets of O2 and Colombia Telecom in 2006.

The investment in Telefónica Capex in 2006 rose to EUR 8,003 million, which means an increase of 55.3% compared to 2005.

During 2006, Telefónica allocated more than EUR 4,300 million to technological innovation all over the world, 588 of which were issued to research and development.

Profits

The income of Telefónica Group increased 41.1% compared to 2005, reaching the amount of EUR 52,901 million.

The OIBDA of Telefónica Group reached EUR 19,126 million, with an increase of 27% in relation to 2005.

The net profit of Telefónica Group reached EUR 6,233 million, with an inter annual increase of 40.2%, due to the fine development of all the operations and to the positive contribution of the new acquisitions.

Employees

The staff of Telefónica adds up to more than 227 thousand employees. 24.5% of them are in Spain, 13.7% in the rest of Europe and 61.4% in Latin America.

Shareholders

Telefónica is a fully private company, with more than 1.5 millions of direct shareholders; its shares are quoted on the main stock exchanges in Spain and abroad.

The Group is included in the Dow Jones Global Titans 50 index, which lists the world top 50 blue-chips, i.e. companies of major Stock capitalization listed in the main stock markets of he world.

Business Strategy

Industrial Trend

The telecommunications sector is changing rapidly as a result of three key trends:

- Globalisation: within the telecommunications market the operators are strengthening their regional leadership and heading global brands. In addition, the customers themselves are setting up global communities, not only in private terms but also in the companies' arena, to which they choose to be linked no matter where they are physically settled.
- Local market activation: the operators try to offer proposals of distinctive value to the customers, mainly through proximity, and a greater specialisation of its trading force. In order to achieve this, it is crucial to devote a big effort to innovation and dynamic improvement of operative efficiency.
- Convergence of services, accesses and electronic devices caused by the convergence of technologies associated to them. Consequently, the telecommunications business needs to establish new business lines in order to take the existing opportunities in association with the content companies, applications, technologies and computing systems.

Strategy: profitable development

Telefónica has identified the keys to maintaining its profitable development even in the next future:

- Strengthening leadership in the communication services by encouraging a major use of mobile services and a greater introduction of fixed wide band in the already developed markets, and encouraging the introduction of both, fixed and mobile communications, in the emerging markets in which we are currently present. In order to achieve this, the key must be to strengthen and deepen the proximity with customers.

- Reinforcing growth capacity by getting into communications related businesses. Specifically, by developing new mobile solutions that allow more than 100% penetration of developed markets, by building new solutions of added value over the wide band used in homes and companies, and by selecting and transferring all those solutions from the established markets to the emerging ones as soon as the last ones reach the necessary level of development to be accepted.

The business model that will allow us to achieve these growing opportunities has to be based in our access leadership reinforcement, favouring the asset of our connectivity with added value services and making a wider offer of solutions and digital content with the connectivity.

Only the companies that are able to adapt themselves to the new tendencies within the sector will they take advantage of the arising opportunities; something which we are performing at Telefónica.

Organizational Profile

In recent years, Telefónica has concentrated its telecommunications business, reinforcing its presence in the fixed and mobile telephony markets and orientating its business model towards satisfying the communication needs of all its customers. The Corporate Centre is responsible for the global strategy and corporate policies, the management of common activities and the coordination of the activity of the business units. The different operations of the Telefónica Group, in a total of 19 countries, are organised around three geographical regions: Spain, Latin America and Europe. In addition, there are other areas of activity with specific functions to support the companies dedicated to offering telecommunication services.

Telefónica España

Its main activity is the operation of fixed, mobile and broadband telephony services in Spain. Currently, it manages more than 16 million landline connections, 4.4 million ADSL connections (wholesale and retail) and more than 21 million mobile connections.

Telefónica O2 Europe

Its main activity is the operation of fixed, mobile and broadband telephony services in Europe. This business unit has operations in the United Kingdom, Ireland, Germany and the Czech and Slovak Republic.

By the end of 2006, Telefónica O2 Europe manages 35.2 million of mobile accesses, 2.4 million of fixed accesses and 607 thousand data and internet accesses.

Telefónica Latinoamérica

Its main activity is the operation of fixed, mobile and broadband telephony services in Latin America, with presence in all the key markets and a position of leadership in the region.

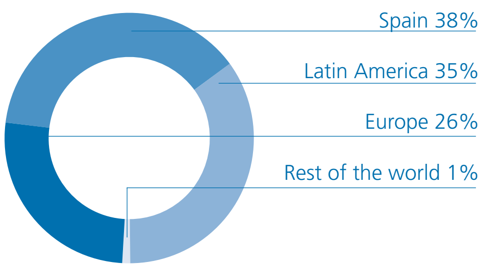
By the end of 2006, Telefónica Latinoamérica manages more than 21 million of fixed line accesses, 5.9 million of data and Internet accesses and more than 83 million of mobile accesses.

It offers its services in the following countries: Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Nicaragua, Mexico, Panama, Peru, Puerto Rico, Uruguay, United States and Venezuela. In addition, it manages the office of Telefónica in China and the alliance with China Netcom.

Other lines of activity
Atento provides customer care services through contact centres or multi-channel platforms.

Focuses on the creation of services, the management of networks, services and businesses, with particular attention to technological innovation of a strategic nature or non-existent in the market.

Distribution of income by region



Size of the market (data in thousands)

1 Spain
F T. de España: 15,950
i T. de España: 4,842
C T. Móviles: 21,446
TV Imagenio: 383

2 Czech Republic
F T. O2 Czech Rep.: 2,402
i T. O2 Czech Rep.: 561
C T. O2 Czech Rep.: 4,862
TV O_2 TV: 16

3 Germany
A Wholesale
T. Deutschland Group: 618
C O2 Germany: 11,025
i O2 Germany: 19

4 United Kingdom
C O2 UK: 17,633
i O2 UK: 17

5 Ireland
C O2 Ireland: 1,632

6 Morocco
C Medi Telecom: 5,155

7 México
i Terra ISP: 3
C TEM México: 8,553

8 Guatemala
F T. Guatemala: 50
i Terra ISP: 3
C TEM Guatemala: 1,491

9 El Salvador
F T. El Salvador: 71
i T. El Salvador: 21
C TEM El Salvador: 847
TV T. El Salvador: 14

10 Nicaragua
C TEM Nicaragua: 553

11 Panama
C TEM Panamá: 939

12 Venezuela
C TEM Venezuela: 8,826

13 Colombia
F Colombia T.: 2,359
i Colombia T.: 68
i Terra ISP: 3
C TEM Colombia: 7,760

14 Ecuador
C TEM Ecuador: 2,490

15 Brazil
F Telesp: 12,107
i Telesp: 3,557
i Terra ISP: 1,011
C VIVO: 29,053

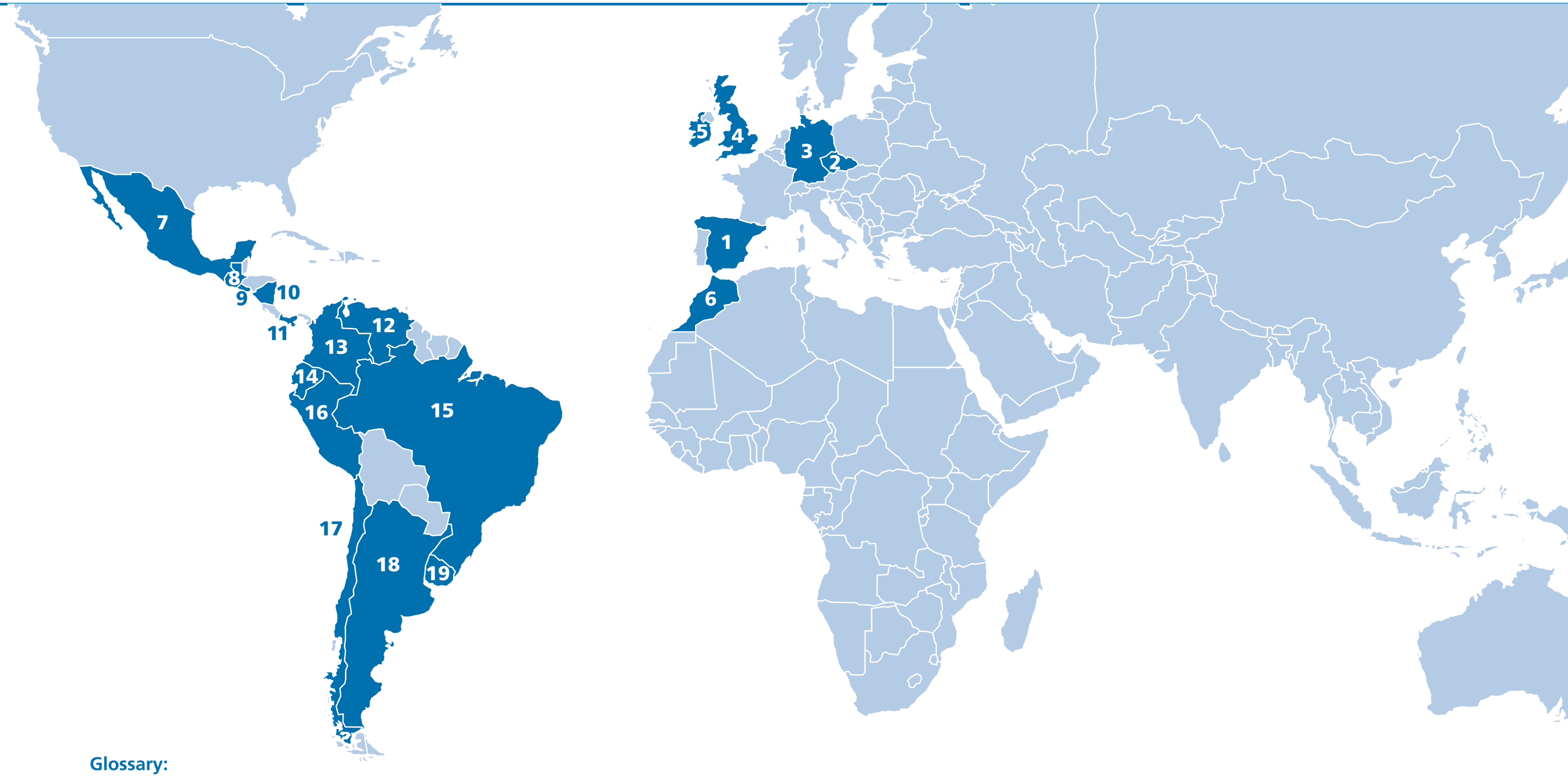
16 Peru
F T. del Perú: 2,498
i T. del Perú: 526
C TEM Perú: 5,130
TV Cable Mágico: 557

17 Chile
F T. Chile: 2,206
i T. Chile: 558
C TEM Chile: 5,680
TV TV Digital: 94

18 Argentina
F T. de Argentina: 4,636
i T. de Argentina: 974
C TEM Argentina: 11,199

19 Uruguay
C Uruguay: 777

Other countries:
Slovakia, Puerto Rico, EE.UU., China



Glossary:
F – Fixed Telephony Accesses
i – internet
C – Cellular Accesses
TV – Pay TV
A – ADSL lines

Corporate Responsibility

Telefónica's Vision:

We want to enhance people's lives, the performance of businesses and the progress of the communities where we operate, by delivering innovative services based on information and communication technologies.

Business Principles

In December 2006, the Board of Directors of Telefónica, S.A. unified its Ethical Business Principles throughout the world. These principles are based on the highest standards and the best practices in business ethics. They are the result of the combination of the Business Principles of O2 and the Codes of Ethics of Telefónica, S.A. and Telefónica Móviles. Furthermore, they reaffirm Telefónica's vision and values.

The Business Principles inspire and define the way in which the employees of Telefónica Group carry out their activities and interact with customers, shareholders, professionals, suppliers and the different communities in which they work. To ensure their implementation, the company has set up its Business Principles Office, which comprises the corporate areas of the General Office of the Secretary to the Chairman, the General Office of the Legal Secretary and the Internal Auditing and Human Resources departments, as well as Telefónica's three geographical areas.

Based on the said principles, Telefónica builds its reputation as a company, gains the trust of its stakeholders and maximises its long-term value for its shareholders and the society in general.

Driving Social Progress

The 1st Latin American Forum on the United Nations Millennium Development Goals and Information and Communications Technologies, organised by the General Office of the Ibero-American Secretary and AHCIET, showed the potential of the services offered by Telefónica to enable social development.

Throughout 2006, Telefónica has shown signs of its commitment to society in all the countries in which it works. The areas in which it showed greater commitment included the following:

- Responsible use of services: throughout 2006, Telefónica has developed various programmes to encourage the responsible use of technology by its Spanish and European customers in collaboration with public and social players. As a result of this experience, an adapted terminal for minors was launched in Spain.
- Digital social inclusion: with a view to incorporating collectives that are suffering the digital divide as customers, Telefónica develops geographical, economic and educational inclusion programmes. In particular, in Latin America, the company offers a controlled cost services at 30% of its fixed access base price and maintains more than 536 thousand public terminals.
- Social and cultural action: in 2006, Fundación Telefónica dedicated more than EUR 30.7 million to social and cultural action activities, most of which were developed in the area of education. The number of individuals who benefited from the various programmes is in excess of 30.6 million. In particular, special mention must be made of the Proniño project, which is dedicated to the eradication of child labour and has enabled more than 25 thousand children in the region to attend school.
- Accessibility: the aim of the Telefónica Accesible programme, developed in collaboration with CERMI (Spanish Committee of Representatives of the Disabled), is to enable

the social integration of the disabled using new technologies. This project makes good use of the more than 30 years' experience of ATAM (Telefónica Association for the Care of the Disabled), which involves the collaboration of more than 60 thousand of the group's employees and an allocation in 2006 of over EUR 4.7 million. In addition, the company complemented this amount with a further EUR 8.7 million.

- Environment: the levelling-up of Telefónica's environmental management systems has enabled the certification of mobile telephone operations in Ecuador and Peru as compliant with the ISO 14001 standard and has increased those in existence in Spain, Mexico, United Kingdom, Ireland and Germany. In particular, O2 Germany is developing a pioneer programme to become the first mobile telephone operator to become carbon neutral as a response to the growing concern for the climatic change.

Telefónica values

Innovative

We translate technology into something easy to use and understand. Innovation is a constant source of inspiration to everything we do, as much in our services as in our management systems; and it enables us to anticipate market trends and customers expectations.

Competitive

Innovation helps us to be more competitive. We constantly strive to push our limits, never being fully satisfied with our achievements; our sincere ambition of being a world telecommunications leader is endless. Our aim is going even further in every little thing we do, without ever giving up.

Open

We perform in a way that is clear, open, transparent and accessible to all. Listening and engaging in dialogue with all are our key strengths. We get deeply involved and learn from every cultural and social reality, in the communities where we operate.

Commited

We deliver our commitment when we responsibly walk the talk, when we become aware of the transformational capabilty of information technologies; and when we assume that the way we reach the result is as important as the results itself.

Trusted

To be trusted means to deserve everybody's trust. Thus, responsibility in everything we do has to be a source of differentiation, competitiveness, leadership, and relationship with all our stakeholders in the long run. We become trust, or we do not, through our responsibility and through our capability of delivering, or not delivering, our commitments. Our aim is to earn everybody's trust.


02

Board of Directors' Report on Business Activity

Telefónica O2 Czech Republic Group

Consolidated revenues reached CZK 61.3 billion in 2006.

Overview of the Group and the main changes in 2006

Until 31 June 2006, the ČESKÝ TELECOM Group (the Group) comprised ČESKÝ TELECOM, a.s. (ČESKÝ TELECOM), Eurotel Praha, spol. s r.o. (Eurotel), and other smaller subsidiaries. On 1 July 2006, ČESKÝ TELECOM and Eurotel merged into one company. On the same date, the corporate name of ČESKÝ TELECOM was changed to Telefónica O2 Czech Republic, a.s. (Telefónica O2, the Company). For more information concerning the merger and integration of the two companies please refer to page 37. In the second half of the year, the corporate names of some other companies in the Group changed, too. A complete overview of the Group as at 31 March 2007 is given on page 65.

Telefónica O2 was the only operator in the Czech Republic to offer a comprehensive range of voice, data and internet access services in the fixed and mobile segments. In the second half of 2006, the Company entered the multimedia entertainment market with the launch of its IPTV product. The Company also offered its network infrastructure for lease by other operators of public and private networks and services. As at 31 December 2006, the total number of fixed accesses operated by the Company stood at 2.402 million and the number of users of the Company's mobile services was 4.864 million.

The Company's services were mostly provided on the territory of the Czech Republic and, from 2 February 2007, in Slovakia, too. The Company's retail focus was in the two primary customer segments – residential and business. The business segment included the SME, corporate and government sub-segments. Telefónica O2 also provided wholesale services to other operators of public telecommunications networks and providers of public telecommunications services in the Czech Republic and abroad.

Telefónica O2 Slovakia

In August 2006, Telefónica O2 Slovakia s.r.o. (Telefónica O2 Slovakia), a wholly-owned subsidiary of Telefónica O2 Czech Republic, won a tender for the third mobile network licence in Slovakia. Its bid beat those from Telekom Austria and the České Radiokomunikace–Penta investment group consortium. Telefónica O2 Slovakia bid SKK 150 million for the frequency allocation. The licence confers the right to use the GSM 900 MHz, GSM 1800 MHz, UMTS and FS 29 GHz frequencies for a period of 20 years in order to provide telecommunications services in Slovakia. The decision of the Slovak Telecommunications Office to grant the licence came into force on 7 September 2006. The licence imposes the following main obligations on the licence holder:

- To bring its own GMS mobile network into operation within 6 months of the licence decision coming into force;
- To bring the UMTS mobile network into operation within 12 months of the licence decision coming into force;
- To have 400 GSM base stations in operation and providing services within 12 months of the licence decision coming into force;
- To have 800 GSM base stations in operation and providing services within 24 months of the licence decision coming into force;
- To cover 12% of the population with its own network within 12 months of the licence decision coming into force;
- To cover 45% of the population with its own network within 24 months of the licence decision coming into force;
- To launch basic services by the end of 2007.

For the Telefónica O2 Group, the award of the licence represented an organic regional expansion and the leveraging of regional synergies with Telefónica O2 Czech Republic. The plans to enter the Slovak market were forged on innovative marketing, the Telefónica O2 brand and modern technology. The goal of Telefónica O2 Slovakia was to contribute to the development of the competitive environment on the Slovak telecommunications market, to provide benefits to its customers and to generate extra value for Telefónica O2 Group's shareholders. One of the strategic objectives was to secure a strong position on the Slovak telecommunications market in a relatively short period of time.

In November 2006, Telefónica O2 Slovakia signed a national roaming agreement with T-Mobile Slovensko, enabling the customers of Telefónica O2 Slovakia to enjoy a quality and full-featured service right from the first day of operation. In January 2007, Telefónica O2 Slovakia performed network tests as required under the national roaming agreement, and interconnected its network with those of other telecommunications operators. The company's long-term strategy is to roll out its own network within two years and to use national roaming in locations not covered by its own network. The company has already built its own exchange in Bratislava and has begun to roll out its network of shops and build its own customer care call centre. The call centre will operate on a 24/7 basis; Brno was initially selected as its location; the call centre will be relocated to Banská Bystrica at a later stage.

From 15 December 2006 until 31 January 2007, customers who were considering using the services of Telefónica O2 Slovakia could register free of charge and without commitment as O_2 Jednotka and so qualify for benefits later on should they decide to subscribe to the mobile services of Telefónica O2 Slovakia. By becoming customers of the pre-paid services they qualified for on-net calls for the unprecedented price of SKK 2 per minute, forever. The company registered enormous interest in the first few days of the promotion. By 2 February 2007, when Telefónica O2 Slovakia launched its commercial pre-paid service for O_2 Jednotka, it had registered more than 600 thousand prospective customers. Other customers of pre-paid services could start using Telefónica O2 Slovakia's services from 28 February 2007. The service for post-paid customers is scheduled for launch in the second quarter of 2007.

Risk management

Risk management is one of the primary management tools for effective governance of companies in the Group. Its purpose is to render support in accomplishing the Company's vision and strategy. Risk management conforms to the best international practice in the field of corporate governance. It is a pro-active, dynamic and self-improving system focused primarily on eliminating or mitigating the negative effects of risks that are external and internal to the Company, and on taking maximum advantage of the positive effects of risks on the Company. Risk management is an inherent part of the strategic management of the Group.

The Company implemented an integrated risk management system in 2003, and the system is being constantly improved. The system guarantees that risks to the Group are identified, assessed and monitored in time, that measures exist for risk mitigation and that procedures are in place for preventing potential future losses.

Risks are identified based on an assessment of the relevant management levels and suggestions made by Risk Management, Internal Audit and other units of the Group, and are evaluated in terms of their potential financial impact and likelihood of materialisation. Where the value of a risk exceeds a set limit, the risk is included in the risk catalogue of the Company. Every month, a risk management report is submitted to the governing bodies of the Group.

Also in 2006, Risk Management was responsible for the methodology and risk management system on the Group level. The governing bodies – the Board of Directors and the Supervisory Board, or, where appropriate, its Audit and Control Committee – were informed on a monthly basis of all major risks to which the Group was exposed.

The Company is exposed to risks which, completely or in part, fall outside its control and may have a significant bearing on its business.

Financial markets risk

Telefónica O2 is exposed to the risk of exchange rate and interest rate fluctuations. In line with the Treasury Policy, standard financial instruments are used to hedge the Company against exchange rate and interest rate fluctuations that could present a risk to the Company's future cash flow.

Regulation

Activities in the fixed line segment are subject to supervision and regulatory intervention by regulatory authorities (CTO). The Company's results could also be materially impacted by the decision of the European Commission to regulate roaming charges which is presently on the table. The impacts of such risks may be assessed to only a limited extent. These risks are continuously managed and mitigated to the maximum extent by the Regulation and Interconnect Unit.

Competition

The fixed line sector has undergone extensive consolidation in the past few years. The fixed line and mobile segments are fiercely competitive. This risk presents a direct danger to the Group's market share, revenues and profitability. The Company aims to provide its customers with technologies, products and services that will prevent any negative effects.

Major damage to or interruption of network/system operation

Major damage to or interruption of the network/system operation would mean that the Company would not be able to provide customers with the usual scope and quality of services. Most system and network elements are designed to activate back-up systems in the event of damage or a shutdown. The Group has contingency plans for cases where the risks materialise. These documents limit the potential lapse in service to the time needed to restore the systems affected.

Human resources

In 2006, Telefónica O2 strived to achieve a balance between continuous performance improvement, highly motivated employees, personal and professional development and employee satisfaction.

As at the end of 2006, the Group had 9,416 employees, 9,265 of which were employees of Telefónica O2. Compared to the end of 2005, there was a 7.5% decrease in the workforce. During 2006, 1,794 employees left the Company, 46% of them for organisational reasons. Those employees received severance pay depending on the duration of their employment with the Company, as per the collective agreement. The average severance was 9.96 times the average monthly wage of the departing employees.

At the end of January 2006, an employee satisfaction survey was carried out in the two former companies ČESKÝ TELECOM and Eurotel; the survey is a regular feature in Telefónica Group as a whole at this time of year. The questionnaire was designed by Telefónica and contained 34 questions identical for all companies in the Group. To preserve anonymity and ensure a detailed analysis of the results, the whole process was contracted out to Atento of Spain. A total of 6,307 employees of both companies gave their feedback on life in the company. The results showed that two out of every 3 employees are satisfied with their working environment. Telefónica's image, leadership and innovation received the highest positive ratings.

From July, the main task of Human Resources was to incorporate the values of O_2. To aid the process of integration of the two companies, we launched Our New World, an e-learning programme which explained the new values, visions, attitude and customer treatment. One fifth of all employees enrolled in the programme via the intranet.

The area of remuneration and performance management was also integrated. The first part of the process covered the performance management system, in particular the setting and evaluation of key performance indicators in conformity with the goals of the new company. The purpose of the integration was to preserve the best features of the systems of the two former companies by implementing changes only as necessary. Rules for non-commercial units and for usage of integrated electronic systems were codified. During the second half of the year, performance management systems for commercial units were gradually integrated, and systems and conditions were laid down to facilitate the completion of the integration of Customer Care, which is scheduled for the first half of 2007. The Company as a whole took part in salary surveys by Watson Wyatt and Hay Group, to benchmark itself against the salary market.

Relations with the trade unions can be described as irreproachable. Social dialogue proceeded continuously. On 1 January 2006, the collective agreement was signed; 3 amendments were later concluded to accommodate the integration and changes in the legislation.

The employee benefit portfolio was consolidated and expanded to form an integrated system. The hallmark of 2006 was the selection and drawing of employee benefits in the form of Company products, leisure activities and support for people with disabilities. In 2006, the Company employed dozens of people with disabilities (e.g. in call centres and brand shops).

E-learning has become a standard platform for employee development. The Company continued its Spanish and English language courses by means of the combined method – in the Virtual University and live sessions with a tutor. Emphasis was also laid on developing courses for the sales force in order to improve their relationship with customers and build their sales potential. Entry-level training for new employees, focused on adjustment to and familiarisation with the new environment, was again an inherent part of the training system in 2006.

O_2 Life, a programme designed to facilitate cultural alignment, was launched at the end of 2006. A two-day kick-off meeting of 120 selected employees, referred to as pilots, was held. O_2 Life comprised activities directed at helping all employees understand the corporate values of O_2 and at giving them a chance to make the company their own – one which they want to work in and work for.

Environment

After the formation of the integrated company Telefónica O2, a new environmental policy was promulgated. Taking into consideration the Company's activities as well as scientific and technological developments, the policy focused on mitigating the potential impacts and eliminating potential damage to or degeneration of the environment as a whole or in part. Our policy is to continually improve the ways in which we care for the environment, prevent pollution and comply with the statutory and other environmental requirements applicable to the Company. The Company's environmental principles have not changed with its integration and incorporation into the global Telefónica Group; they are fully in line with the key principles espoused by the global Group.

The Company strived to increase the environmental standards which apply to its suppliers. A new set of standards was published. Customer audits were performed at selected suppliers, aimed at integrated management systems or environmental protection in activities which relate to the supply of products and services.

In the whole mobile part of the business and in a selected fixed line pilot unit, the Company's environmental management system successfully underwent an ISO 14001:2004 audit. The audit was performed by TÜV NORD (in the mobile units) and Lloyd's Register Quality Assurance (in the fixed line unit). Telefónica O2 became the only Czech telecommunications operator to be certified to ISO 14001:2004 in the environmental protection area.

The trend of reducing negative impacts on the environment continued into 2006. Compared to 2005, Telefónica O2 managed to reduce the total volume of waste produced by 67.2%, of which 25.7% was recyclable waste. A large part of the remaining waste could be used for other purposes. To provide for its operations, the Company consumed 5.7% less heat in 2006 than in 2005, and electricity consumption fell by 5.4% year on year. In comparison with 2005, the total volume of pollutants released into the environment from heat generation facilities and vehicles was also reduced.

Sponsoring and charity

The Company's sponsoring and interactive partnership activities focused on expanding and promoting interpersonal relationships, contacts and communication. They were also an important vehicle for promoting the Telefónica O2 brand: the Company aspires to be perceived as a modern provider of telecommunications services. Sponsorship projects were selected so as to reach out to the broadest public at both the national and regional level.

Sponsoring activities focused primarily on sports, music, culture and the arts. Our long-term sports sponsorship projects include Extraliga (the top Czech ice hockey league), the National Ice Hockey Team, Zlatá lyže (a skiing event) and Kateřina Neumannová, the cross-country skier. In the field of culture and music, the Company supported the Karlovy Vary International Film Festival, the O_2 Sázavafest, Mezi Ploty and Struny podzimu festivals, the O_2 Žluté lázně leisure park and others.

The Company also pursued philanthropic activities, which, in 2006, were consolidated under the umbrella of the O_2 Foundation. The foundation carries on the tradition of the Eurotel Foundation, which was established in 2002 and since its inception has distributed more than CZK 75 million in grants to various non-profit projects.

By means of long-term, carefully considered and systematic sponsorship, Telefónica O2, the founder and principal donor of the O_2 Foundation, wishes to reach out to its surroundings and to accept joint responsibility for the wellbeing and development of society. To this end, the O_2 Foundation endorsed several projects last year; for instance it distributed CZK 10 million in an open grant call to regional non-profit organisations which help children, awarded the traditional O_2 Foundation Award and ran a special campaign against bullying in Czech schools. All activities of the foundation were made possible thanks to voluntary work by Telefónica O2 employees.

In the 2006 TOP CORPORATE PHILANTHROPIST list, Telefónica O2 ranked 8th among the most generous corporate donors as measured by the absolute sum of donations. The Company is a founding member of the Donor Club at the Donor's Forum. The Company used the LBG Standard Responsible Company method to measure the effect of its sponsoring activities.

Integration

On 1 March 2006, the Board of Directors and the Supervisory Board of ČESKÝ TELECOM approved the plan to integrate Eurotel and ČESKÝ TELECOM into one telecommunications company. The decision became legally effective on 1 July 2006 and Telefónica O2 Czech Republic, a.s., was formed. The long term strategy of the new company, Telefónica O2 Czech Republic, the experience of Telefónica and O2, and, last but not least, the experience and position of ČESKÝ TELECOM and Eurotel on the Czech telecommunications market were taken as a basis for the goals of the integration. Eurotel contributed in particular its leadership in the field of new innovative products and services, its flexibility and insight into customer needs, its customer orientation and its experience in fostering long term relationships with customers. ČESKÝ TELECOM's assets included, among many other things, its premium quality and high capacity fixed line network. With these in mind, the integration goals were formulated with an emphasis on maximum leveraging of synergies, especially in the following areas:

- generating new revenues by means of an attractive range of new, integrated products and solutions;
- increasing sales efficiency by integrating distribution channels to achieve a greater cross-selling potential and to prevent customer churn;
- achieving savings in the area of operating costs by integrating IT and network infrastructure and consolidating support services;
- integrating and standardising internal processes for greater efficiency.

The integration process, including its management and co-ordination, its individual stages and schedule and the key integration projects, are described in the 2006 Half-year Report.

Key integration accomplishments in 2006

The projects *Developing Integrated F-M Corporate and Government Sales Force* and *Unified F-M Business Sales Force and Customer Care* set out to integrate the fixed and mobile parts of the sales organisation into a single unit, thus giving the customer one point for effective customer care. The projects consisted of segmentation, requirements for an integrated customer database, a customer care management system and a single product catalogue. In 2006, the sales units were fully integrated, customers were put in the care of dedicated key account managers, and the first changes were implemented in the field of customer care – a single point of contact by telephone where all the customer's fixed and mobile service requirements would be attended to.

The *Customer Care Integration* project focused on integrating and streamlining customer care in the consumer (residential) segment. In 2006, the sales channels were completely separated from the customer care function, and fixed business customer care was merged with its mobile counterpart. A single sales number (800 020202) and a single customer care number (800 123456) now provide information about the whole portfolio of services to customers.

The *Point of Sale Integration* project, whose goal was to develop an integrated network of retail brand shops, also produced tangible results. As of 1 July 2006, all brand shops offer the complete portfolio of products and services. Moreover, 18 re-designed shops, two free-standing counters and one franchise shop were opened in 2006.

The goal of the *Products 2006* project was to develop and launch new integrated products combining mobile and fixed services. The brief was to design products which would demonstrate the benefits of an integrated operator and facilitate the launch of the new brand on the market. The products also helped the Company deliver on its integration goal of new revenue generation by means of new business acquisition and churn reduction. In 2006, the *Internet komplet* service was launched, combining ADSL internet access and CDMA mobile internet access. Another new service was *O_2 Nejbližší*, which allowed users to call between selected fixed and mobile numbers as part of their monthly subscription, with calls between the members of the user's group being free of charge. The main result of the *Network Operations Programme* was the full integration and reorganisation of network operations, including fixed and mobile network construction and maintenance.

The *ICT Convergence Strategy Programme* analysed the life cycles of all main network platforms, current operating capacity and the potential for further development, taking into consideration the strategic plans of Telefónica O2 and the whole Telefónica Group. Scenarios for further development of all the main technology platforms were elaborated based on the requirements of the new portfolio of integrated products/services, the requirements of the Czech legal environment and an analysis of the options for the most efficient operation of technological assets. The approved network strategy for the period 2006–2009 became a part of the general corporate strategy. The programme was conceived with a view to supporting further growth of the Company and achieving its vision by means of a range of solutions based on the convergence of fixed and mobile technologies.

The project *IT Infrastructure and Operations* focused primarily on matters relating to the integration of two companies and the resulting requirements for internal and external support systems. The goal was to fully integrate the IT infrastructure. A strategy for full integration of all systems in the fixed and mobile parts of the business was elaborated.

The *Re-branding* project set out to launch a new brand for the Company and its products on the Czech market. Since 1 September 2006, Telefónica O2 has been marketing all its products and services under the O_2 brand, supported in all communications by the logo of Telefónica, the parent company and guarantor of quality and international backing. The O_2 brand is built on four key values – Bold, Open, Trusted and Clear, which are reflected in both the Company's products and services and its corporate culture. The project had two phases. The first – internal re-branding – commenced in July 2006 and was itself divided into several areas: brand strategy, marketing and marketing communication, corporate re-branding, customer care, procurement and internal communication. The second phase, external re-branding, kicked off on 1 September 2006 and was aided by a massive advertising campaign. The results of a survey commissioned by the Company showed that the new brand had been positively received not only by customers, but by the whole business community in the Czech Republic. By the end of 2006, spontaneous brand recognition among the respondents increased to 76% while consideration for O_2 brand reached 49%.

2006 also saw the successful launch of the *Cultural Alignment* project under the title O_2 Life. The emphasis was on introducing changes that would efficiently implement a new corporate culture reflecting the O_2 brand values, a culture which would make customers more satisfied with the services of the Company.

The goal of the *Key Finance Processes Alignment* project was the re-design and integration of the Company's controlling processes, incorporating best practice and the know-how of the Telefónica Group, and the modification of the SAP system. In 2006, the key processes were integrated as part of the project, and preparation work on new integrated processes began, especially in respect of the projected SAP system.

The implementation of the new, single SAP system and the related standardisation of some internal processes, the completion of customer care integration in the SME and corporate segments, and the completion of call centre integration in the residential segment are all among the integration goals for 2007. Implementation of other flagship projects is set to continue. One new project is the *Customer Experience Programme*. Its goal is to enhance selected processes that have a direct impact on the customer experience: service delivery, distribution and provisioning and improvements in call centre operation.

The telecommunications market in the Czech Republic

The developments on the Czech telecommunications market in 2006 confirmed the trends of the past two years, including the continuing trend of fixed to mobile substitution. According to estimates, the share of voice traffic generated by mobile operators' customers in total traffic increased to 75% in 2006, compared to 70% in 2005. This indicator is one of the highest in the whole of Europe. While mobile voice traffic increased in 2006 by approximately 18% year on year (6% in 2005), the number of minutes generated by fixed line customers fell 24% last year (22% in 2005). On the other hand, the demand for data, internet and other value added services grew at the expense of traditional voice services, which were in decline.

Total market growth, as measured by revenues, lagged behind GDP growth, mainly due to declining revenues in the fixed line market, which could not be fully offset by revenue growth in the mobile market. According to estimates by Telefónica O2, the Czech telecommunications market grew in 2006 by approximately 3% on the year before; in 2005 the rate of growth had been 5%. Fixed line segment revenues fell, according to estimates, by 2%, but the mobile market recorded year-on-year growth of approximately 7%. The result was a drop in fixed line penetration to around 24%, confirming the trend of the previous years. On the other hand, mobile SIM card penetration reached almost 120% at the end of 2006. It will most probably continue to grow as the number of customers with more than one SIM card for different uses rises.

An important event in the field of regulation – one which will shape the future telecommunications market – was the completion of an analysis of relevant markets by the Czech Telecommunications Office (CTO). In markets where a Significant Market Power (SMP) entity was found to exist, the entity was subject to various regulatory interventions in order to install a situation of healthy market competition.

Trends on the fixed line market

After stagnating 2005, revenues on the fixed line market fell by approximately 2% in 2006. This trend is due to declining revenues from traditional voice services, which could not be fully offset by growth in revenues from internet and other services. For fixed line operators and cable providers, 2006 was a year of ownership changes and general consolidation. Most alternative operators concentrated primarily on providing services to the business segment. Another area of interest was the provision of services to households by means of Carrier Selection and Carrier Pre-selection and, more recently, retailing of broadband internet access.

The voice service market saw increasing competition. The two biggest cable operators entered the market in 2006, with offers of voice services at unprecedented prices. The penetration of VoIP telephony also grew, mainly due to low prices (PC-to-PC calls are even free of charge), the growing number of internet users (growing xDSL penetration) and the increasing number of operators offering this service. The trend of fixed to mobile substitution continued as well. In 2006, the total number of fixed lines also decreased. For Telefónica O2, which operated approximately 90% of all fixed lines in the Czech Republic, the net loss was 17.4%. In 2006, cable operators began to market service bundles combining voice services, internet access and television. Telefónica O2 entered the multimedia entertainment market on 1 September 2006 when it launched its IPTV product branded as O_2 TV. Unlike the cable operators' offers, O_2 TV allows for film rental from the Videotheque and recall of missed programmes from the TV Archive, and it has many other interactive features.

2006 saw ongoing consolidation in the fixed line and cable markets. GTS Novera concluded the first stage of the integration of the operators acquired by its parent group, GTS CEH, in late January/early February 2006. On 1 April 2006, Contactel was renamed GTS Novera Contact, NEXTRA Czech Republic renamed GTS Novera Next and Telenor Network renamed GTS Novera Tel. As of 1 July 2006, GTS Novera Contact, GTS Novera Next and GTS Novera

Tel were wound up as a result of a merger. GTS Novera, the successor company, is the largest alternative telecommunications operator measured by revenues.

On 3 May 2006, Radiokomunikace announced the take-over of Tele2's operations, making Radiokomunikace the largest alternative telecommunications operator in the Czech Republic measured by number of customers (in the range of hundreds of thousands). The Tele2 take-over process was concluded on 1 June 2006, with Radiokomunikace securing the approval of the Office for the Protection of Competition.

On 23 November, a group of investors centred around investment bank Lehman Brothers announced they had acquired a 100% stake in Radiokomunikace for CZK 1.2 billion. Radiokomunikace is the holder of a 39.2% stake in T-Mobile Czech Republic.

The cable operator market also consolidated. Liberty Global, the parent company of the largest Czech cable operator, UPC, announced its acquisition of the second largest cable provider, Karneval, for EUR 322.5 million. The merger of the two largest cable operators was approved by the Office for the Protection of Competition in a decision dated 22 December 2006. The merger of the two companies produced a company with approximately 800 thousand active customers.

Trends on the mobile market

The Czech mobile market, measured by revenues, grew approximately 7% in 2006. One of the market trends was the ongoing migration of customers from the pre-paid to the post--paid service. Telefónica O2 and Vodafone introduced new post-paid tariffs featuring credit which the customer can draw flexibly in the form of voice services, SMS and MMS. The mobile operators' focus on offering data and internet services in order to meet the growing demand also continued. Telefónica O2 heavily marketed its high-speed internet access products using the CDMA and HSDPA technologies. T-Mobile offered the same service branded as Internet 4G, using the UMTS TDD technology. Vodafone announced that it would suspend investment in its own UMTS network and reached agreement with T-Mobile for the construction of a joint UMTS network. It is also possible that they will co-operate in the field of mobile television broadcasting (DVB-H).

On 1 February 2006, Oskar Mobil changed its corporate name to Vodafone Czech Republic and its commercial brand from Oskar to Vodafone.

Despite having reached 112% at the end of 2005, SIM card penetration in the Czech population increased even further to almost 120% in 2006. Penetration of active customers was estimated at around 85% of the population. Net adds of customers were 877 thousand in 2006, compared to 867 thousand in 2005, representing year-on-year growth in the number of customers of 8%, the same as in 2005.

Even though the conditions on the mobile market were very challenging, Telefónica O2 increased the number of its customers by 4% to 4,864 thousand, which represents a 39% share of the market. Net adds of customers were 189 thousand. As a result of the successful migration of customers from the pre-paid to the post-paid service, the number of post-paid customers grew in 2006 by 329 thousand (21%) to close at 1,875 thousand. The figure represents a 38% market share in the segment – for illustration, the market shares of T-Mobile and Vodafone were 36% and 26% respectively at the end of 2006. The share of post-paid customers in the total number of customers grew from 33.1% at the end of 2005 to 38.5% at the end of 2006.

Regulation

Several changes occurred to the legal environment of the electronic communications market in the Czech Republic in 2006. Act No. 127/2005 Coll., on electronic communications and on amendment of some other related laws, as amended (Electronic Communications Act), was amended in respect of radio and television broadcasting, the provision of so-called special price plans as part of the Universal Service, emergency numbers and the construction permit procedure. Furthermore, an amendment to the act on radio and television broadcasting was passed, primarily to accommodate the transition to terrestrial digital broadcasting. A technical plan for the transition from analogue to digital television broadcasting was published. During the first half of 2006, all existing pricing decisions were revoked and new pricing decisions were issued on the basis of market analyses (see below).

Relevant market analyses

Under the approved Electronic Communications Act, regulatory remedies could in 2006 be imposed only on Significant Market Power (SMP) entities. SMP entities were identified and remedies were imposed based on the conclusions of market analyses performed by the CTO in accordance with the Electronic Communications Act. These measures were pivotal for the overall situation in the regulation of electronic communications.

The above remedies included, for instance, pricing regulation and the imposition of the duty to give access to specific network elements, non-discrimination, etc. The measures also fundamentally affected the area of interconnection.

The CTO completed the analysis process by the end of 2006. Out of the total of 18 markets, the CTO assessed five markets as having effective competition; an SMP entity was identified in each of the remaining markets, and regulatory remedies were imposed on the SMPs in order to make the competition effective on the market in question. Telefónica O2 was designated an SMP entity in 12 markets, both retail and wholesale.

In April 2006, the law cancelled regulation of prices for access to the telephone network at a fixed point, and the regulation of retail prices for calls in the fixed network was also abolished. Subsequent analyses of the relevant markets showed that no further price regulation of these markets was necessary.

- Market No. 1 – Access to the public telephone network at a fixed point for non-business natural persons – Telefónica O2 was designated an SMP entity.
- Market No. 2 – Access to the public telephone network at a fixed point for legal and self-employed natural persons – Telefónica O2 was designated an SMP entity.
- Market No. 3 – Publicly available national telephone services provided at a fixed point to non-business natural persons – Telefónica O2 was designated an SMP entity.
- Market No. 8 – Call origination at a fixed point of the public telephone network – Telefónica O2 was designated an SMP entity and price regulation was imposed. The maximum price of call origination was set at CZK 0.30 (peak) / 0.15 (off peak) per minute at a local exchange (originally CZK 0.31 and 0.16 respectively).
- Market No. 9 – Call termination in public telephone networks provided at a fixed point – each provider of call termination in its own network was classified as an SMP entity, and price regulation was imposed. The maximum price of call termination was set at CZK 0.30 (peak) / 0.15 (off peak) per minute at a local exchange (originally CZK 0.31 and 0.16 respectively).
- Market No. 11 – Full wholesale access to the local loop or shared access to the local loop or a part thereof for the provision of electronic communications services – Telefónica O2 was designated an SMP entity and price regulation was imposed. The maximum price for full access was set at CZK 360 (CZK 403 originally) and for shared access at CZK 92 (CZK 158 originally).
- Market No. 16 – Call termination in public mobile telephone networks – each provider of call termination in its own network was classified as an SMP entity, and price regulation was imposed. The CTO set a maximum price of CZK 2.99 (CZK 3.11 originally) applicable to all mobile operators.

Imposition of duties related to the provision of the Universal Service
Under the transitional provisions of the Electronic Communications Act, Telefónica O2 provided the Universal Service under the conditions of the previous regulatory framework of the Telecommunications Act and related regulations. The Company provided the Universal Service until it was assigned duties in respect of the individual components of the Universal Service, after new CTO decisions were issued under the new Electronic Communications Act. The Company then began to provide the following Universal Service components:

- from 22 December 2005 – regular publication of directories of subscriber telephone numbers in the area of the public telephone service, and access of end users to those directories;
- from 22 December 2005 – directory services;
- from 11 May 2006 – the public payphone service;
- from 11 October 2006 – 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;
- from 28 October 2006 – ancillary services to the service of access to the public telephone service at a fixed point of the public telephone network;
  - payment of the charge for connection to the public telephone network in instalments – residential customers only;
  - free-of-charge selective blocking of outgoing calls;
  - free-of-charge itemised billing – residential customers only;
- from 1 January 2007 – special price plans for low income persons, persons with special social needs and persons with disabilities, which are different from the regular price plans provided under the standard commercial terms and conditions.

In its communication dated 1 September 2006, the CTO decided that the Universal Service components "connection to a fixed point of a public telephone network" and "access to the publicly available telephone service at a fixed point" would not be imposed as a duty, owing primarily to the actual level of use of the services and their substitutability by mobile services.

Financing of the Universal Service
Under the Telecommunications Act, the Company was entitled to compensation for the pro rata part of the legitimate loss it incurred as a result of providing loss-making components of the Universal Service. The legitimate loss for 2005 (the figure for 2006 will be presented at the end of the first half of 2007) is deemed to be the difference between the legitimate costs, including a reasonable profit, incurred as a result of the duty to provide the Universal Service which the Company would not have incurred if it had not been bound by the duty, on the one hand, and the revenues and earnings from the duty to provide the Universal Service, on the other.

The law prescribes a mechanism for the compensation for the loss that may be incurred by the Universal Service Provider as a result of providing the Universal Service by means of a so-called Universal Service Account; on this account, mandatory contributions are pooled from all other holders of telecommunications licences. The loss from the provision of the Universal Service which Telefónica O2 was due from the other telecommunications licence holders for 2005 and which was claimed with the CTO, was CZK 3,596,138,727. The CTO, however, determined a much lower loss from the provision of the Universal Service for Telefónica O2; only a limited scope of the Universal Service as promulgated in Decree No. 235/2001 Coll. of the Ministry of Transport and Communications was taken into consideration, and the effect of a one-off asset impairment was incorrectly reflected in the calculation. The loss from the provision of the Universal Service in 2005 was, according to the CTO, only CZK 286,966,147.

Since Telefónica O2 is one of the holders of telecommunications licences, the effective compensation from the other operators for the loss incurred in connection with the Universal Service will amount to only 40% (the CTO has not yet published the amount of the mandatory contributions for 2004).

Networks and information systems

Fixed line networks

In 2006, Telefónica O2 operated a fully digital fixed line network for the voice PSTN, ISDN and IN services, a network for the provision of ADSL services with points of access in 2,174 locations (year-on-year growth of 55.6%), IP/MPLS, FR and ATM national data networks enabling the provision of a broad range of data and IP services, a leased line network and SDH and DWDM backbone transport networks. Together, the networks guarantee the quality and reliability of all services in the portfolio.

The access network underwent further modernisation. The main part of the network, which is made of metallic cables covering the whole territory of the country, is gradually being strengthened with optical cables and radio relay systems. The total length of the metallic cables was 258 kilometres as at the end of the year. As at 31 December 2006, the optical network spanned 29,727 kilometres and the total length of the optical fibres was 903,225 kilometres.

The network comprised 138 HOST exchanges and 2,389 remote subscriber units (RSUs). The total switching capacity was 4,563,102 ports, of which 2,734,582 were occupied. In 2006, investments in voice service technologies were mostly of a maintenance nature, since the traffic in the voice network has stabilised and there was no need to increase the capacity. The Company started testing a new technology platform, PMS, initially to be used to provide VoIP Connect and VoIP Centrex services. The bulk of the investment budget was spent on increasing the capacity of the metallic access network in new commercial, industrial and residential developments. The optical network capacity continued to increase, reflecting commercial and operating requirements.

There was a boom in broadband data services for the general public that run on the xDSL technology platform. The Company's investments in xDSL technology and related investments in the IP backbone network, LE Ethernet access network and DWDM transport network focused on three main areas of development of xDSL services:

1. Increasing the coverage – the number of locations with ADSL access points reached 2,174 (up 777 from the end of 2005) and the total number of DSLAMs reached 3,198, of which 1,412 were IP DSLAMs supporting the O_2TV service via ADSL2+. The installed capacity of ADSL ports reached 637,135 (year-on-year growth of 101.1%), of which 486,043 ports were occupied.
2. New services – in September 2006 an IPTV service was launched; the Company uses the ADSL2+ technology to provide the service. Preparation for the IPTV service required an upgrade from ATM DSLAMs to IP DSLAMs with the ADSL2+ technology, the construction of an L2Ethernet aggregation network and the strengthening of the backbone network capacity.
3. Strengthening of the network capacity – in the course of 2006, the network capacity and the speeds of ADSL services increased to accommodate the growing numbers of customers and the growing usage of the service by customers.

The number of O_2 Internet Expres customers and the number of users of ADSL services from other providers with whom the Company has a wholesale contract grew significantly in 2006. The aggregate volume of the O_2 Internet Expres service carried by the IP network increased from approximately 3 Gb/s (in the direction of customers) at the beginning of the year to approximately 6.2 Gb/s at the end of 2006. The aggregate data flow from customers to the internet rose proportionately.

As a result of the growth in the data traffic generated by the O_2 Internet Expres broadband services and the launch of IPTV, the capacity of the IP MPLS network and the regional Ethernet networks increased dramatically. The number of backbone nodes in the IP MPLS grew from 7 to 13 – one in every regional capital. The capacity of the lines between the backbone nodes also increased, from 2.4 Gb/s to 10 Gb/s. The RENs (Regional Ethernet Networks) were rebuilt from a token ring topology with a shared capacity of 1 Gb/s to a double hub-and-spoke topology, in which each node is connected to the rest of the network via two lines each with a capacity of 1 Gb/s, with full back-up. This helped each REN to increase its capacity up to 20 times. The capacity of the international data lines increased accordingly.

In the course of 2006, the Company's investments in the transport network were mainly channelled into the WDM technology, which is used to increase network capacity in locations where the optical fibre capacity is not adequate.

Mobile networks

In 2006, Telefónica O2's investments in the mobile network were aimed at increasing the coverage, capacity and quality of wireless networks. In the GSM network, new base stations were built to provide coverage especially in newly developed commercial, industrial and residential areas and along new roads, and to strengthen the GSM network capacity in order to accommodate the growing traffic. A total of 193 new base stations were built; as at the end of 2006, there were 3,985 base stations in all. In the CDMA network, new base stations were built to increase the network capacity and coverage required by the growing numbers of new customers. In all, 425 new base stations were built and, as at the end of the year, the CDMA technology covered 83.7% of the population. In the UMTS network, new base stations were built in Prague and Brno and environs in order to provide basic UMTS signal coverage of these cities; 77 new base stations were added. In April, the HSDPA technology was released for commercial operation in the whole UMTS network. With a software upgrade, the HSDPA launch increased the potential speed to 1.8 Mb/s in phase one. Approximately 1,500 base stations were reconfigured in 2006 in order to deliver sufficient wireless network quality and capacity amid changing traffic density, growing traffic volumes, growing customer complaints etc.

Network-wide projects

Investments in the IPTV service and the E-toll project were among the main network-wide projects of 2006. Telefónica O2 was the selected supplier of transmission capacity in the fixed and mobile networks. The Company met its obligations in respect of the construction and commissioning of the electronic toll system in 2006.

Voice services

In the area of voice services, the trend of fixed to mobile substitution continued. While the total volume of voice traffic generated by Telefónica O2 customers in the fixed network fell 7% year on year in 2006, closing at 3,336 million minutes, the total number of traffic minutes generated by mobile customers grew 21%. In this environment Telefónica O2 strived to retain customers that were exiting the fixed voice service by migrating them to mobile voice services, and thus increase the total voice traffic. This it succeeded in doing, as the total volume of voice traffic generated in the Company's networks grew 6.9% year on year.

Voice services in the fixed line network

The Company implemented several changes for its fixed line voice service customers. Effective from 1 April 2006, the rates for long distance and local calls were consolidated; long distance rates were brought down to the price of a local call, which effectively reduced usage revenues by 53%. The Company also reduced its rates for calls to mobile networks by up to 28%, for all tariffs. Time zones – peak and off peak – were introduced for calls to the mobile network, as with calls to the fixed line networks.

On the same date, the Company introduced Telefon Nonstop, a new tariff offering free-of-charge calls 24 hours a day to all fixed line networks. The tariff also offers cheaper calls to mobile networks and cheaper international rates. The monthly subscription to the tariff was set at CZK 639 exclusive of VAT. A special promotion gave customers one month's free subscription.

On 11 May 2006, the monthly subscription was raised for all five main tariffs; the price increase ranged from 14.2% (Telefon Volno Plus) to 22.6% (Telefon Standard). Changes were also implemented for the Telefon Mini tariff. The monthly subscription increased by 19% to CZK 199 exclusive of VAT; compared to the other tariffs, this was still relatively low. Usage charges were cut to the Telefon Standard tariff (i.e. by around 50%), and a flat charge of CZK 5 exclusive of VAT was added to every call made via the Telefon Mini tariff. Newly, the tariff can be combined with top-up packages and the Carrier Selection and Pre-selection services. Subscribers to the Telefon Expres Mini tariff, which has a monthly subscription of CZK 299 exclusive of VAT, were given the option to select from the family of O_2 Internet Expres broadband internet services.

In the SME segment, the Company registered increased demand for so-called Colour Lines. The new portfolio of Colour Lines, launched on 1 June 2006, certainly contributed to the rise. The products – branded as Ekonom, Efektiv and Elite – were aimed at increasing the penetration of more price-sensitive customers. The price of the basic service, Ekonom, was lower than in the previous portfolio of these products.

Voice services in the mobile network

At the end of June 2006, the Company decided to terminate its 450 MHz NMT voice service. The phase-out of this analogue technology resulted in the termination of all T!P services. Customers of these services were given the option to migrate to GSM and UMTS services. They retained their existing numbers and tariffs and could also take advantage of one of the applicable special promotions.

In mid-January 2006, the Company introduced a new tariff for customers of its pre-paid services. The tariff included SMS for as little as CZK 0.20. From 23 January to 31 March 2006, customers who wished to leave their current operator or switch from the pre-paid service to one of the post-paid tariffs, could, by activating one of the current tariffs and committing for 24 months, keep their number and benefit from a combination of special offers – free calls after the third minute and on weekends, and a bonus of up to 400 free minutes per month on calls to all networks.

On 3 April 2006, the Company released new pre-paid tariffs and an innovated loyalty scheme. The O_2 TXT tariff caters to users who prefer text and multimedia messages; the user can choose one number to which they can send unlimited SMS messages free of charge. The activation and subscription to this tariff is CZK 35 per week. Another new tariff was O_2 Mix, suitable for users who frequently purchase credit. The last tariff was O_2 Fajn – great for users who make a lot of calls, send SMS messages to all networks, make international calls and do not wish to be bound by a contract. Customers who ported their number from another operator received a pre-paid service set for free.

On 1 September 2006, the Company introduced O_2 Simple – a new tariff concept. O_2 Simple lets customers adapt their tariff to their expected communication needs, thus giving them the best value for money. Moreover, all O_2 Simple tariffs come with a free bonus, so customers always get more than they pay for. Customers choose the tariff which, in their judgement, best meets their needs and then spend their subscription on calls or SMS at their discretion. There are five tariffs to choose from, differentiated by subscription: O_2 Simple 240, O_2 Simple 600, O_2 Simple 980, O_2 Simple 1350 and O_2 Simple 1980.

For the students among its customers, Telefónica O2 prepared O_2 Pohoda Simple, a tariff based on the same concept as the O_2 Simple tariffs. All customers who activated the tariff received a 100% bonus on top of their subscription for a period of three months.

All new post-paid customers who activated one of the selected O_2 mobile tariff plans between 1 November and 31 December 2006 could enjoy free calls to all mobile and fixed line numbers in the Czech O_2 network all day from Friday to Sunday for up to one year. Users of pre-paid services who bought an O_2 Fajn SIM card as part of the Christmas campaign and activated the *Long Weekend* service between 1 November 2006 and 31 January 2007 can now call for free in the Czech Republic all day from Friday to Sunday for up to 6 months.

In June 2006, the Company cut the prices of roaming calls in all networks at selected holiday destinations by almost 60%. Moreover, the Company introduced a new, simpler structure of roaming charges. Global destinations were classified into zones, with competitive and easy-to-understand roaming charges. The next step in this direction took the form of My Europe and My Europe SMS, tariffs that let roaming customers take incoming calls without incurring a charge. For a monthly payment of CZK 299 (exclusive of VAT), customers avoid incoming call roaming charges, and their outgoing calls to the Czech Republic and within the roaming network are charged at a lower rate of CZK 18.90 per minute (exclusive of VAT). The service covered all roaming partners' networks in Slovakia, Poland, Germany, Austria, the United Kingdom and Spain. For CZK 99 exclusive of VAT per month, My Europe SMS lets the customer send SMS messages from the above-listed countries at the special economy rate of CZK 5.90 exclusive of VAT.

One of Telefónica O2's first services to offer the benefits of an integrated operator to business customers of voice services was O_2 Team Pevná. The service lets the customer choose up to ten fixed line numbers in the Czech Republic, for which a special rate of CZK 1.50 per minute exclusive of VAT applies. O_2 Team Pevná complemented the O_2 Team service, which permits customers to add up to ten mobile numbers (O2 or non-O2) into their O_2 Team, which they could call for the special price of CZK 1.50 per minute exclusive of VAT.

From 1 October 2006, customers of the *Volejte domů* service (Call Home) can make unlimited calls to a selected fixed line number for CZK 19 per week; the calls are limited neither by time nor by duration.

Another innovation in 2006 was the launch of Eurotel Web Video Calls, a service which lets pre-paid and post-paid service users make video calls without a mobile telephone and outside the UMTS network coverage.

Internet, data and value added services

Internet, data and other value added services were again among the business priorities of Telefónica O2 in 2006. While in the area of fixed lines the Company focused mainly on high-speed ADSL internet access, its mobile services were based on the broadest range of technology on the market – ADSL, CDMA, GPRS, EDGE, HSCSD, WiFi, UMTS and HSDPA, offering the customers a wide choice of internet access products to fit every usage and price bracket.

On 1 February 2006, the Company quadrupled the speed of all O_2 Internet Expres services while keeping prices at the same level. For the basic service, O_2 Internet Expres Impuls, the speed increased from 128/64 kb/s to 512/128 kb/s, for O_2 Internet Expres Ideal from 512/128 kb/s to 2,048/256 kb/s, for O_2 Internet Expres Sprint from 1,024/256 kb/s to 3,072/256 kb/s and for the fastest product, O_2 Internet Expres Maxi, from 2,048/256 kb/s to 4,096/512 kb/s. The periodicity for Fair User Policy monitoring also changed – the weekly limits were aggregated into one monthly limit. There were other changes in the application of the Fair User Policy. Under the new rules, the connection speed is decreased only after the whole monthly data limit is exhausted; the two-tier speed limitation has been abolished. By the end of the first half of 2006, the connection speed was increased for the vast majority of customers subscribing to one of the ADSL internet access services provided.

The speed increases for the O_2 Internet Expres services stimulated customer interest in broadband internet. In the period following the speed enhancements, the number of orders rose sharply: in the period from 1 February until the end of March, the average number of orders was 8 thousand per week. The demand peaked in week 10 at 10 thousand. In week 11, the Company installed a record 10 thousand connections.

On 20 December 2006, the Company increased the data limits for existing and new customers of the O_2 Internet Expres service while keeping the price at the same level. For O_2 Internet Expres 512 the data limits increased from 1 to 3 GB, for O_2 Internet Expres 2048 from 8 to 12 GB, for O_2 Internet Expres 3072 from 12 to 20 GB and for O_2 Internet Expres 4096 from 20 to 30 GB.

As part of the Christmas promotion of O_2 Internet Expres services, the first 30 thousand customers who activated the service by 31 December 2006 received an LG KG 110 mobile handset for CZK 1 exclusive of VAT. They also received a free O_2 pre-paid card with bonus credit and the O_2 Fajn tariff with additional benefits. Customers of the mobile post-paid service could activate one of the O_2 Simple tariffs.

From 1 February 2006, business customers could start using their high-speed internet connection without a data limit; the service retails as O_2 Internet Expres Extreme. Customers could choose from a range of products with speeds ranging from 512/128 kb/s to 4,096/512 kb/s, priced CZK 899–1,799 exclusive of VAT. Telefónica O2 recorded increased demand for security services and other internet-related value added services from business customers. With them in mind, the Company developed the O_2 Internet Expres Business Pack, which, for CZK 899 exclusive of VAT, combined internet access, PC Strážce and a lower-priced fixed IP address.

In April 2006, the Company launched HSDPA mobile internet access. This technology increased the real downlink speed in the UMTS 3rd generation mobile network up to 1,024 kbit/s, not just in Czech UMTS-covered locations, but also in an ever increasing number of international destinations. Telefónica O2 started marketing this mobile data service as Internet Speed in a bundle with a data PCMCIA card.

On 1 September 2006, Telefónica O2 entered the multimedia entertainment market by launching its IPTV product under the brand of O_2 TV. The service was developed by the parent company, Telefónica, and has been successfully marketed in Spain since 2003. In addition to a wide range of television and radio channels, the product features a Videotheque that functions as a virtual video rental shop. The Video Library lets the customer choose from an extensive catalogue of feature films, children's stories and documentaries for unlimited 24 hour viewing. The Video Library initially offered some 250 titles; an agreement with Sony Pictures Television International, a major Hollywood film studio, granted Telefónica O2 access to a back catalogue of more than 2 thousand titles. Another feature of O_2 TV is the TV Archive, which lets customers watch missed films, TV series or sports events up to seven days later. The service is free of charge and covers the programme archives of the ČT 1, ČT 2, ČT 4 Sport, ČT 24 and Prima TV channels. O_2 TV also offers an interactive O_2 TV TV Guide, which lets the user search the content of television and radio channels, including individual programme details.

At the time of its launch, the service was available to more than one million fixed lines in Prague, Brno, Ostrava, Olomouc, Pilsen, Liberec, České Budějovice and a number of other regional capitals. Five months after the launch, the service reached 2 million households with fixed lines.

By the end of 2006 – that is, four months after the launch – O_2 TV had attracted 16 thousand customers. To encourage demand for the service, Telefónica O2 began to offer a self-installation package allowing users to install the service and connect the modem and the set-top box to their television set themselves, using the enclosed instructions. This eliminates the need to wait for installation by a professional.

In the area of data services in 2006, the Company continued developing new VPN products, branded as VPN Expres, and value added services to complement its traditional data products. In April 2006, the Company introduced the premium VPN Expres service, Komfort, and in May the mid-range service, Optimum; the low-end Lite followed in the third quarter.

In September 2006, Telefónica O2 presented a new solution for corporate customers of mobile services – the BlackBerry mobile office solution. This technology for remote access to e-mail, intranet and corporate applications is a professional package aimed at the most demanding corporate customers, giving their employees access to important documents anytime, even from outside the office. A special device, the BlackBerry 8700, combining a mobile telephone, internet browser and PDA, is used for accessing and working with documents. At the time, the device was the most advanced communicator offered by the Company, featuring a wide array of features and functions (e.g. a QWERTY keyboard). The service was intended primarily for the most discerning customers. It complements the O_2 Office Connector service, which targets large corporations as well as SMEs and features some of the functions found with BlackBerry.

BlackBerry was offered with two tariffs. O_2 BlackBerry comes with a monthly subscription of CZK 499 exclusive of VAT and a data limit of 4 MB. O_2 BlackBerry Roaming, for CZK 1,499 exclusive of VAT, is designed for customers who frequently travel abroad; it contains a data limit of 4 MB to be used internationally, with an additional 4 MB data limit for the Czech Republic. The service activation fee is CZK 495 exclusive of VAT.

Telefónica O2 also cultivated its relationships with government entities, offering them the full range of telecommunications services on the market. All important departments of the central government, down to regional and local government level, were customers of the special solutions developed by the Company especially for the government sector.

In addition to providing a comprehensive telecommunications service, Telefónica O2 was an important provider of ICT solutions to the government, corporate and SME segments. On 1 November 2006 it expanded its professional team by adding new system integration experts, formerly staff of its wholly-owned subsidiary Telefónica O2 Services (formerly

Omnicom Praha). Telefónica O2 Services is one of the leading ICT service providers, with customers such as the Ministry of Agriculture, the Ministry of Transport, tour operator Fischer and consumer finance company Home Credit.

The ICT services provided by Telefónica O2 Services fell into two areas, the first being comprehensive IT infrastructure outsourcing and the second comprising ICT services, infrastructure operation, hosting, housing and, last but not least, managed ICT services. The subsidiary offered a comprehensive portfolio of additional services, e.g. staff training, maintenance and professional consultations in areas of customer interest. The main competitive advantages of Telefónica O2 Services were its access to technologies and its optimisation of technology usage, leading to financial savings. Due to the implementation of the ITIL (IT Infrastructure Library) standard for ICT management, which is one of the most widely used ICT infrastructure administration philosophies, the company was able to offer the most effective solutions, bringing the customers the highest possible savings on ICT operation and usage costs.

Telefónica O2 also introduced O_2 Internet Komplet as part of its portfolio of convergent internet access services combining fixed and mobile access. For a single monthly subscription, users get both high-speed internet access with the O_2 Internet Expres (ADSL) service, and mobile internet connectivity with the O_2 Internet Mobil (CDMA) service, with speeds of up to 512 kb/s and 20 free usage hours a month. Customers committing to the service for a minimum of 12 months received an ADSL modem for CZK 1 and a discount of almost CZK 3,000 on a CDMA modem. The customer uses a single user name and a single password to connect. The user account also grants access to the widest network of WiFi hotspots in the Czech Republic. Customers who ordered the service before 31 December 2006 also qualified for special discounts on HP notebook computers.

Domestic and international wholesale services

Domestic wholesale services

In 2006, the Czech telecommunications market, including the cable networks market, continued in its consolidation. This increased the competition on the wholesale market and the downward pressures on prices for the lease of telecommunications capacities, especially leased lines and data services.

In 2006, the main alternative operators continued to expand their own networks using local loop unbundling (LLU). As a result, lower demand for other wholesale services, especially Carrier Broadband, was registered in locations with alternative operators' network coverage. This trend was partly offset by growing demand from alternative fixed network operators and Internet Service Providers (ISPs) for high capacity data services. The implementation of new data services (e.g. Carrier Ethernet) made up for the overall price erosion on the leased line market and the resulting loss of revenues.

As at 31 December 2006, Telefónica O2 registered 23 networks of other public electronic communications service providers interconnected with its fixed line network. At the end of 2006, an agreement was signed with GTS Novera concerning the consolidation of its legacy networks (the former Aliatel, GTS Czech, Contactel and Nextra networks). The agreement came into legal force on 1 January 2007. By the end of 2006, five local loop agreements had been concluded, as well as framework co-location agreements. Amendments to existing agreements were signed with other operators in the course of the year, mainly as a result of changes in the legislation. In June 2006, a new Reference Interconnect Offer, Reference Unbundling Offers and Co-location Offers were published. Later, a Reference Interconnect Offer for the HOST exchange level was published.

No major changes occurred in the area of interconnection of the Company's mobile electronic communications network with the networks of other domestic operators.

As at 31 December 2006, the mobile network was interconnected with 11 networks of public electronic communications service providers.

International wholesale services

Telefónica O2 has extensive experience with the provision of international voice services, occupying a significant position on the wholesale market, primarily in Central and Eastern Europe. In addition to its own infrastructure covering Germany, Austria and Slovakia, the Company added new direct lines to the networks of international telecommunications operators; the number grew to 107 in 2006 (compared to 95 in 2005). The biggest customers were transit operators forwarding traffic to mobile networks, since this type of traffic generates significantly higher revenues than traffic directed to fixed line networks. In 2007, we expect another drop in prices due to competition and regulator-imposed lower interconnection charges.

In the area of hubbing in particular, the Company dominated the market in Central and Eastern Europe. The total volume of hubbed traffic was approximately 1.5 billion minutes and the total revenues from international wholesale voice services in 2006 grew 22% year on year.

As regards international wholesale data services, the Company used its own transmission infrastructure with points of presence in neighbouring countries. In 2006, the number of leased lines sold grew significantly (by 45% on 2005). Capacities provided to wholesale, mainly international, customers also recorded sharp growth (of more than 50% in capacities higher than E3). Working in partnerships, the Company also expanded the availability of its international wholesale services into more Central and Eastern European countries, thus increasing the attractiveness of its service range.

The Company successfully increased its total sales despite fierce competition on the international wholesale data services market in Central and Eastern Europe. The competition stems from a growing number of market players, a dramatic decline in prices and demand for ever larger capacities (speeds in the range of Gb/s are now a commonplace requirement). The result was a moderate stagnation of market size in terms of revenues. The number of lines, however, is growing steadily.

In 2006, the Company forged a close commercial partnership with Telefónica International Wholesale Services (TIWS) with a view to strengthening the competitiveness of the global Telefónica Group on the international wholesale market by capitalising on the synergies to be found in its existing commercial operations.

Comments on the financial results

This section presents the consolidated financial results of Telefónica O2 Czech Republic Group for 2006 prepared under International Financial Reporting Standards (IFRS).

Consolidated Financial Statements

Revenues, Operating Costs and OIBDA

Consolidated revenues (business and recurring revenues) reached CZK 61.3 billion in 2006, up by 0.4% yoy, and up by 0.1% yoy in Q4 alone. The mobile business was the key driver of this growth, while revenues in the fixed business continued to decline, although the rate of this decline slowed during the year. Revenue growth was slightly higher than our guidance for 2006 of flat revenues. Total consolidated operating costs reached CZK 34.1 billion, up by 2.7% yoy and 13.2% in Q4 alone. Re-branding costs and costs related to the Slovak project incurred in Q4 were the major drivers of the OPEX increase, temporarily offsetting the ongoing cost efficiencies. Consolidated OIBDA amounted to CZK 27.9 billion, up by 2.4% yoy, confirming healthy performance and the tight cost control already seen in previous quarters. OIBDA margin (OIBDA over business revenues) reached 45.8% in 2006, compared to 44.9% in 2005. The 2005 OIBDA margin was significantly affected by an impairment charge of CZK 1.3 billion, while in 2006 the impairment charge amounted to CZK 253 million. OIBDA margin excluding these impairment charges would have reached 46.9% and 46.3% in 2005 and 2006 respectively.

Depreciation and Amortization

Consolidated depreciation and amortization amounted to CZK 16.7 billion in 2006, a decline of 6% yoy, on the back of ongoing investment discipline as a result of the strong investment activity already made in the past, continuing the trend seen in previous quarters.

Operating Income, Income Before Tax and Net Income

Consolidated operating income and consolidated income before tax went up by 18.3% yoy and 25.1% yoy to reach CZK 11.2 billion and CZK 10.9 billion respectively in 2006, on the back of the decrease in consolidated depreciation and amortization and financial expenses and supported by OIBDA growth. Consolidated net income amounted to CZK 8 billion, up by 28.3% yoy.

Capex

Similar to the first three quarters of 2006, in Q4 the Group focused its investments on the growth areas of the business. Total consolidated CAPEX amounted to CZK 6.5 billion in 2006, up by 7% yoy. While CAPEX in the fixed segment increased by 42.1% yoy to CZK 3.2 billion and was spent largely on ADSL rollout and IPTV development, investments in the mobile segment were related largely to the CDMA and UMTS networks development and the launch of the Slovak operation. CAPEX in the mobile segment decreased by 13.7% to CZK 3.3 million. Despite increased CAPEX due to the accelerated rollout of the ADSL and IPTV project launch, the CAPEX/Revenues ratio reached 10.6%, confirming our year-end target of 10 to 12%.

Free Cash Flows

The total amount of the Group's free cash flows was CZK 18.4 billion in 2006, down by 1.4% yoy. Operating cash flows went up by 3.4% yoy to CZK 24.5 billion, driven by the increase in OIBDA, while accelerated investments into growth areas resulted in net cash used in investing activities increasing by 26.4% compared to 2005.

Cash and Debt Levels
The Group's consolidated financial debt (long-term and short-term) amounted to CZK 9.4 billion at 31 December 2006, down by 2.8% compared to the end of 2005. The amount of cash and cash equivalents reached CZK 7.5 billion on the same day. This resulted in net leverage of 2.1% and gross leverage of 10.6%, compared to 6.3% and 10.1% at the 2005 year end.

Mobile Segment Overview[1]
Activities in the mobile segment continued to focus on offering data, internet and value added services including content. At the same time we improved the attractiveness of our traditional voice packages with the aim of increasing voice traffic. This strategy is clearly reflected in the financial and operational results of the mobile segment for 2006. In addition, we continued to encourage prepaid-to-postpaid migration with the aim of developing the ARPU potential of these customers.

Total business revenues in the mobile segment increased by 6.1% yoy and amounted to CZK 30.9 billion in 2006. Total data revenues (revenues from value added services and internet & data) accounted for 20.8% of service revenues in 2006, compared to 19.7% in the previous year.

Revenues from voice services (monthly fees, traffic and interconnection) increased in total by 4.4% yoy to CZK 22.9 billion, while the increase in Q4 alone was 6.6%, compared to 5.1% and 2.5% in Q3 and Q2 respectively.

In the competitive Czech mobile market, where SIM card penetration reached almost 121% at year end, we managed to increase the total number of mobile customers by 4% yoy to 4,864 thousand at the end of 2006. Net additions reached 188 thousand in 2006 (compared to 282 thousand in 2005), with a strong performance in Q4 alone of 93 thousand net additions on contract and 11 thousand on prepay. The total number of contract customers reached 1,875 thousand at 31 December 2006, up by 329 thousand yoy, which represents 21.3% growth following the active prepaid-to-contract migration strategy. Contract customers accounted for 38.5% of the total customer base at the end of 2006, up from 33.1% a year ago.

The number of prepaid customers decreased by 141 thousand in 2006, with net adds of 11 thousand in Q4 alone. The total number of prepaid customers thus amounted to 2,989 thousand at the end of 2006, down by 4.5% yoy. Under the methodology which defines a prepaid customer as one generating revenue in the last 3 months, the number of mobile prepaid customers amounted to 2,640 thousand at 31 December 2006, down by 4.7% yoy.

The blended monthly average churn rate amounted to 1.5% in 2006, up from 1.3% in 2005, while it reached 1.4% in Q4 2006.

Revenues from monthly fees increased by 9% yoy to CZK 6.4 billion, mainly as a result of the 21.3% yoy growth in the contract customer base.

Traffic revenues increased by 1.4% yoy to CZK 11.5 billion, while total traffic usage increased by 21% yoy in 2006. Average MOU per subscriber improved to 102 minutes in 2006, up from 92 minutes (10.9% yoy) in 2005, mainly due to the growing number of contract customers generating higher average traffic per customer and traffic stimulation activities.

Interconnection revenues amounted to CZK 5 billion in 2006, up by 5.9% yoy, mainly due to 9.6% growth in incoming traffic driven by increased mobile to mobile traffic.

[1] Mobile segment of Telefónica O2. Figures are shown net of inter-segment charges between the fixed and mobile segments.

In Q4 2006, blended monthly ARPU[1] reached CZK 528, up by 2.7% yoy, while for the whole of 2006 it reached CZK 511, up by 0.2% yoy. Contract monthly ARPU reached CZK 982 in Q4 2006, down by 8.9% yoy, while it amounted to CZK 989 in 2006, 15.1% down. The main reason for lower contract ARPU is the dilution caused by customer migration from the prepaid to the contract segment. Prepaid monthly ARPU increased by 2.1% yoy to CZK 248 in Q4 2006, while it went down by 2% yoy to CZK 239 in 2006.

Total revenues from value added services (including SMS, MMS and content) increased by 8.5% yoy to CZK 4.4 billion as a result of the growing volume of SMS and MMS messages. O_2 customers sent and received in total 2,858 million SMS in 2006, up by 13.5% yoy.

Revenues from Internet and Data recorded a 24.5% yoy increase and reached CZK 1.7 billion. The total number of data customers (GPRS and CDMA) increased by 22.6% to 168 thousand at 31 December 2006. The total number of CDMA-based service customers amounted to 94 thousand (up by 34.3% yoy) and the total number of GPRS customers reached 74 thousand (up by 10.4% yoy) on that date. Data ARPU reached CZK 108 in 2006, compared to CZK 102 in the previous year. Non-SMS data ARPU represented 41% of total data ARPU in 2006, compared to 39% in 2005, as a result of the growth in CDMA and GPRS customers, growth in MMS and the launch of UMTS services in December 2005.

Equipment sales (including connection fees) decreased by 0.6% in 2006 to CZK 1.6 billion as a result of the lower number of handsets sold and lower connection fees charged to new contract customers.

Other business revenues (IT services and other revenues) increased by 73.1% yoy to CZK 303 million, partly because of higher commercial activities in this area (introduction of new services) leading to growth of customers.

Fixed Segment Overview[2]

In 2006, activities in the fixed segment continuously focused on the development and marketing of new internet and data services such as ADSL and IPTV. Despite our focus on reducing the decline of revenues from traditional voice services, the fixed to mobile substitution of voice traffic continued. As a result, revenues from internet, broadband, data and other value added telecommunication services accounted for 27.7% of business revenues in 2006, compared to 26.3% in 2005. In addition, a significant improvement was reported in revenues from IT services, confirming our increasing activities in the ICT/Business Solution area. We expect these services to be a relevant revenue source in the future.

Total business revenues in the fixed segment decreased by 5.1% yoy to CZK 29.9 billion, driven by the shift from traditional voice services, which was not fully compensated by the increase in revenues from broadband Internet-based services, data and value added services.

The total number of fixed telephony accesses[3] amounted to 2,402 thousand as at the end of 2006, down by 17.4% yoy mainly as the result of the strong fixed to mobile substitution effect. Revenues from traditional access decreased by 6.5% yoy to CZK 10.5 billion in 2006, although the impact of the residential monthly fees increase saw this trend begin to slow, with a 2.3% decrease in Q4 alone.

Revenues from traditional voice services (voice traffic and interconnection) declined in total by 9.6% yoy to CZK 10.0 billion. Revenues from voice traffic declined by 16.2% yoy to CZK 5.5 billion, as a result of lower voice traffic generated by our customers, which decreased by 7% yoy to 3,336 million minutes. However, the unification of local and long distance rates effective as of 1 April 2006 helped long distance traffic to increase slightly by 0.3% in 2006.

[1] Including inter-segment revenues.
[2] Fixed segment of Telefónica O2. Figures are shown net of inter-segment charges between the fixed and mobile segments.
[3] Excluding incoming only lines.

Interconnection revenues were flat in 2006 compared to 2005 and amounted to CZK 4.4 billion. While revenues from domestic operators went down as a result of a decrease in interconnection charges and lower incoming traffic, revenues from international operators went up due to higher international transit traffic.

Revenues from internet & broadband increased in total by 9.7% yoy to CZK 3.4 billion and by 17.9% in Q4 alone. This turn around in the revenue trend is due to the strong growth of broadband revenues, which more than offset decreasing revenues from narrowband, confirming our successful strategy to focus on growing services based on ADSL technology. Narrowband internet represents a decreasing proportion of internet revenues with limited downside potential.

Revenues from broadband services amounted to CZK 2.7 billion in 2006, up by 49.9% yoy. Of this, CZK 2.4 billion represented revenues from retail broadband (up by 51.7% yoy) and CZK 396 million from wholesale services (up by 39.9% yoy). Telefónica O2 Czech Republic recorded 196 thousand net additions to ADSL accesses in 2006, compared to 172 thousand net additions in 2005. This progressive increase was supported by a successful marketing campaign that began in Q1. The total number of ADSL accesses reached 470 thousand at 31 December 2006, compared to 274 thousand at the end of 2005 (up by 71.5% yoy). On 1 September 2006, Telefónica O2 Czech Republic entered the multimedia entertainment market with the launch of O_2 TV service, an IPTV-based product. By the end of 2006, O_2 TV had 16 thousand customers.

Revenues from narrowband internet decreased by 50.4% yoy to CZK 610 million in 2006. In the same period, dial-up internet traffic went down by 58.1% yoy to 1,181 million minutes, as a result of continuing dial-up traffic migration to ADSL broadband internet access and other fast internet service alternatives.

Revenues from data services decreased by 4.1% yoy to CZK 4.2 billion, mainly due to a decline in revenues from leased lines, which went down by 10.9% yoy to CZK 2.3 billion. Revenues from data network services increased by 6.2% yoy and reached CZK 1.8 billion, due to the growth of IP Connect and IP VPN connections and the introduction of new ADSL-based data services.

Equipment sales amounted to CZK 593 million, down by 23.2% yoy due to the lower number of handsets sold and other equipment and special discount offers. Revenues from IT services and business solutions reached CZK 584 million in 2006, compared to CZK 231 million in 2005, as a result of the growing activities of the Company in ICT and IT services.

Group Operating Expenses

Due to the integration of ČESKÝ TELECOM and Eurotel and the gradual alignment of systems (including accounting systems), it has become increasingly difficult to properly allocate operating costs related to the fixed and mobile segments without the risk of distorting the profitability ratios. Therefore, the Company has decided to report and comment on group operating costs only and to discontinue segment OIBDA reporting as from Q4 2006. Further reporting of fixed and mobile operating costs and OIBDA would be misleading.

Total group operating costs amounted to CZK 34.1 billion in 2006, up by 2.7% yoy, while they reached CZK 10 billion in Q4 alone, up by 13.2% yoy. This increase is to a large extent the result of higher marketing and sales costs and other subcontracts (external services) related to the re-branding and operating costs related to activities in Slovakia.

Supplies expenses grew by 2.2% yoy to CZK 15.4 billion. Interconnection costs increased by 3.2% yoy to CZK 10 billion due to higher activities in transit business and growth in mobile off-net traffic generated by our customers. Cost of goods sold went down by 12.6% yoy to CZK 3.1 billion on the back of lower sales of handsets, while other supplies increased by 24.5% to CZK 2.3 billion due to higher capitalized material costs and subdeliveries.

Personnel costs, including headcount reduction costs, amounted to CZK 7.1 billion, down by 9.4% yoy in 2006 as a result of one-off items recorded in 2005 and headcount reduction. The total number of employees of the Group reached 9,416 at 31 December 2006, down by 6.4% yoy. Telefónica O2 Czech Republic's headcount went down by 7.3% yoy to 9,265 during this period.

The cost of external services increased in total by 12.4% yoy and reached CZK 10.6 billion. Marketing and sales went up by 20.2% yoy to CZK 3.1 billion due to higher marketing activities related to new ADSL offers and higher marketing spend related to the re-branding project, which was launched on 1 September 2006. Network & IT repairs and maintenance increased by 7.5% yoy to CZK 2.6 billion, while rentals, buildings and vehicles costs reached CZK 1.7 billion, up by 2.7% yoy due to higher maintenance costs. Utilities supplies increased by 23.5% yoy to CZK 746 million due to higher energy costs. Other external services including consultancy fees and other external services went up 12.7% yoy to CZK 2.4 billion in 2006, with an increase of 188.9% in Q4 alone due to re-branding costs and costs incurred in Slovakia.

Taxes, comprising taxes other than income tax, fees and provisions increased by 17.2% yoy to CZK 1.1 billion.

Outlook for 2007

In 2007, the Company's activities will continue to address the current trends in the Czech telecommunication market, specifically in the areas of broadband, data, value added services and convergent products. At the same time, we will maintain a focus on revenue retention in traditional voice and data services in both the fixed and mobile segments.

Reducing the fixed lines cancellation rate remains among the top priorities for 2007. The introduction of new convergent services offering a combination of fixed and mobile voice services, broadband services and IPTV should increase the value of the fixed line proposition and eventually reduce churn. Broadband services will be the fundamental product of the bundles, with the main focus on value proposition accompanied by quality of service, coverage expansion and on further customer care improvements. The Company will also continue to roll out our newly introduced IPTV service, improve provisioning and customer care and increase product attractiveness by offering new channels, movies and interactive services. The Company will focus more on IT and integrated customer solutions primarily for corporate and government customers. The strategy in the mobile segment continues to focus on ARPU sustainment via onward prepaid-to-postpaid migration and growing mobile data and Internet revenues through CDMA and HSDPA-based services. Maximum customer experience and satisfaction remain the principal goal and the customer is at the heart of all Company´s activities.

The fixed/mobile integration will continue internally as well externally through the realization of ongoing integration projects with the aim of achieving significant synergies leading to revenue growth and OPEX and CAPEX savings. These include mainly sales channels and customer care integration, regional network operations integration and controlling, budget and reporting processes alignment. At the same time we will continue to benefit from the global experience of and close interaction with Telefónica, O2 and other Telefónica Group operating companies, largely in the areas of procurement and process improvement and new product development.

At the beginning of February 2007, Telefónica O2 Slovakia launched commercial operation in Slovakia. The Company will continue to support the gradual deployment of the Slovak operation, including the development of systems, processes and network rollout, to achieve a quality and customer experience equal to O2 in the Czech Republic while applying a cost conscious approach. The operational target for 2007 is to gain a 5% market share.

The key strategic effort of the management is to maintain our leading position in a highly competitive and changing Czech telecommunication market. The main aspects of the financial management of the Telefónica O2 Czech Republic Group will remain focused on OIBDA growth, efficient CAPEX levels and strong free cash flows.

In 2007 the Company expects group revenues to grow by 1% to 3% and OIBDA to decline by 1% to 0% compared to 2006. The expected negative impact of the Slovak operation is already included in this range. CAPEX is expected to be around CZK 9 billion in total, with around 20% of this figure invested in Slovakia.[1]

At the Annual General Meeting held on 26 April 2007, the Board of Directors of Telefónica O2 Czech Republic intends to propose a dividend payment of CZK 50 per share, i.e. a total dividend amount of CZK 16,104 million, from the profit for 2006 and retained earings from previous periods. This proposal is based on the Company's intention not to hold surplus cash balances in the current environment and is consistent with its investment strategy to lock its investments into growing areas (broadband, mobile, business services and Slovakia).

[1] Guidance assumes constant exchange rates as of 2006.

03

Corporate Governance

Corporate Governance of the Telefónica O2 Czech Republic Group

The total number of traffic minutes generated by mobile customers grew 21%.

As in other areas, the corporate governance of Telefónica O2 Czech Republic (Telefónica O2, the Company) was influenced in 2006 mainly by the ongoing integration of ČESKÝ TELECOM and Eurotel and the related events. The personnel changes in the governing bodies of the Company were also mostly linked with the integration process, as was the implementation of a new executive macrostructure of the Company. In April 2006, the General Meeting of the Company's shareholders approved the amended Articles of Association. The integrated Company launched a new commercial brand in September 2006 – O_2, signifying the Company's membership in the Telefónica O2 Europe group. As regards subsidiaries, changes were made in Telefónica O2 Services, spol. s r.o. (formerly OMNICOM Praha, spol. s r.o.), CenTrade, a.s. and Telefónica O2 Slovakia s.r.o. (formerly CZECH TELECOM Slovakia s.r.o.).

Telefónica O2's ownership rights in its subsidiary companies, save for those incorporated in foreign jurisdictions, are exercised by the Board of Directors of Telefónica O2 Czech Republic acting in the capacity of the sole member. Persons with power of attorney given by the Board of Directors of the parent company exercise the ownership rights in foreign subsidiaries within the limits of the mandate approved by the Company's Board of Directors. Personnel changes in the subsidiary companies' statutory and supervisory bodies (in positions occupied by the Company's representatives) are approved by the Board of Directors of the Company and, in accordance with the Articles of Association, are also subject to prior approval by the Supervisory Board of the Company. After a period of analysis, changes were made gradually during 2006 in the subsidiary companies in order to support their integration into and contribution to the Telefónica O2 Czech Republic Group (i.e. Telefónica O2 and all its subsidiary companies).

During 2006, the global Telefónica Group realigned its governance structure, which led to the Company being incorporated into the Telefónica O2 Europe division, which includes all Telefónica's European operations except for Spain. The ownership structure of the Company saw no major changes. Telefónica, S.A. remains the majority shareholder with a 69.4% stake.

Subsidiaries and associated companies
(as at 31 March 2007)

The most important changes in the Telefónica O2 Czech Republic Group in 2006 were the merger of ČESKÝ TELECOM, a.s. and Eurotel Praha, spol. s r.o., by way of a take-over of Eurotel by its sole member ČESKÝ TELECOM, and a change of the corporate name of ČESKÝ TELECOM, a.s. to Telefónica O2 Czech Republic, a.s. The integrated company was formed on 1 July 2006. On the same date, the subsidiary Eurotel was wound up without liquidation and the new corporate name became effective. The details of this process were given in the Company's 2006 Half-year Report.

As a result of the change of name of the parent company, the two subsidiaries also changed their corporate names: CZECH TELECOM Slovakia s.r.o. changed its corporate name to Telefónica O2 Slovakia s.r.o. with effect from 8 July 2006, and OMNICOM Praha, spol. s r.o. changed its corporate name to Telefónica O2 Services, spol. s r.o. with effect from 1 November 2006.

Following the Company's victory in the tender for the third mobile licence in Slovakia, changes were made in the statutory bodies of Telefónica O2 Slovakia in September 2006 in order to put the company in a position to capitalise on the new business opportunity. Details of the company and its commercial activities are given on the page 32 of the Annual Report.

In the last quarter of 2006, the sole shareholder of CenTrade increased the company's equity by CZK 40 million by way of new share subscription in order to provide for regular operation of the company going forward. As part of the corporate structure optimisation undertaken in the Telefónica O2 Czech Republic Group, the sole shareholder decided in December 2006 put CenTrade in liquidation as of 1 January 2007.

As a result of the integration of Eurotel and ČESKÝ TELECOM, Telefónica O2 became the owner of a 23.25% holding in První certifikační autorita, a.s., originally held by Eurotel.

The company is the largest provider of comprehensive electronic certificate issuance and administration services in the Czech Republic; other major corporations (Česká spořitelna, a.s., Československá obchodní banka, a.s., PVT, a.s. and Státní tiskárna cenin s.p.) are among its shareholders.

Subsidiaries and associated companies in which Telefónica O2 has direct ownership of more than 10% of the registered capital.

As at 31 March 2007

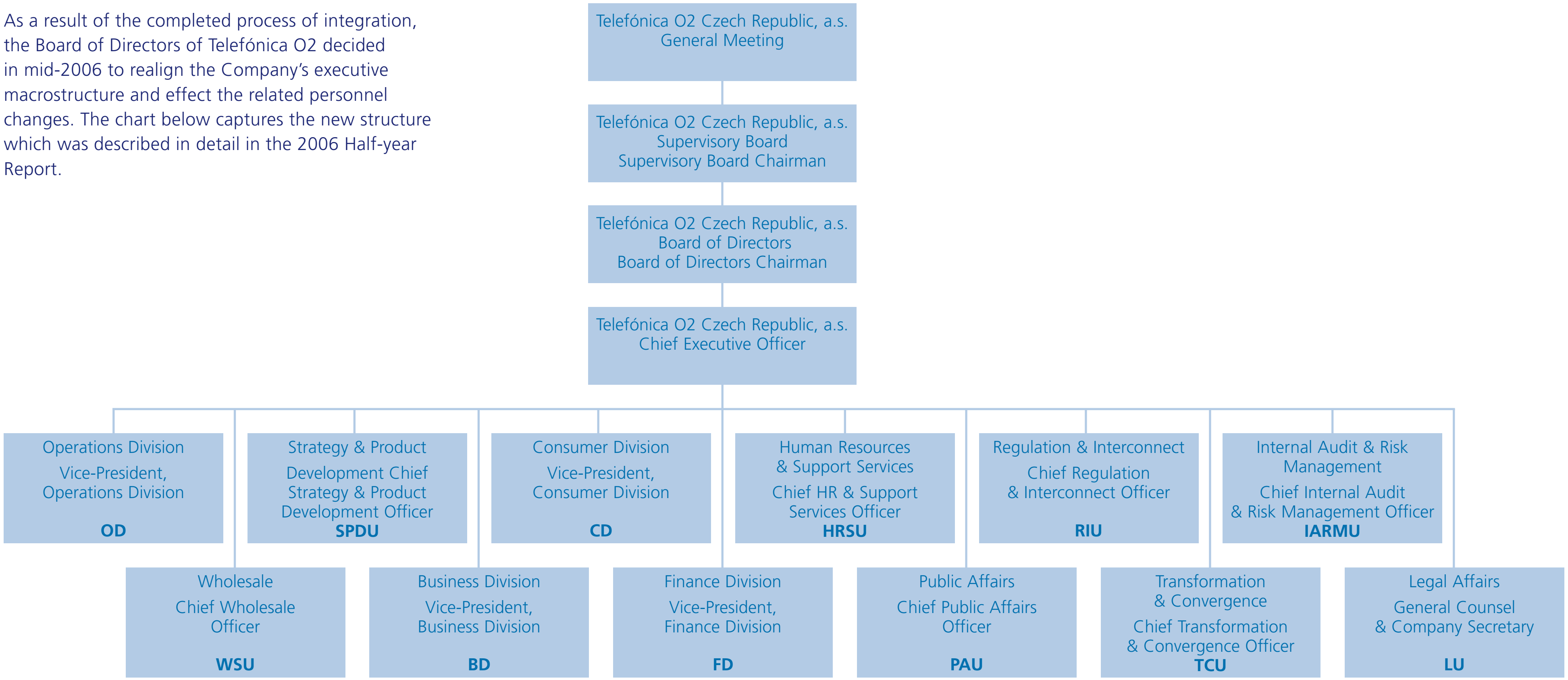
Corporate Name	Registered Capital	Share of Telefónica O2 Czech Republic
Telefónica O2 Slovakia s.r.o.	SK 200,000	100%
Telefónica O2 Services, spol. s r.o.	CZK 10,000,000	100%
CZECH TELECOM Austria GmbH	EUR 35,000	100%
CZECH TELECOM Germany GmbH	EUR 25,000	100%
CenTrade, a.s. v likvidaci	CZK 42,000,000	100%
SPT TELECOM (Czech Republic) Finance B.V.	EUR 18,151	100%
První certifikační autorita, a.s.	CZK 20,000,000	23.25%
AUGUSTUS, spol. s r.o.*	CZK 166,000	39.76%

* Telefónica O2 Czech Republic has no controlling interest in the company.

Organisation chart of Telefónica O2 Czech Republic

(as at 31 March 2007)

As a result of the completed process of integration, the Board of Directors of Telefónica O2 decided in mid-2006 to realign the Company's executive macrostructure and effect the related personnel changes. The chart below captures the new structure which was described in detail in the 2006 Half-year Report.



Governing Bodies of Telefónica O2 Czech Republic
(as at 31 March 2007)

General Meeting
General Meeting, which comprises the Company's shareholders, decides on fundamental business, organisational and operating matters. Its authority and powers are determined by the Commercial Code and the Articles of Association. As a rule, the Board of Directors convenes the General Meeting once a year. Basic information on the General Meeting and its status and authority can be found in Articles 7–13 of the Company's Articles of Association.

Supervisory Board
The Supervisory Board has fifteen members and supervises the discharge of the Board of Directors' powers and the running of the Company's business. Its composition, authority and powers are determined by the Commercial Code and the Articles of Association. As a rule, the Supervisory Board meets once two calendar months, but at least six times in the course of a calendar year. Two thirds of the Supervisory Board members are elected and recalled by the General Meeting, one third of the Supervisory Board members are elected and recalled by employees of the company. Members of the Supervisory Board are elected for tenure of five years. Basic information about the Supervisory Board and its authority can be found in Articles 20–27 of the Company's the Articles of Association.

Board of Directors
The nine-member Board of Directors is a statutory body which manages the business of the company and acts on its behalf. The Board of Directors decides on all corporate affairs which, by law or the Articles of Association, are not reserved for the General Meeting of the Supervisory Board. As a rule, the Board of Directors meets once every calendar month, but at least 12 times in the course of a calendar year. Members of the Board of Directors are elected and recalled by the Supervisory Board. The tenure of a member of the Board of Directors is five years. Basic information on the Board of Directors and its authority can be found in Articles 14–19 of the Company's Articles of Association.

Committees of the Supervisory Board
Under its powers, the Supervisory Board sets up committees as its advisory and initiative bodies. Committees of the Supervisory Board are an inherent part of corporate governance. These always include an Audit and Control Committee and a Nomination and Remuneration Committee. Members of committees are elected and recalled by the Supervisory Board. The tenure of a member of a committee is 2,5 years. Committees established by the Supervisory Board can comprise only members of the Supervisory Board. The scope of authority of the Supervisory Board's committees is set out in Article 26 of the Company's Articles of Association. As at the end of 2006, the Company had the following committees of the Supervisory Board:

Audit and Control Committee
Nomination and Remuneration Committee
Ethics and Corporate Social Responsibility Committee

Board of Directors of Telefónica O2 Czech Republic
(as at 31 March 2007)

Jaime Smith Basterra (*1965)
Graduated in Economics and Business Administration (BA, Universidad Comercial Deusto, Spain) and holds an MA in Finance and Investments (Exeter University, UK). Before joining Telefónica, he worked in the financial sector for a Spanish brokerage firm and for Banesto (BSCH Group) as Director for Global Equities in its fund management division. He joined the Telefónica Group in 1999 as Director for Financial Planning at Telefónica Internacional and was promoted to Chief Financial Officer in December of the same year. In October 2000, he was appointed Controller of the Telefónica Group. From December 2002 he was the Chief Financial Officer of Telefónica de España. Since June 2005 he has been Chief Executive Officer and Chairman of the Board of Directors of ČESKÝ TELECOM – now Telefónica O2 Czech Republic. He also serves as member of the Board of Directors of Telefónica O2 Europe plc.

Juraj Šedivý (*1962)
Graduated from the College of Mechanical Engineering in Nitra in 1984 and Comenius University in Bratislava in 1990. He worked as assistant professor and research associate in the area of vehicle mechanics until 1991. He received his MBA degree from the Rochester Institute of Technology, New York, in 1992, and joined Johnson & Johnson Consumer Products, Inc. in New Jersey where he worked as a financial analyst, then as Controller of Professional Products, Czech and Slovak Republic Division, in Prague. He gained his first experience in the telecommunications sector as the Finance Director of Globtel, a mobile subsidiary of France Telecom in the Slovak Republic, in 1996 and 1997. In late 1997, he joined ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic), as Executive Director of Planning and Controlling, and in 2001 became Chief Financial Officer. Since 2003 he has been the First Vice-Chairman of the Board od Directors of Telefónica O2 Czech Republic. On 1 October 2006 he was appointed Chief Executive Officer of Telefónica O2 Slovakia.

Jaime Smith Basterra
Chairman of the Board of Directors

Juraj Šedivý
First Vice-Chairman
of the Board of Directors

Petr Slováček
Second Vice-Chairman
of the Board of Directors

Salvador Anglada Gonzalez
Member of the Board of Directors

Petr Slováček (*1959)
Graduated from the Technical University, Prague, with a degree in telecommunications from the Faculty of Electro-technical Engineering. Also holds a postgraduate Master of Business Telecommunications (MBT) degree from the Technical University of Delft in the Netherlands. After graduation he joined the Telecommunications Research Institution, Prague. He joined SPT TELECOM (a legal predecessor of ČESKÝ TELECOM) in 1989, working in switching, technical development, network management projects and OSS. He currently holds the position of Vice-President – Operations Division. In June 2003 he was elected Second Vice-Chairman of the Board of Directors of ČESKÝ TELECOM, now Telefónica O2 Czech Republic.

Salvador Anglada Gonzalez (*1965)
Graduated in Industrial Engineering in Madrid, holds MBA from Instituto de Empresa and PDG from IESE Madrid. Before joining Telefónica he held a number of executive positions in Dell Computer and Dow Jones Markets. In 2002 he joined Telefónica Group as Sales and Marketing Director for corporate clients in Telefónica de España. Since June 2005 he has been Chief Executive Officer and Statutory Representative of Eurotel, and member of the Board of Directors of ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic). Now he holds the position of Vice-President – Consumer Division in Telefónica O2 Czech Republic.

Ramon Ros Bigeriego (*1967)
Graduated in Business Administration and European Masters in Management at ESCP EAP, Paris. Carried out studies at Alcalá de Henares University and also at Dublin City University. Before joining Telefónica, he worked in Banesto, one of the biggest financial corporations in Spain. He joined the Telefónica Group in 1997, after serving as manager at Telefónica Internacional in Business Development, participated in the set up of Terra Networks where he later held the position of Senior Vice-President for Corporate Development. From July 2005 he was Chief Corporate Development Officer in ČESKÝ TELECOM (legal predecessor of Telefónica O2 Czech Republic); since October 2005 he has been member of the Board of Directors, Statutory Representative and Chief Financial Officer of Eurotel. Now he holds the position of Vice-President – Finance Division in Telefónica O2 Czech Republic.

Jakub Chytil (*1961)
Graduated from the Faculty of Law, Charles University, Prague, where he got his JUDr. degree. In 1991–1995, he was a junior associate and, later on (1994), an attorney specialising in commercial and civil law, working with international law firms. In 1995–2000, he was Corporate Legal Counsel for the Czech and Slovak Republics at Philip Morris ČR and Kraft Foods. In 2000–2003, he was the Senior Counsel of Philip Morris International, Lausanne, Switzerland, where he was responsible for the legal affairs of Philip Morris International's subsidiaries in various countries. Since 1 December 2003 he has been in the position of General Counsel at ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic). He was elected member of the Board of Directors on 27 April 2006, and with effect from 1 May 2006 he was appointed the Company Secretary.

Ramon Ros Bigeriego
Member of the Board of Directors

Jakub Chytil
Member of the Board of Directors

Martin Bek
Member of the Board of Directors

José Fernando Astiaso Laín
Member of the Board of Directors

Martin Bek (*1969)

Studied foreign trade at University of Economics, Prague, and completed his studies at the European Business School, France, where he majored in Finance. He worked for ABC International, DRT International and later at Guérard Viala Prague as senior consultant and tax advisor. From 1996, he worked at ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic) as Executive Director for Tax and Accounting, later as Executive Director for Planning and Controlling. In April 2004 he was appointed Statutory Representative of Eurotel and since September 2004 he has been Eurotel's Chief Operating Officer. Now he holds the position Chief Human Resources & Support Services Officer in Telefónica O2 Czech Republic.

José Fernando Astiaso Laín (*1961)

Graduated in telecommunications engineering at the Polytechnic University, Madrid and holds a postgraduate degree from IESE Business School. Has more than twenty years of experience in technology sectors in companies like Sener, IBM, Cable & Wireless, Unisource and Telefónica. He joined Telefónica de España in 1997 where he worked in various sales and marketing management positions in the SMEs and Corporate segments. Before joining Telefónica O2 Czech Republic he was Commercial Director for the SME segment. Now he holds the position of Vice-President – Business Division in Telefónica O2 Czech Republic.

Antonio Botas Bañuelos (*1963)

He earned his Bachelor degree at Universidad Complutense in law and a Master degree in Economics and Business Administration (MBA) at IESE. He has more than seventeen years of experience in operative and strategic marketing, management and co-ordination of large multinational teams, and he has worked in international markets, namely those in the Americas. He worked as Marketing Manager in Royal Insurance, which he joined after leaving Johnson & Johnson. In the Telefónica Group he worked for TPI, Doubleclick Iberoamérica and then in Terra in positions ranging from Chief Sales and Marketing Officer to Executive Vice-President for Central Marketing and Global Sales. Now he holds the position of Chief Transformation and Convergence Officer in Telefónica O2 Czech Republic.

Changes in the personnel composition of the Board of Directors during 2006:

Jakub Chytil
elected by the Supervisory Board to the post of member of the Board of Directors on 27 April 2006

Martin Bek
elected by the Supervisory Board to the post of member of the Board of Directors on 27 April 2006

José Fernando Astiaso Laín
elected by the Supervisory Board to the post of member of the Board of Directors on 27 April 2006

Antonio Botas Bañuelos
elected by the Supervisory Board to the post of member of the Board of Directors on 27 April 2006

Antonio Botas Bañuelos
Member of the Board of Directors

Executive management of Telefónica O2 Czech Republic
(as at 31 March 2007)

Jaime Smith Basterra
Chief Executive Officer
(résumé in Section Board of Directors of Telefónica O2)

Ramon Ros Bigeriego
Vice-President, Finance Division
(résumé in Section Board of Directors of Telefónica O2)

Petr Slováček
Vice-President, Operations Division
(résumé in Section Board of Directors of Telefónica O2)

José Fernando Astiaso Laín
Vice-President, Business Division
(résumé in Section Board of Directors of Telefónica O2)

Salvador Anglada Gonzalez
Vice-President, Consumer Division
(résumé in Section Board of Directors of Telefónica O2)

Antonio Botas Bañuelos
Chief Transformation & Convergence Officer
(résumé in Section Board of Directors of Telefónica O2)

Jakub Chytil
General Counsel & Company Secretary
(résumé in Section Board of Directors of Telefónica O2)

Martin Bek
Chief Human Resources & Support Services Officer (résumé in Section Board of Directors of Telefónica O2)

Zdeněk Radil (*1975)
Graduated from the University of Economics in Prague and the Faculty of Law, Charles University. He started his professional career in the Czech National Bank; later, he held the position of Head of Risk Management in SPT TELECOM and in AliaChem. In 1999, he joined Alcatel as Treasurer, being responsible for the treasury activities in Central and Eastern Europe. He also worked for Deloitte & Touche as project manager in the areas of risk and treasury management, finance and restructuring. In January 2005, he was appointed Chief Risk Management Officer in ČESKÝ TELECOM Group (the legal predecessor of Telefónica O2 Czech Republic), being responsible – as a member of the executive management – for risk management in the entire Group. At present he is the Chief Internal Audit and Risk Management Officer in Telefónica O2 Czech Republic. He is Vice-President of the Czech Treasury Association and Secretary-General of the Czech Association of Investment Companies.
He holds a full broker's licence.

Jaroslav Kubišta (*1948)
After his graduation from the Faculty of Electrical Engineering of the Slovak Technical University, Bratislava, in 1972, he worked in Tesla Lanškroun, in development. In 1973 he joined the Federal Ministry of Foreign Affairs where he worked by rotation at the Ministry and at the Czech Embassy in Washington. During his time at the Ministry he completed a two-year postgraduate programme in International Relations in the Czech Republic, as well as a number of shorter courses abroad. From 1992 he was Director for External Relations in Eurotel Praha. After Eurotel´s integration into ČESKÝ TELECOM he was appointed Chief Public Affairs Officer of Telefónica O2 Czech Republic.

Zdeněk Radil
Chief Internal Audit & Risk Management Officer

Jaroslav Kubišta
Chief Public Affairs Officer

Stanislav Kůra
Chief Strategy & Product
Development Officer

Pavel Jiroušek
Chief Wholesale Officer

Stanislav Kůra (*1968)
Graduated from the Brno Technical University, School of Civil Engineering, studied project management at the Cranfield Institute of Technology, UK, and went on to earn his MBA at the London Business School. He worked in managerial positions at UNISYS in London and in Prague, at Idom, a Deloitte & Touche subsidiary, and as a junior partner responsible for telecommunications in McKinsey & Company in Prague and in Silicon Valley, California. He has 15 years of experience in the fields of telecommunications and IT. He joined Eurotel on 1 April 2005 as Director for Broadband Services with overall responsibility for implementation of the UMTS network and services, and in October 2005 he was appointed Eurotel's Chief Strategy and Product Development Officer and Statutory Representative. After the integration of ČESKÝ TELECOM and Eurotel, his responsibility for strategy and product development now covers the new company, Telefónica O2 Czech Republic.

Pavel Jiroušek (*1963)
Graduated from the Department of Computer Systems and Technical Cybernetics at the University of Western Bohemia and continued his research in the field of the Systems Control at the Academy of Science (PhD program). In 2000 he completed his MBA program at the University of Pittsburgh. From 1992 to 1995, he worked as Director for Marketing and Product Management in Eurotel and later at the same position in SPT TELECOM – NEXTEL. He joined ČESKÝ TELECOM in 1997 and after the inception of Telefónica O2 Czech Republic, he is the new company´s Chief Wholesale Officer.

David Šita (*1969)
Graduated from the University of Economics, Prague, with a degree in finance and macroeconomics in 1998. He went on to earn his MBA at the US Business School accredited by the Rochester Institute of Technology, New York. Later he worked in the banking sector – at GE Capital Bank, mainly in operations, and managed a small brokerage firm. He joined ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic). In 2000 as manager for cost and profitability calculation. In 2002 he was promoted to Director for Cost and Profitability Calculation. In 2003 he left finance for the field of regulation as Chief Regulation Officer. Since October 2004 he has been Chief Regulation and Interconnect Officer.

David Šita
Chief Regulation & Interconnect Officer

Report by the Supervisory Board

In keeping with the Company's Articles of Association, the Supervisory Board of Telefónica O2 Czech Republic in 2006 supervised the discharge of the Board of Directors' powers and the running of the Company's business. Supervisory Board members have the power to inspect all documents and records concerning the Company's activities; check whether the accounting records are kept to reflect the reality; determine whether the business of Telefónica O2 Czech Republic is done in compliance with the law, Articles of Association and instructions of the General Meeting.

The Supervisory Board continuously monitored the activities of Telefónica O2 Czech Republic and key decisions made by the Board of Directors and the management. Further, the Supervisory Board dealt with the suggestions raised by its committees and its members individually. The Board of Directors and the management provided the Supervisory Board with the documentation and information necessary for the discharge of its functions in accordance with the legislation and the Articles of Association.

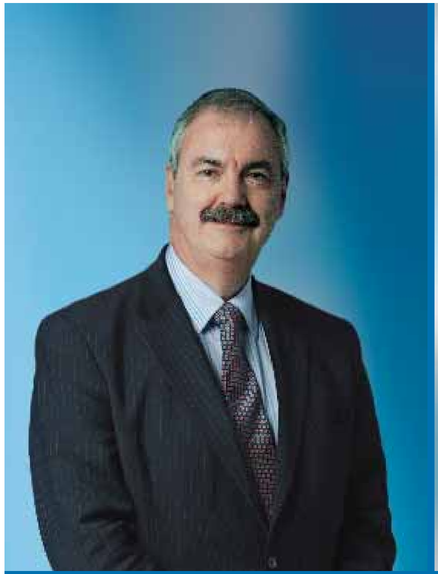
At its meeting of 22 February 2007, the Supervisory Board examined the audited annual financial statements for 2006 (unconsolidated and consolidated) prepared under the International Financial Reporting Standards, and recommended them to the Ordinary General Meeting for approval.

Peter Anthony Erskine
Chairman of the Supervisory Board
Prague, 22 February 2007

Supervisory Board of Telefónica O2 Czech Republic

Peter Anthony Erskine (*1951)
He joined O2 from BT where, since March 1993, he held a number of senior positions including Director of BT Mobile, President and Chief Executive of Concert, and, from 1998, Managing Director of BT Cellnet. Prior to joining BT, he was European Vice President of Mars Electronics and Senior Vice President Sales and Marketing for UNITEL. He also served as a member of the Advisory Board of the University of Reading Business School until the start of 2006. From 2005 he was Chairman and Chief Executive Officer of O2 plc. Following the acquisition of O2 plc by Telefónica, S.A., in January 2006, he became Chief Executive Officer of the subsidiary. He was at the same time appointed to the Board of Telefónica, S.A., and the company changed its name to Telefónica O2 Europe plc on 2 January 2007.

Julio Esteban Linares López (*1945)
Started as telecommunications engineer with Telefónica's R&D Centre in May 1970 and held various positions there before being appointed Head of Telefónica's Technology department in 1984. In April 1990 he was appointed General Manager of Telefónica Investigación y Desarrollo (Telefónica I + D) and in December 1994 he became Deputy General Manager of Telefónica's Marketing and Services Development department, in the commercial area, subsequently moving to the position of Deputy General Manager for Corporate Marketing. In July 1997 he was appointed Chief Executive Officer of Telefónica Multimedia and President of Telefónica Cable and Producciones Multitemáticas. In May 1998 he was appointed General Manager of Strategy and Technology in Telefónica, S.A.'s Corporate Centre. Since January 2000 he has been Executive Chairman of Telefónica de España. He has been Executive Chairman of Telefónica de España since January 2000, as well as a member of the board of Telefónica Data Corp. In December 2005 he became Managing Director for Coordination, Business Development and Synergies in Telefónica S.A., where he is also a Member of the Board of Directors and Secretary for the Executive Committee. He is also a member of the Board of Directors in Telefónica O2 Europe, Sogecable S.A., the Social Council of the Complutense University of Madrid, of the Advisory Scientific Council of Telefónica I+D and Counsellor representing innovating companies in the Science and Technology Advisory Board. In June 2005 he was appointed Chairman of the Supervisory Board of ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic) and is currently the Vice-Chairman of the Supervisory Board of Telefónica O2 Czech Republic.



Peter Anthony Erskine
Chairman of the Supervisory Board

Julio Esteban Linares López
First Vice-Chairman
of the Supervisory Board

Lubomír Vinduška
Second Vice-Chairman
of the Supervisory Board

Alfonso Alonso Durán
Member of the Supervisory Board

Lubomír Vinduška (*1956)

Graduated in radio and communication from the Secondary School of Electrical Engineering. In 1974–1979 he worked as a TV repairman and later as an electrical technician at Okresní kovopodnik Praha-východ (Prague-East Regional Metal Works), then at TESLA Strašnice and Czechoslovak Radio. In 1979 he joined ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic) as an electrician. Later he worked as an energy operations foreman, head of energy operations and head of territorial transport and mechanisation, Prague. At present he holds the position of Transport and Mechanisation Specialist.
He is Deputy Chairman for Telecommunications of the Post, Telecommunications and Newspaper Services Employees Trade Union, Deputy Chairman of the Trade Union Steering Committee at Telefónica O2 Czech Republic, and Chairman of the Prague Trade Union Steering Committee.

Alfonso Alonso Durán (*1957)

Holds a BA degree in Economics from the Universidad Autónoma Madrid. He started his professional career with Banco de Bilbao as manager/controller. He joined Telefónica as economist and worked in several departments: accounts, infrastructure, international communications, financial controlling and cost management in the Spanish fixed business unit. In 1999 he left Telefónica de España for Telefónica, S.A., as Deputy Director for Planning and Management Control. Now he holds the position of General Manager for Strategy, Budget and Control.

Andrew Harley (*1960)
Is Group HR Director for Telefónica O2 Europe. He was appointed to the Telefónica O2 Europe plc Board on 1 January 2007. He joined O2 from British Telecommunications plc where he had worked since 1980 in a number of senior HR positions at BT Cellnet (now O2 UK), BT openworld, BT's fixed internet service provider, and BT Wireless. He was also Human Resources Director for Telenordia in Sweden. He is also a Fellow of the Chartered Institute of Personnel.

Vlastimil Barbořák (*1953)
Qualified at the Secondary Vocational School, Ostrava-Poruba, specialising in switched communications. He has been with Telefónica O2 Czech Republic and its legal predecessors since 1971: until 1975 – exchange and PABX assembly, Vsetín; until 1994 – analogue exchange mechanic, Kaplice; until 1999 – specialist and head of OMC Department, České Budějovice; until 2005 – manager of decentralised EWSD-J maintenance. Now he holds the position of specialist for operation and maintenance of digital telecommunications technology. Studied at the Czech Institute of Directors training course, he was certified with a title of Corporate Governance Director in 2004. He presently studies Corporate Ethics Management.

Andrew Harley
Member of the Supervisory Board

Vlastimil Barbořák
Member of the Supervisory Board

Pavel Herštík
Member of the Supervisory Board

Catherine Jane Keers
Member of the Supervisory Board

Pavel Herštík (*1951)
Graduated in communication technology from the Secondary Technology School of Electrotechnical Engineering. In 1972, he started working as a telephone test centre technician in Ředitelství telekomunikací Praha (Telecommunications Headquarters, Prague). For the next 20 years (1975–1995), he was a planner and later became chief planner. From 1995 to 1996, he was Head of Information Management and went on to become Head of the Management, Organisation and Administration Department. At present, he is a Senior Specialist in the area of management and administration of management documents in the Human Resources Unit at Telefónica O2 Czech Republic. In 2005 he completed a course in international accounting standards. He is Chairman of the Trade Union Steering Committee of Telefónica O2 Czech Republic.

Catherine Jane Keers (*1965)
She has been Customer Director responsible for Brand and Corporate Strategy and Communications in O2 UK since April 2005, providing clear direction for the UK business. She was previously Marketing Director, O2 UK for 4 years and prior to that General Manager of Customer Care in BT Cellnet. Before joining O2, she worked for a number of major UK brands including Next, BSkyB, Avon Cosmetics and Thorn EMI in marketing, operational and business development roles.

Guillermo Fernández Vidal (*1946)
He holds a degree in Industrial Engineering and Computer Science and in 1989 he joined Telefónica, first as a manager and later he was promoted to Commercial Director (1992-1995) and General Manager of Companies of Telefónica (1995-1999). In 1999 he was appointed Chief Executive Officer of Telefónica Data and President of Telefónica Data España. In the same year he was also a member of statutory bodies at Telefónica Móviles, Telefónica de España, Vía Digital and Portugal Telecom. In 2003 he was appointed General Manager for Subsidiaries. From 2004 to 2005 he was General Manager for Commercial Development and Affiliates at Telefónica, S.A. In 2005 he was appointed as Corporate General Manager of Telefónica, S.A. and member of the board of Telefónica Móviles de España, Telefónica de España and TPI. He is presently advisor to Telefónica.

Miloslav Krch (*1958)
Graduated from the Faculty of Electro-Technical Engineering at the University of Technical Engineering, Pilsen. Has been working at ČESKÝ TELECOM and its legal predecessors since 1986. His first position with ČESKÝ TELECOM was a technician at the E10 Exchange in Vlašim in 1986. From 1987–1995, he worked as the head of the ATÚ Vlašim telecommunications centre. Later he held the following positions in ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic): specialist in the Department of the Regional Director of MTTÚ RBU Prague; Head of the Maintenance Management Department and Deputy Director for operation of switching and access network systems, Prague; Director of Local Operations, Prague Area. He presently holds the position of Manager of Operations, Prague Area, in Telefónica O2 Czech Republic.

Guillermo Fernández Vidal
Member of the Supervisory Board

Miloslav Krch
Member of the Supervisory Board

Luis Lada Díaz
Member of the Supervisory Board

Sohail Qadri
Member of the Supervisory Board

Luis Lada Díaz (*1949)

He holds a degree in telecommunications engineering and joined the Telefónica Group in 1973 in the Research and Development Department, rising through the ranks to hold various managerial and executive positions within the group. In 1989 he was Deputy Director for Technology, Planning and International Services. Later he joined Amper Group, a manufacturer of telecommunications system and equipment, as Director of Planning and Control. He returned to the Telefónica Group in 1993 as Chief Controller for Subsidiaries and Participated Companies. In 1994 he was appointed Chief Executive Officer of Telefónica Móviles de España, S.A., and in September 2000 he went on to become President and Chief Executive of Telefónica Móviles, S.A. until 2004, when he was named Director for Development, Planning and Regulatory Affairs of Telefónica, S.A. In 2005 he was appointed Executive Chairman of Telefónica de España, S.A.U. Until he left his executive positions in Telefónica in July 2006, he had served on the boards of directors of Telefónica, S.A., Telefónica Móviles, S.A., Telefónica Internacional, S.A. and other corporations, and currently is a member of several Foundations and Think-Tank Groups in Spain, Professor "Ad Honorem" of the Politechnic University of Madrid, Member of the Royal Academy of Engineering, the Scientific Advisory Board of Telefonica Research & Development (TID, S.A.) and the Telefonica Latinoamerica Advisory Board.

Sohail Qadri (*1960)

He is Group Director Strategy & Development for the O2 plc. He was appointed to the O2 plc Board on 23 January 2006 following the acquisition of O2 plc. He joined O2 from British Telecommunications plc where he had worked since 1993 initially as Director of Operations and Strategy for BT Cellnet, from 1997 as Director of Mobility, Group Strategy and Development, and from 2000, as President, Strategy & Business Development of BT Wireless. Before joining BT, he was Principal Consultant at Coopers & Lybrand, now PricewaterhouseCoopers.

Dušan Stareček (*1956)
Qualified in Electronic and Electrical Technology at the Technical and Engineering Secondary School in Rožnov p. Radhoštěm. In 1975, he started work as a technician at Long-distance Cables Administration, Prague (a legal predecessor of ČESKÝ TELECOM). In 1992, he was promoted to the position of Head of External Maintenance in the Transmission Technology Unit. At present, he works as a Specialist for Operation and Maintenance of Digital Telecommunications Technology in Ostrava. He is a member of the Trade Union Steering Committee of Telefónica O2 Czech Republic and Chairman of KOV MORAVA.

Ángel Vilá Boix (*1964)
Graduated in Industrial Engineering from the Universitat Politécnica de Catalunya (1988) and holds a MBA from Columbia University (1990). After working as a financial analyst at Citibank NA and consultant at McKinsey & Co. he went to work for Ferrovial and Pacsa, two Spanish construction and service companies. In 1997 he joined Telefónica as Group Controller. In 1998 he was promoted to CFO at Telefónica Internacional, and later to Managing Director of Corporate Development at Telefónica, S.A. Presently he is also member of the Board of Directors of Banco Bilbao Vizcaya Argentaria (BBVA) and Endemol NV.

Dušan Stareček
Member of the Supervisory Board

Ángel Vilá Boix
Member of the Supervisory Board

Petr Zatloukal
Member of the Supervisory Board

Petr Zatloukal (*1970)
Graduated from the Transport and Communications University in Žilina. From 1994 to 2001, he worked at MICOS Prostějov as Head of the Bidding Department and later as Head of the Commercial Department, and in 1997 went on to manage the whole division. From 2001 till February 2005, he has been Director of the Department for Communications and Information Services of the Czech Interior Ministry. At present he works in the field of security and investment consulting.

Changes in the personnel composition of the Supervisory Board during 2006:

Santiago Javier Fernández Valbuena
recalled by the General Meeting on 27 April 2006

Javier José Aguilera Arauzo
recalled by the General Meeting on 27 April 2006

José María Álvarez-Pallete López
recalled by the General Meeting on 27 April 2006

Antonio Pedro de Carvalho Viana-Baptista
recalled by the General Meeting on 27 April 2006

Peter Anthony Erskine
elected a member of the Supervisory Board by the General Meeting on 27 April 2006 and elected Chairman by the Supervisory Board on the same date

Catherine Jane Keers
elected a member of the Supervisory Board by the General Meeting on 27 April 2006

Sohail Qadri
elected a member of the Supervisory Board by the General Meeting on 27 April 2006

Gerhard Franz Mayrhofer
elected a member of the Supervisory Board by the General Meeting on 27 April 2006

Luis Lada Díaz
recalled from the post of 1st Vice-Chairman of the Supervisory Board by the General Meeting on 27 April 2006

Julio Esteban Linares López
recalled by the Supervisory Board from the post of its Chairman on 27 April 2006 and elected by the Supervisory Board as 1st Vice-Chairman of the Supervisory Board on the same day

Gerhard Franz Mayrhofer
terminated his discharge of duties of a Supervisory Board member as of the discussion of his resignation by the Supervisory Board on 27 October 2006

Andrew Harley
nominated (co-opted) as substitute member of the Supervisory Board on 15 January 2007 pending the next General Meeting

Telefónica O2 Czech Republic's Declaration of Compliance with the Code of Good Corporate Governance based on OECD Principles

Telefónica O2 has been espousing the principles of good corporate governance in its annual reports since 2001. In 2006 the Company made progress in implementing international corporate government standards in line with the latest trends and the best practice of the Telefónica Group. The Company's Board of Directors is systematically supportive of the application of best practice in the field of corporate governance in all subsidiary companies controlled by Telefónica O2.

Telefónica O2 meets all the criteria, principles and recommendations of the updated 2004 Code of Good Corporate Governance based on OECD Principles as published by the Czech Securities Commission (the Code), with the exception of those criteria which fall outside the direct control of the Company's governing bodies and depend on the decisions of the Company's owners (namely the requirement regarding the number of independent members of the Supervisory Board). In 2006, an amendment to the Company's Articles of Association was approved. This reflects modern trends in the field of corporate governance, performance improvement and greater transparency and has introduced a better way of sharing powers between the Company's Board of Directors and the Supervisory Board and its committees.

Corporate Governance

In the first half of 2006, the Company practised the corporate governance model described in the 2005 Annual Report. The modifications effected in connection with the integration of ČESKÝ TELECOM and Eurotel were described in detail in the 2006 Half-year Report. In the second half of the year, Telefónica O2 was governed and managed according to the joint-stock company governance model; this is based on interaction between the executive Board of Directors, made up exclusively of executive managers of the Telefónica O2 Group, and the Supervisory Board. The Supervisory Board has powers to control key decision-making processes and monitor other important aspects of the Company's operation. An implicit part of the model is the combination of the Chief Executive Officer's function with the function of Chairman of the Board of Directors, the application of "prior approvals" and "prior standpoints" by the Supervisory Board, and full use of the advisory and initiative roles of the Supervisory Board's committees.

Telefónica O2 continued to apply the principles of good corporate governance in its subsidiaries. Following the integration of ČESKÝ TELECOM and Eurotel, the transparency of activities allocated to subsidiaries improved, leveraging their contribution to the Group. The corporate name of the subsidiary OMNICOM Praha, spol. s r.o. was changed to Telefónica O2 Services, spol. s r.o., and – in connection with its participation in a tender for the third mobile licence in Slovakia – the corporate name of CZECH TELECOM Slovakia s.r.o. was changed to Telefónica O2 Slovakia s.r.o. As part of a project to optimise the corporate structure of the Telefónica O2 Czech Republic Group, the sole shareholder of CenTrade, a.s. decided to liquidate the company; the subsidiary was put into liquidation on 1 January 2007.

Organisation of Corporate Governance

The corporate governance model applied in Telefónica O2 ensured that throughout 2006 the Company had adequate strategic management and the management's actions were monitored by the Board of Directors and the Supervisory Board, thus providing for the responsible discharge of the duties of the governing bodies towards the company and its shareholders.

An **Ordinary General Meeting** of the Company was held on 27 April 2006. In addition to the usual items on the agenda, it approved the payment of a dividend of CZK 45 per share, gave its consent to the integration of Eurotel and ČESKÝ TELECOM and the change of corporate name to Telefónica O2 Czech Republic, and approved an amendment to the Company's Articles of Association. Full details of the conclusions of the General Meeting are given in the 2006 Half-year Report and on the Company's website.

In connection with the amended Articles of Association, new rules of procedure were approved at meetings of the Board of Directors and the Supervisory Board and its committees. These rules reflect the integration of the Company into the Telefónica O2 Europe Group and the process of integration of the Company itself.

The **Board of Directors** of the Company held 32 meetings in 2006, thus complying with the duty to hold a minimum of 12 meetings each year. The higher-than-usual number of Board of Directors meetings was linked primarily with the integration process and the implementation of the new commercial brand of the Company. The number of Board of Directors members increased from 5 to 9. In connection with the expansion of operations in Slovakia and the related appointment of one of the members of the Telefónica O2 Czech Republic Board of Directors as Chief Executive Officer of Telefónica O2 Slovakia, the Slovak subsidiary gained representation in the Board of Directors of Telefónica O2 Czech Republic. The other Board of Directors members were executive managers of Telefónica O2 Czech Republic. Full details of all personnel changes in the Board of Directors in 2006 and the first quarter of 2007, together with the current line-up as at 31 March 2007, are given on page 72 of the Annual Report. The résumés of the members of the Board of Directors, attesting to their competence, professional skills and practical experience, are given on pages 68–72.

The **Supervisory Board** held 7 meetings in 2006, in compliance with the original and amended Articles of Association. The amended Articles of Association came into force on the date of the Ordinary General Meeting and prescribe a minimum of 6 meetings a year. During the year, the composition of the Supervisory Board changed several times; these changes were related to the integration of the Company into the Telefónica O2 Europe Group. Full details of all personnel changes in the Supervisory Board in 2006 and the first quarter of 2007, together with the current line-up as at 31 March 2007, are given on page 86 of the Annual Report. The résumés of the members of the Supervisory Board are given on pages 78–86. As at 31 December 2006, the Supervisory Board included one member who qualifies as independent under the Code – Petr Zatloukal.

The system and principles for remuneration of members of the Board of Directors and Supervisory Board of ČESKÝ TELECOM are described in detail in Section 5 of the Annual Report.

From the commencement of their terms of office, new members of the Board of Directors and the Supervisory Board and its committees have access to all information concerning the main areas and principles of corporate governance in the Telefónica O2 Czech Republic Group, as well as all financial and other material information and facts they need to discharge their duties properly. The Corporate Governance Office disseminates all such information. In the latter half of 2006, an electronic information system was put into operation on the Corporate Governance Information Portal of the Group.

The discharge of duties of all governing bodies, their committees and the Internal Audit is governed by rules of procedure and charters, which are always updated after any changes are made.

As part of the modifications to the corporate governenace model in reaction to the integration of the Company in the Telefónica Group and in connection with the project of the new integrated company Telefónica O2 Czech Republic, the office of Company Secretary was combined with that of General Counsel; the status and authority of the Company Secretary was further specified in the amended Articles of Association. A new office – Company Vice-Secretary – was established in order to reinforce the discharge of corporate governance duties in the integrated company.

The Internal Audit and Risk Management unit is also a part of the Company's corporate governance. It was created in mid-2006 by way of integration of the Internal Audit units of ČESKÝ TELECOM and Eurotel with Risk Management. The new unit now reports directly to the Chief Executive Officer. The change was effected as part of the integration process with a view to simplifying the line management of these units whilst observing all the main best practice and good corporate governance principles in the functional areas.

Internal audit provides the Company's governing and executive bodies with independent and professional assessment of the Company's internal control system and the situation and trends in the given area compared to current best practice, the rules and regulations in force, and work orders and instructions issued, thus helping to continuously improve the Company's internal control system. In 2006, Internal Audit carried out 22 audits, including audits performed in Eurotel in the first half of the year, and a number of other ad hoc controls at the request of the governing bodies and the Chief Executive Officer. The audit conclusions were used by the management to formulate actions to redress the issues identified. Internal Audit monitors the implementation of such actions and reports to the governing bodies and the executive management.

The activities of Internal Audit and its main processes are laid down in the Internal Audit Charter of Telefónica O2 Czech Republic, which was amended in 2006. The work of Internal Audit is monitored on a regular basis by the Audit and Control Committee.

In 2006, the implementation of a **risk management** system was completed. This system reflects the best international practice and the nature of the business of Telefónica O2 Czech Republic, and provides for continuous risk management – risk identification, assessment, mitigation and follow-up. In line with the Company's Articles of Association, a report on the main risks is regularly made to the executive management and governing bodies of the Company.

More information on internal audit and risk management can be found in Section 2 of the Annual Report.

The implementation of a new version of the electronic **Corporate Governance Information Portal** was completed. The portal is fully bilingual (in Czech and English), contains data and basic documents in respect of all Telefónica O2 Czech Republic companies and allows for effective administration of the Company and all subsidiaries that together make up the Telefónica O2 Czech Republic Group. The portal's functions give all members of the statutory and supervisory bodies of Telefónica O2 Czech Republic and its subsidiaries, as well as other users authorised by the Company's Board of Directors, secure, safe, direct and remote access to archived and current documents for discussion at meetings, including Internal Audit and Risk Management outputs. This tool is a major help to Telefónica O2 Czech Republic in meeting the requirements of the Code and best practice for the delivery of timely and sufficient information to the governing bodies as an input for their decision-making processes. The new version supports an extended content for members of Telefónica O2 Czech Republic Group's governing bodies and the recently implemented new group governance agendas.

The portal also features a section open to all employees of the Telefónica O2 Czech Republic Group. It contains all fundamental information concerning the Group's companies and the Company's and Group's governance agendas. It also contains the full wording of the Business Principles of Telefónica O2 Czech Republic adopted by the Group in August 2006, together with a commentary.
A "whistleblowing channel" was implemented across the whole Telefónica O2 Czech Republic Group in the first quarter of 2006; the channel is a means of collecting concerns with respect to financial, accounting and property matters. The implementation of the whistleblowing

channel is mandatory for Telefónica S.A. and its subsidiary companies under the Sarbanes-Oxley Act, a U.S. law. This act is binding on all companies whose shares are listed on U.S. stock markets.

Since late 2006, the Company has been implementing a Corporate Responsibility System which codifies the management of this area.

Shareholder relations

Telefónica O2 declares that in 2006 it took great care to observe all statutory shareholder rights and comply with the principle of equal treatment of all shareholders of a similar standing, while respecting the specific statutory rights of minority shareholders. The mechanisms and procedures for the support and administration of governance are permanently configured to ensure that shareholders get timely and complete information on the company in the course of the year (above and beyond the statutory disclosure duty) and to enable them to attend General Meetings without hindrance or limitation (e.g. with regard to time and location).

The Company thus protects shareholders' rights and facilitates the exercise thereof. Using the instruments detailed below, the corporate governance model provides for consistently fair treatment of all shareholders.

The Rules of Procedure of the General Meeting, approved at each meeting of the governing body, allow shareholders to participate effectively in decision-making on fundamental changes in the Company and to ask questions and seek information on matters included on the agenda of the General Meeting. In addition to members of the Board of Directors and the Supervisory Board, shareholder meetings are always attended by the chairpersons of the committees of the governing bodies established under the Articles of Association, and shareholders may address them with questions.

The Board of Directors answered all questions (seven in total) put by shareholders at the Ordinary General Meeting of 27 April 2006; no questions were put by shareholders to members of the Supervisory Board or the committee chairpersons.

Transparency and open information policy

In line with the directives of the Czech Securities Commission, the recommendations of the European Union and the OECD for corporate governance and the principles of the Code of Corporate Governance, Telefónica O2 continually and pro-actively provides shareholders and potential investors with all vital information on its business, financial standing, ownership structure and governance issues. Furthermore, the Company is very scrupulous in seeing that all price-sensitive information and facts are published in a timely manner.

In addition to the information channels and publication procedures provided for by law and in its Articles of Association, the Company makes great use of its website (www.cz.o2.com), where its Articles of Association, Annual Reports, conclusions of General Meetings and other important documents relating to the Company's governance are available both in Czech and English, to inform its shareholders. This helps international institutional investors in particular to access information on the Company and be fully and actively involved in the decision-making on the Company's affairs.

Both the Corporate Governance Section and the Financial Section (the Financial Statements and the Report of Independent Auditor) of the Annual Report contain information on the remuneration and other emoluments paid to members of the Company's governing bodies and on the company shares in the possession of these persons. Disbursement of remuneration to members of the Board of Directors and of the Supervisory Board and disbursement of discretionary benefits, including liability insurance in connection with the discharge of office of member of a governing body, to members of the Supervisory Board is governed by rules approved by the General Meeting, which the shareholders can find on the Company's website from March 2005 (for more information please refer to Section 5 of the Annual Report).

An integral part of the decision-making processes and practices in the Company's governing bodies is a rule that members of these bodies should refrain from voting on matters where their neutrality could be questioned (affiliated transactions).

Potential conflicts of interests arising from membership in the governing bodies of other companies, involvement in commercial transactions and other selected instances are examined in Telefónica O2 minimally twice a year by a dedicated committee established by the Supervisory Board – the Ethics and Corporate Social Responsibility Committee (for details, see page 92).

In 2006, the implementation of Sarbanes-Oxley Act provisions was concluded and the first phase of their audit by the External Auditor was carried out. The report of the statutory External Auditor on this area is also the subject of the external audit of the Company's performance. As in the previous years, also in 2006, Telefónica O2 won local and international recognition for its efforts in the area of implementing and improving good corporate governance practices. The Company was also recognised for the Best 2005 Annual Report in the Czech Republic in the Commerce and Services category; the Annual Report ranked 4th overall. The Company was also awarded a Certificate of Excellence by the European Foundation for Quality Management and a Certificate of Security Integrity by the National Security Office.

Committees established by the governing bodies of the Company

The Supervisory Board committees have been an integral part of the Company's system of corporate governance since 1996 and continue to play a major role in discharging the powers of the governing bodies.

The Audit and Control Committee /ACC/ has five members. The committee agenda was modified and its name changed (formerly it was the Finance and Audit Committee) in 2006, in line with the Code of Good Corporate Governance. Personnel changes in the composition of the committee were a direct result of the personnel changes in the composition of the Supervisory Board. As at the end of 2006, the ACC had the following members: Alfonso Alonso Durán, Chairman; Ángel Vilá Boix, Vice-Chairman; Peter Anthony Erskine, Julio Esteban Linares López and Pavel Herštík, members. Despite the extensive experience, professional qualifications and other competences in the field of accounting and finance, none of the members was a chartered accountant as at the end of 2006. The committee usually meets once in two months, before a scheduled meeting of the Supervisory Board. The ACC meets primarily to monitor financial statements and accounting practices in terms of their integrity, reliability and completeness, discuss internal and external audit matters and make recommendations concerning these matters to the Supervisory Board, and monitor the system for the management of financial and other risks. The ACC also invokes the institute of closed consultation with the External Auditor and internal auditors. The committee also reviews all request for using the services of the external auditor for non-auditing activities in the company. The committee has access to all Internal Audit outputs, also via the Corporate Governance Information Portal. In 2006, the committee held six meetings.

The Nomination and Remuneration Committee /NRC/ has five members. The committee agenda was modified and its name changed (formerly it was the Staff and Remuneration

Committee) in 2006, in line with the Code of Good Corporate Governance. Personnel changes in the composition of the committee were a direct result of the personnel changes in the composition of the Supervisory Board. The committee proposes personnel changes in the Company's Board of Directors and the Supervisory Board committees and in the governing bodies of its subsidiary companies. It reviews the principles applied to the remuneration of members of the Board of Directors and the Supervisory Board and monitors and evaluates the performance of members of the Company's governing bodies. In 2006, the committee held five meetings. As at the end of 2006, the NRC had the following members: Peter Anthony Erskine, Chairman; Julio Esteban Linares López, Vice-Chairman; Luis Lada Díaz, Guillermo Fernández Vidal and Sohail Qadri, members.

The Ethics and Corporate Social Responsibility Committee /ECSRC/ has eight members. The committee name was changed (formerly it was the Ethics and Social Responsibility Committee) in 2006 as a result of a shift in the committee´s focus. Personnel changes in the composition of the committee were a direct result of the personnel changes in the composition of the Supervisory Board. In addition to issues related to potential conflicts of interest, the committee monitors compliance with the business principles and corporate responsibility principles of the Company. As at the end of the year, the ECSRC had the following members: Pavel Herštík, Chairman; Petr Zatloukal, Vice-Chairman; Peter Anthony Erskine, Vlastimil Barbořák, Dušan Stareček, Julio Esteban Linares López, Ángel Vilá Boix and Guillermo Fernández Vidal, members. In 2006, the committee held three meetings and reviewed affirmations of non-conflict of interest from all members of the governing bodies of all companies in the Telefónica O2 Groups and from managers in the so-called designated positions within the Company. No conflicts of interest were identified.

Company policy towards stakeholders

Telefónica O2 wants to be actively involved in the development of the society where it has a presence. Preserving and improving the Company's good image with its business partners, financial institutions, employees and other stakeholders is one of the principal instruments in accomplishing this goal. Telefónica O2 is aware that the Company's value and its systematic building depend on careful observance of ethical and professional principles and, of course, on full conformity with the law. Telefónica O2 aspires to be an employer-of-choice to top professionals who want to drive the company's performance forward and to dedicate their skills and knowledge to that end. Telefónica O2 wants also to continue to be a credible and transparent partner of first choice to investors, business associates and contractors. Telefónica O2 is aware of the implications its business decisions have on the community, fully respecting its position in the communities where it has a presence. This is reflected also in the business activities of Telefónica O2, the way the company reliably delivers on its obligations and in its public relations, sponsoring and donor policy. Telefónica O2 promotes active co-operation with stakeholders, and recognises their rights, with the goal of building the Company's value in harmony with its environment.

To deliver and build on these values, Telefónica O2 espoused the concept of Corporate Responsibility (CR) in 2006. This will ensure that all areas in the Company concerned by the CR will systematically managed and developed. To this end, GoodCorporation, an external entity, carried out a comprehensive assessment of the Company's Corporate Responsibility processes at the end of 2006. The conclusion of the assessment will help in defining future development areas; the know-how of the global Telefónica Group and Telefónica O2 Europe, leaders in the field of Corporate Governance, will be used in the process.

04

Financial section

OIBDA increased by 2,4% in 2006.

Consolidated Financial Statements for the Year Ended 31 December 2006

General information

Telefónica O2 Czech Republic, a.s. Group (the Group) consists of Telefónica O2 Czech Republic, a.s. (the Company) and its subsidiaries: Telefónica O2 Services, spol. s r.o., CenTrade, a.s, SPT TELECOM (Czech Republic) Finance B.V., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH and Telefónica O2 Slovakia s r.o. As of June 2005, the Group became a member of the Telefónica Group of companies (the Telefónica Group) with a parent company, Telefónica, S.A. (the Telefónica).

The Company is the principal supplier of fixed line telecommunication services and is one of the three suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Group amounted in average to 9,951 in 2006 (2005: 10,506).

Telefónica O2 Czech Republic, a.s. has a form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Olšanská 5/55, Prague 3, 130 34, Czech Republic.

The Company's shares are traded on the Prague Stock Exchange and London Stock Exchange (GDRs).

These consolidated financial statements were approved for issue by the Company's Board of Directors on 22 February 2007.

Transfer of assets and liabilities (Up-stream merger) and restructuring of the Group in 2006

On 27 April 2006, the General Shareholders Meeting approved a transfer of assets and liabilities of the former 100% subsidiary Eurotel Praha, spol. s r.o. (the former Eurotel) to ČESKÝ TELECOM, a.s. and approved an Agreement on transfer of assets and liabilities between ČESKÝ TELECOM, a.s. and former Eurotel. The General Shareholders Meeting further approved a change in the Articles of Association related to a transfer of the National Property Fund's stake in 2005.

In addition, the Company changed its registered name from ČESKÝ TELECOM, a.s. to Telefónica O2 Czech Republic, a.s. within the transfer of assets and liabilities process as a result of the Company's integration with the Telefónica Group.

As a result of the Decision of the General Shareholders Meeting of 27 April 2006, the following changes have been incorporated in the Company's Register with effective date 1 July 2006 and decisive date 1 January 2006:

- Dissolution of former Eurotel without liquidation and transfer of its assets and liabilities to its sole shareholder ČESKÝ TELECOM, a.s.
- Change of the registered name of ČESKÝ TELECOM, a.s. to Telefónica O2 Czech Republic, a.s.

Relationship with the Czech state, privatisation and acquisition process finalised in 2005

The Czech state, through the National Property Fund of the Czech Republic (the NPF), had been the majority shareholder of the Company until the take-over of Telefónica, S.A. and completion of the privatisation process in June 2005. As a majority shareholder, the NPF had the power to control certain decisions taken at the General Shareholders' Meetings, including the election of the members of the Supervisory Board and the approval of dividend payments.

The acquisition process was completed on 16 June 2005, once Telefónica, S.A. paid the remaining 90% of the purchase price, and the NPF transferred its 51.1% stake in the Company to Telefónica, S.A. Telefónica, S.A. then increased its stake in the Company from 51.1% to 69.4% of the common stock.

Telefónica, S.A. applied effectively its control at the General Shareholders Meeting which took place on 23 June 2005. The Group was included in the Telefónica Group since finalisation of the take-over. Mutual transactions, representing generally supplies of telecommunication services take place amongst Telefónica companies. All these transactions are being made under common commercial terms and conditions that are not more preferable than those offered to other customers and suppliers.

The Group supplies telecommunication services to and acquires services from various state-owned entities, agencies and companies in which the Czech state holds the majority shareholding. All such transactions are made under normal commercial terms and conditions that are not more preferable than those available to other customers and suppliers. In aggregate, the state-owned entities, agencies and companies comprise one of the Group's largest customers. In providing services to these entities, agencies and companies, Telefónica O2 Czech Republic, a.s. conducts business with them as separate customers. Services provided to any individual governmental entity, agency or state-owned company do not represent a significant component of the Group's revenues.

Independent auditors' report to the shareholders of Telefónica O2 Czech Repulic, a.s

We have audited the accompanying financial statements of Telefónica O2 Czech Republic, a.s. and its subsidiaries (the Group), which comprise the consolidated balance sheet as at 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 financial statements in order to design audit procedures that are appropriate for 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 financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Ernst & Young

Ernst & Young Audit & Advisory, s.r.o., člen koncernu
Licence No. 401
Represented by

Brian Welsh
Partner

Magdalena Souček
Auditor, Licence No. 1291

22 February 2007
Prague, Czech Republic

Consolidated income statement

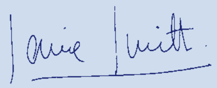
	Notes	Year ended 31 December 2006	31 December 2005
Revenue	2	61,311	61,040
Gains from sale of non-current assets		98	116
Internal expenses capitalized in fixed assets	2	911	594
Operating expenses	3	(34,161)	(33,249)
Impairment loss	8,9,10	(253)	(1,261)
Depreciation and amortisation	8,9	(16,746)	(17,808)
Operating profit		**11,160**	**9,432**
Interest income	4	149	46
Interest expense	4	(430)	(748)
Other finance income (net)	4	61	18
Profit before income tax		**10,940**	**8,748**
Taxes on income	5	(2,920)	(2,500)
Profit for the year		**8,020**	**6,248**
Attributable to:			
Equity holders of the Company	6	8,020	6,249
Minority interest	29	–	(1)
Earnings per share (CZK) – basic*	6	25	19

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

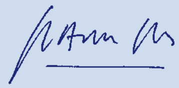
Consolidated balance sheet

	Notes	31 December 2006		31 December 2005	
ASSETS					
Property, plant and equipment	8	78,755		88,003	
Intangible assets	9	21,628		22,846	
Available-for-sale investments	13	–		58	
Held-to-maturity investments	13	27		29	
Investment in associate	28	11		11	
Deferred tax receivable	17	26		–	
Other financial assets	12	377		412	
Non-current assets			**100,824**		**111,359**
Inventories	11	987		716	
Receivables and prepayments	12	8,346		8,013	
Income tax receivable		–		124	
Available-for-sale investments	13	56		–	
Cash and cash equivalents	14	7,461		3,639	
Current assets			**16,850**		**12,492**
Non-current assets classified as held for sale	**8**		**203**		**360**
Total assets			**117,877**		**124,211**
EQUITY AND LIABILITIES					
Ordinary shares	24	32,209		32,209	
Share premium		30,816		30,816	
Retained earnings, funds and reserves		25,456		31,950	
			88,481		**94,975**
Minority interest	**29**		**–**		**–**
Total equity			**88,481**		**94,975**
Long-term financial debts	16	9,156		9,324	
Deferred taxes	17	4,495		5,721	
Non-current provisions for liabilities and charges	19	2,037		2,111	
Non-current other liabilities	15	807		1,265	
Non-current liabilities			**16,495**		**18,421**
Short-term financial debts	16	207		307	
Trade and other payables	15	11,129		9,634	
Income tax liability		730		251	
Provisions for liabilities and charges	19	835		623	
Current liabilities			**12,901**		**10,815**
Total liabilities			**29,396**		**29,236**
Total equity and liabilities			**117,877**		**124,211**

These consolidated financial statements were approved by the Board of Directors on 22 February 2007 and were signed on its behalf by:



Jaime Smith Basterra
Chairman of the Board of Directors and Chief Executive Officer



Ramon Ros Bigeriego
Member of the Board of Directors and Chief Financial Officer

Consolidated statement of changes in shareholders' equity

	Notes	Share capital	Share premium	Hedging reserve	Foreign exchange translation reserve	Funds*	Retained earnings	Minority interest	Total
Balance at 1 January 2005		**32,209**	**30,816**	**(47)**	**13**	**5,628**	**20,080**	**6**	**88,705**
Fair value losses (net of tax) – cash flow hedges	26	–	–	36	–	–	–	–	36
Currency translation differences – amount arising in year		–	–	–	(13)	–	–	–	(13)
Changes in statutory reserves and other movements		–	–	–	–	405	(401)	(5)	(1)
Net income/(expense) recognised directly in equity		–	–	36	(13)	405	(401)	(5)	22
Net profit		–	–	–	–	–	6,249	–	6,249
Minority interest		–	–	–	–	–	–	(1)	(1)
Balance at 31 December 2005		**32,209**	**30,816**	**(11)**	**–**	**6,033**	**25,928**	**–**	**94,975**
Merger impact – funds		–	–	–	–	(121)	121	–	–
Balance at 1 January 2006 as restated		**32,209**	**30,816**	**(11)**	**–**	**5,912**	**26,049**	**–**	**94,975**
Fair value gains (net of tax) – cash flow hedges	26	–	–	(8)	–	–	–	–	(8)
Currency translation differences – amount arising in year		–	–	–	(9)	–	–	–	(9)
Changes in statutory reserves and other movements		–	–	1	(3)	358	(359)	–	(3)
Net income/(expense) recognised directly in equity		–	–	(7)	(12)	358	(359)	–	(20)
Dividends declared in 2006	7	–	–	–	–	–	(14,494)	–	(14,494)
Net profit		–	–	–	–	–	8,020	–	8,020
Balance at 31 December 2006		**32,209**	**30,816**	**(18)**	**(12)**	**6,270**	**19,216**	**–**	**88,481**

* Refer Note 24 regarding amounts not available for distribution.

Consolidated cash flow statement

	Notes	Year ended 31 December 2006	31 December 2005
Cash flows from operating activities			
Cash generated from operations	26	28,263	27,760
Interest paid		(429)	(889)
Interest received		186	47
Income tax paid		(3,564)	(3,262)
Net cash from operating activities		**24,456**	**23,656**
Cash flows from investing activities			
Purchase of property, plant and equipment		(4,770)	(4,044)
Purchase of intangible assets		(1,444)	(1,156)
Proceeds from sales of property, plant and equipment		214	235
Proceeds from marketable securities		–	184
Grant of loan		(3,294)	–
Repayment of loan		3,253	–
Net cash used in investing activities		**(6,041)**	**(4,781)**
Cash flows from financing activities			
Proceeds from borrowings		–	11,580
Repayment of borrowings		–	(27,393)
Dividends – paid		(14,494)	–
Net cash used in financing activities		**(14,494)**	**(15,813)**
Net increase/(decrease) in cash and cash equivalents		**3,921**	**3,062**
Cash and cash equivalents at beginning of year		3,538	480
Effects of exchange rate changes		2	(4)
Cash and cash equivalents at the year end	**14**	**7,461**	**3,538**

Accounting policies

A Basis of preparation

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These 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 International Financial Reporting Interpretations Committee (IFRIC).

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 this particular time, due to the endorsement process of the EU and the activities of the Group, there is no difference in the policies applied by the Group between IFRS 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, financial derivatives, available for sale investment securities, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS required the Group to use certain critical accounting estimates. It also required management to exercise its judgement 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 T.

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

Adoption of IFRS standards and interpretations

In 2006, the Group applied the below stated IFRS, which are relevant to its operations:

IAS 1 (revised 2005)	Presentation of Financial Statements
IAS 2 (revised 2003)	Inventories
IAS 7 (revised 2005)	Cash flow statement
IAS 8 (revised 2003)	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003)	Events after Balance Sheet Date
IAS 11	Construction contracts

IAS 12	Income Taxes
IAS 14	Segment Reporting
IAS 16 (revised 2003)	Property, Plant and Equipment
IAS 17 (revised 2003)	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21 (revised 2005)	The effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24 (revised 2003)	Related Party Disclosures
IAS 27 (revised 2003)	Consolidated and Separate Financial Statements
IAS 28 (revised 2003)	Investments in Associates
IAS 32 (revised 2004)	Financial Instruments: Disclosure and Presentation
IAS 33 (revised 2003)	Earnings per Share
IAS 36 (revised 2004)	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38 (revised 2004)	Intangible Assets
IAS 39 (revised 2005)	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IFRS 2 (issued 2004)	Share-based Payments
IFRS 3 (issued 2004)	Business Combinations
IFRS 5 (issued 2004)	Non-current Assets Held for Sale and Discontinued Operations

IFRS 3 requires simultaneous adoption with IAS 36 and IAS 38.
IAS 39 requires simultaneous adoption with IAS 32.

IFRIC 1 (issued 2001)	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 4 (effective date 1 January 2006)	Determining whether an Arrangement contains a Lease

Out of the above mentioned standards and interpretations, in 2006 the Group newly adopted the following:

IAS 21 (revised 2005)
The Group adopted the amendments to IAS 21. As a result, all exchange differences arising from a monetary item that forms part of the Group's net investment in a foreign operation are recognised in a separate component of equity in the consolidated financial statements regardless of the currency in which the monetary item is denominated. This change had no impact on the consolidated financial statements of the Group.

IFRIC 4 (effective date 1 January 2006)
The adoption of this interpretation did not have any material effect relating to the Group's activities.

Standards and interpretations issued but not early adopted by the Group

IFRS 7, IAS 30 and IAS 32 (issued in 2005, effective date 1 January 2007) Financial Instruments: Disclosures – the Group does not expect any material effect on the Balance Sheet and the Income Statement relating to the adoption of this standard from the effective date 1 January 2007. This adoption will affect certain disclosures in the notes to the consolidated financial statements.

Amendments to IAS 1 (issued 2005, effective date 1 January 2007) Presentation of financial statements, Capital disclosures – the Group does not expect any material effect on the Balance Sheet and the Income Statement relating to the adoption of this amendment from the effective date 1 January 2007. This adoption will affect certain disclosures in the notes to the consolidated financial statements.

IFRS 8 Operating Segments (effective date 1 January 2009) – the Group does not expect any material effect on the Balance Sheet and the Income Statement relating to the adoption of this standard from the effective date 1 January 2009. This adoption will affect certain disclosures in the notes to the consolidated financial statements.

IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective date 1 March 2006) – the interpretation does not apply to the Group's activities.

IFRIC 9 Reassessment of Embedded Derivatives (effective date 1 June 2006) – the Group does not expect any material effect relating to the adoption of this interpretation since the effective date 1 June 2006.

IFRIC 10 Interim Financial Reporting and Impairment (effective date 1 November 2006) – the Group does not expect any material effect relating to the adoption of this interpretation since the effective date 1 November 2006.

IFRIC 12 Service Concession Arrangements (effective date 1 January 2008) – the Group does not expect any material effect relating to the adoption of this interpretation from the effective date 1 January 2008.

IFRIC 8 Scope of IFRS 2 (effective date 1 May 2006)
IFRIC 11 IFRS 2 Group and Treasury Share Transactions (effective date 1 March 2007)
This adoption will affect certain disclosures in the notes to the consolidated financial statements.

The Group does not intend to early adopt any of those standards and interpretations before their effective date.

B Group accounting

(1) Consolidation
Subsidiary undertakings, which are those companies in which the Company, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations, have been consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date when the Group ceases to have control.

A business combination is accounted for using the purchase method of accounting. An acquisition is accounted for at its cost, being the amount of cash and cash equivalents paid in exchange for control over the net assets of an acquired company, plus any costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill. For detail refer to Note D Intangible assets and also Note 9.

Intercompany transactions and balances between the Group companies are eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies for subsidiaries are changed, where necessary, to ensure consistency with the policies adopted by the Group and another companies within the Group.

Intercompany transactions and balances between the Group and Telefónica companies for the period after the transfer of majority ownership to Telefónica, S.A. are not eliminated. They are identified, disclosed and measured for the disclosure purposes and elimination procedures of the majority shareholder – Telefónica, S.A.

The ultimate parent company of the Telefónica Group is Telefónica, S.A.

(2) Foreign currencies
(i) Functional and presentation currency
Items included in the financial statements of each entity included in the Group are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Czech Crowns (CZK), which is the Company's functional and presentation currency.

(ii) Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Such balances of monetary items are translated at period-end exchange rates. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(iii) Group companies
The income and cash flow statements of foreign entities are translated into the Group's reporting currency at the average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities and of borrowings and other currency instruments designated as hedges of such investments are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

C Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less impairment charges.

Property, plant and equipment acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less depreciation and impairment charges.

Property, plant and equipment include all costs directly attributable to bringing the asset to working condition for its intended use. With respect to the construction of the network, this comprises all expenditure up to the customers' premises, including the cost of contractors, materials, direct labour costs and interest cost incurred during the course of construction.

Repairs and maintenance are expensed as incurred.

Items of property, plant and equipment that are retired, are not intended for sale and are not expected to create any future economic benefits or are otherwise disposed of, are eliminated from the balance sheet, along with the corresponding accumulated depreciation. Any gain or loss arising from retirement or disposal is included in net operating income, i.e. net gain or loss is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is de-recognised or the date the asset is classified as held for sale.

Depreciation does not cease when the asset becomes temporarily idle or retired from active use unless the asset is fully depreciated.

Estimated useful lives adopted in these consolidated financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	5 to 25
Exchanges and related equipment	up to 10
Other fixed assets	2 to 10

Freehold land is not depreciated as it is deemed to have an indefinite life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater then its estimated recoverable amount (refer to Note F Impairment of assets).

D Intangible assets

Intangible assets include computer software, purchased goodwill, licenses, trade names, customer base and roaming contracts. Computer software mainly represents the external acquisition costs of the Group's information systems that are intended for use within the Group. Generally, costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Group and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less amortisation and impairment charges and amortised on a straight-line basis over their estimated useful lives.

Customer bases are amortised over a period of the remaining average terms of the binding contracts (only the post-paid customer base is recognised as a separate intangible asset).

Acquired licenses are recorded at cost and amortised on a straight-line method basis over the remaining life of the license (i.e. over 15 to 20 years), from the start of commercial service, which best reflects the pattern by which the economic benefits of the intangible assets will be utilised by the Group.

Intangible assets with indefinite useful life are not amortised. They are subject to the regular impairment reviews (see Note 9 and Note 10).

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired. Goodwill is not amortised but is tested for the impairment at least annually or anytime there are indications of a decrease in its value.

The Group reviews at least at the balance sheet date the useful lives of intangible assets that are not amortised to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate.

On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

Intangible assets that are no longer in use and it is not expected any future economic benefits or that are disposed of for any other reason are de-recognised from the balance sheet together with corresponding accumulated depreciation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is de-recognised, the date the asset is classified as having the indefinite useful life or the date the asset is classified as held for sale.

E Non-current assets classified as held for sale

The Group classifies separately in the balance sheet a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups), its sale is highly probable and sale is expected within 1 year.

The Group measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Group recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as the impairment loss with impact in the income statement of the relevant period.

From the moment the asset is classified as held for sale and eventually revaluated, it ceases to be depreciated/amortised and an impairment is only being determined.

Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in the income statement.

F Impairment of assets

Property, plant and equipment and other assets, including goodwill and intangible assets, are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or at least on an annual basis for goodwill and for intangibles with an indefinite useful life and for intangibles not yet in use. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level, for which there are separately identifiable cash flows (cash-generating units).

G Investments and other financial assets

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets.

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2005 and 2006, the Group did not hold any financial assets in this category.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are measured at amortised cost using an effective interest rate method and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis, as required under IAS 39.

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets at fair value through profit or loss and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective interest rate method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the income statement in the period in which they arise. On the contrary, unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in equity in the period in which they arise, except for impairment losses, until the financial asset is de-recognised, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement.

An associated undertaking is an enterprise where the Group has significant influence, which has the power to participate in the financial and operating policy decisions, but not exercise control. Investments in associates are accounted for using the equity method (initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition).

Impairment of financial assets

The Group assesses at each balance sheet date whether financial assets or groups of financial assets are impaired.

(1) Assets carried at amortized costs
If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest

rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in the income statement.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial assets, whether significant or not, it is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement and only to the extent that the carrying amount of the financial asset does not exceed its amortised cost at the reversal date.

(2) Available-for-sale financial assets
If this asset is impaired, the cumulative loss that had been previously recognised (due to fair value revaluation) directly in equity shall be removed from equity and recognised in profit or loss even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from equity and recognised in profit or loss shall be the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in profit or loss.

Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the income statement.

De-recognition of financial assets

A financial asset is de-recognised when:

a) the rights to receive cash flow from the asset have expired,
b) the Group retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a “pass-through” arrangement, or
c) the Group has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

H Leases

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment that is required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Group bears substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of finance charges, are included in other long-term payables (depending on maturity). The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. If there is a reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

I Inventories

Inventory is stated at the lower of cost or net realisable value. Costs of inventories include the purchase price and related costs of acquisition (transport, customs duties and insurance). The cost of inventory is determined using weighted average cost. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

J Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the initial market rate of interest for similar borrowers. Cash flows relating to short-term receivables are usually not discounted. The amount of the allowance is recognized in the income statement.

K Cash and cash equivalents
Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

L Financial debt
Borrowings are recognised initially at the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest rate method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings.

Borrowings are classified as current liabilities unless the Group has unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Interest costs on borrowings used to finance the acquisition and construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

M Current and deferred income taxes
Taxation expense represents both current and deferred taxation, where appropriate.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Current income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Deferred income taxation is calculated using the liability method applied to all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates and laws expected to apply when the asset is realised or the liability is settled are used to determine the deferred income tax.

The principal temporary differences arise from differences in the tax and accounting values of property, plant and equipment, impairment of receivables and allowance for obsolete and slow moving inventories, non tax deductible provisions, unused tax credits and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Group accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in the income statement, any related tax effects are also recognised in the income statement. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill.

Deferred income tax assets and tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority. The same applies for offsetting of current tax assets and liabilities.

N Employee benefits
(1) Pension obligations
Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates applicable during the period and are based on gross salary payments. The arrangements of the Government's health, retirement benefit and unemployment schemes correspond to the arrangements for defined contribution plans. The Group has no further payment obligations once the contributions have been paid. The expense for the contributions is charged to the income statement in the same period as the related salary expense. The Group also makes contributions to defined contribution schemes operated by external pension companies. These contributions are charged to the income statement in the period to which the contributions relate.

(2) Redundancy and termination benefits
Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Group recognises redundancy and termination benefits when it is demonstrably committed to terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after balance sheet date.

(3) Bonus plans
The Group recognises a liability for bonuses based on a formula that takes into consideration certain performance related measures, such as turnover or free cash flow, after certain adjustments. The Group recognises a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

O Share-based compensation

During 2006, the Group introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Certain compensation plans are settled in cash, while the others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price with the following accounting treatment:

Option plans that can be cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted.

In the cash-settled share option plan, the total cost of the rights to shares granted are expensed over the period during which terms the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Group revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through the income statement for the period, if appropriate. For 2006, the financial impact on the Group is, however, immaterial.

For the equity-settled share option plan, fair value at the grant date is measured using the binomial methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Group revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity. As the plan will be settled by a physical delivery of equity instruments of the parent, Telefónica, S.A., to the employees, the personnel expense accrued is recognised against equity. For 2006, the financial impact on the Group is, however, immaterial.

P Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Q Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Group, comprises goods sold and services provided. Revenues are measured at their fair value of the consideration received or receivable. The amount of revenue is recognised if it can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. If necessary, revenue is split into separately identifiable components.

The Group offers customers free minutes for selected price based on chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Company is not obliged to reimburse the customer for unused minutes and the option of rolling over any unused minutes is valid for only one month.

The Group recognises revenue for free minutes in the period when the related services is provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

In assessing whether revenue should be recognised gross, i.e. with separate disclosure of costs to arrive at gross profit, or on a net basis, the Group considers these indicators of gross revenue reporting:

- the Group is the primary obligor in the arrangement,
- the Group has general inventory risk,
- the Group has price latitude,
- the Group changes the product or performs part of the service,
- the Group has discretion in supplier selection,
- the Group is involved in the determination of product or service specifications,
- the Group has credit risk,
- the Group has the ability to set the terms of the transaction,
- the Group has the managerial control over the transaction.

The relative strength of each indicator is considered when concluding which accounting treatment to use for principal/agency arrangement.

If a transaction is considered to meet conditions of an agency arrangement, the revenue is recognised only at the amount of the commission received/realised, e.g. premium rate lines.

Revenue from fixed price construction contracts (long-term contracts) is recognised on the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. An expected loss on the construction contract is recognised as an expense immediately, when it is probable that total contract costs will exceed total contract revenue.

The Group offers products, which may include deliverables such as a handset, activation and airtime. These are then defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

(1) Fixed line telephony revenues
Revenue is recognized as follows:

Domestic and international call revenues
Domestic and international call revenues are recognised in the income statement at the time the call is made.

Subscription revenues
Revenue from subscriptions is recognised in the income statement in the period in which the services are rendered.

Revenues from sales of prepaid cards
Prepaid call card sales are deferred until the customer uses the stored value on the card to pay for the relevant calls. The expiry date for prepaid cards is not longer than 36 months.

Connection fees
Connection fees, arising from the connection of the customers to the Company's network, are deferred and recognised in the income statement over the estimated average customer relationship period on the basis of degressive accounting method.

Equipment sales and other sale of goods
Revenue from the sale of telephone equipment and accessories and other sale of goods is recognised at the time of sale i.e. when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods.

Local loop unbundling
Revenue from access to the local loop unbundling is deferred in the income statement and recognised in the period in which the service is rendered. Regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the space (collocation) for an alternative operator is recognized upfront in the income statement when it occurs.

(2) Mobile telephony revenues
The Group earns mobile services revenue from customers usage of the Group's network, interconnection and roaming – collectively, "Mobile service revenue". The Group also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues
Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is accrued as their airtime and other services are used. Prepaid customers recharge a credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognized as the airtime and other services are used. Upon termination of the customer contract or expiration of voucher (up to 24 months), all deferred revenue for unused airtime is recognized in income.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime and that are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

Equipment sales and mobile services
Monthly service revenues and revenues from handset sales are recognized as revenue when the product or service is delivered to the distributor or to the end customer. Resulting losses from sale of handsets at a discount are recognised at the date of sale.

Roaming revenues
Mobile segment derives roaming revenue as a result of airtime and other services used by the mobile segment's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled net on a regular basis.

Costs
Commissions and discounts directly related to the sale of equipment, SIM cards and activations are netted against revenue in the period the product is sold to the dealer, distributor or the end customer. Other commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

(3) Interconnect revenues
Interconnect revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but use the Group's network. These revenues are recognised in the income statement at the time when the call is received in the Group's network.

The Group pays a proportion of the call revenue it collects from its customers to other domestic and foreign operators' for calls and other traffic that originate in the Group's network but use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet and data services
The Group earns revenue from providing Internet services. Revenue from such services is recognised at the time the service is provided.

(5) Dividend income
Dividend income is recognized when the right to receive payment is established.

(6) Interest
Revenue is recognised as interest accrues (using the effective interest method).

R Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

S Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives.

Financial risk management

The Group's activities expose it to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Group. The Group uses derivative financial instruments such as forward foreign exchange contracts, currency swaps, interest rate swaps, forward rate agreements and currency options to hedge certain exposures.

The Group does not conduct any speculative trading activities.

Risk management is carried out by the treasury department under approved policies. The Board provides written principles for overall risk management. In line with these principles, policies exist for specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign exchange risk
The Group is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the Euro and US Dollar. The treasury department is responsible for hedging the net position in each currency by using currency borrowings, external forward foreign exchange contracts, currency swaps and currency options.

The Group primarily hedges the foreign currency exposure of its contract commitments to purchase network technology and other operating expenses from European Union countries. The forward contracts used in its program mature in 6 months or less, consistent with the related purchase commitments.

Additionally, the Group hedges the foreign currency exposure of its borrowings in foreign currencies. The Group's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes. The exchange rate derivatives (including forward foreign exchange contracts, currency swaps and currency options) are designed to match anticipated foreign currency transactions (interest rate payments or principal payments).

(ii) Interest rate risk
The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group sometimes borrows at variable rates and uses interest rate swaps and forward rate agreements as cash flow hedges of future interest payments, which have the economic effect of converting borrowings from floating rates to fixed rates. The interest rate swaps and forward rate agreements allow the Group to raise long-term borrowings at floating rates and swap them into fixed rates. Under the interest rate swaps, the Group agrees with other parties to exchange, at specified intervals, the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts.

(iii) Credit risk
Concentrations of credit risk, with respect to trade accounts receivable, are limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Group does not currently foresee higher credit risk associated with these receivables, repayment is significantly impacted by the financial stability of the national economy.

Derivative counterparties and cash transactions are limited to high credit quality financial institutions. The Group has policies that limit the amount of credit exposure to any one financial institution.

(iv) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of money market (committed and uncommitted) credit facilities and the ability to close out market positions. The treasury department aims to maintain flexibility in funding by keeping money market credit lines available.

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are re-measured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Group designates certain derivatives as either

(1) a hedge of the fair value of a recognised asset or liability (fair value hedge), or

(2) a hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective are recorded in the income statement, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective are recognised in equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity are transferred to the income statement and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects the income statement.

Certain derivative transactions, while providing effective economic hedges under the Group's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Group has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the fair value of such derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting under IAS 39, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the committed or forecasted transaction ultimately is recognised in the income statement. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The Group also documents its assessment, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 20. Movements on the hedging reserve in shareholder's equity are shown in Note 25.

Fair value estimation

Except for currency options, the fair values of the derivative financial instruments reflect estimates based on calculations performed using the Group's own discounted cash flow models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Group's bankers.

T Critical accounting estimates and judgments

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The estimates and assumptions that might have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next year are discussed below:

(1) Income taxes and deferred taxes

The Group created a provision for current income taxes and in consideration of the temporary differences also for deferred tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business and the measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Group expects to recover or settle the carrying amount of assets and liabilities. Where the final tax-deductible expenses are different from the amounts that were calculated, such differences will impact the current income and deferred tax provisions in the period in which such determination is made. The total amount of provision for current income taxes is CZK 3,689 million, advances paid for income taxes amount to CZK 2,959 million and the net deferred tax liability is CZK 4,469 million.

(2) Goodwill
The Group tests at each reporting date goodwill for an impairment. However goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. From 1 January 2005 the Group implemented IFRS 3 and accordingly ceased to amortize the goodwill. In accordance with the requirement of IAS 36, goodwill is tested annually for its recoverable amount, as well as when there are indications of impairment. The carrying amount of goodwill is CZK 13,320 million.

(3) Provisions and contingent liabilities
As set out in Note 21 the Group is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Group's treatment of obligations with uncertain timing and amount depends on the management's estimation of the amount and timing of the obligation and probability of an outflow of resources embodying economic benefits that will be required to settle the obligation (both legal or constructive). A provision is recognised when the Group has a present obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Contingent liabilities are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. Contingent liabilities are assessed continually to determine whether an outflow of resource embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

(4) Interconnect
The Group provides and enters into the contracts for interconnect services and the revenue is recognised on the basis of the reasonable estimation of expected amount. Such estimation is regularly reviewed, however the final agreement and invoicing can be with some operators stated on up to a yearly basis.

(5) Impairment of the fixed line business assets
The Group makes an assessment at each balance sheet date whether there is any indication that an impairment loss recognised for the fixed line business assets in prior years may no longer exist, may have decreased or may have increased. If any such indication exists, may have decreased or may have increased, the Group estimates a recoverable amount of the assets and compares to the carrying value (net of the impairment allowance). In assessing whether there is any indication that the impairment loss recognised in the past may not longer exists, the Group considers both external and internal indicators (declination of asset's market value, changes expected in the market, including technological changes etc.). Where an estimate of recoverable amount is performed, this involves the use for a number of management assumptions about future business performance, which may, ultimately, differ from reality.

Based on the assessment performed by the Company, no increase or decrease of the previously recognised impairment of fixed line business assets was recognised in 2006.

U Change in accounting policy

Connection fees and related costs – 2005 change

During 2005, the Company changed its accounting policy for revenue recognition of the connection fees relating to the activation of the fixed line for all periods starting from 1 January 1996. Retrospective application of the new accounting policy for the periods before 1996 was impracticable because appropriately detailed information for these periods is not available. In previous periods, the Company had recognised such revenue in full in the income statement upon connection of the customers to the network. Since 2005, the Company has decided to defer these revenues over the estimated average customer relationship period and the management also judges that the new policy is preferable, gives more relevant information about the effects on transactions and will be consistent with the telecommunication industry practice. Such policy is also in accordance with the Telefónica Group policy.

Connection fees are deferred and recognised in the income statement over the estimated average customer relationship period on the basis of the degressive accounting method. For the periods starting 2006, the Group estimates the customer relationship period being 12 years (13 years as at 1 January 2005).

Together with the above-mentioned retrospective change in accounting policy for connection fees the Group identified associated connection costs that met the definition of subsequent costs increasing the carrying value of property, plant and equipment but were originally expensed by the Company. In 2005 the Company decided to retrospectively capitalise these costs as property, plant and equipment. The retrospective capitalization resulted in the increase in carrying amount of fixed assets and associated depreciation with the effect on opening 2004 and subsequent balances.

No substantial changes in accounting policies have been applied in 2006.

V Mobile license in Slovakia

On 2 August 2006, Telefónica O2 Slovakia s.r.o., a wholly owned subsidiary of the Company, was announced as a winner of the tender for the 3rd mobile license in Slovakia. Based on this decision, the Telecommunication office of the Slovak Republic awarded Telefónica O2 Slovakia s.r.o. the 20 year license for GSM and UMTS networks on 25 August 2006.

The license award became effective on 7 September 2006. Telefónica O2 Slovakia s.r.o paid SKK 150 million (EUR 4.1 million) for the license. The license conditions require GSM/UMTS network operation launch in 6/12 months from license award. Additionally, Telefónica O2 Slovakia s.r.o is required to achieve 12%/45% own network population coverage in 12/24 months and to build 400/800 own base stations in these periods.

The new operation is considered as an organic expansion of the Telefónica Group business in the region and will take advantage of synergies with the Company operations. The leverage on the Czech operation is expected in areas of network (development, monitoring, support), IT, procurement and back office (finance, HR, legal). Telefónica O2 Slovakia s.r.o. will use the O_2 brand. The commercial launch is expected in 1Q 2007.

During the initial phase, Telefónica O2 Slovakia s.r.o. will provide services on the basis of national roaming. Thus, Telefónica O2 Slovakia s.r.o. entered into agreements with T-Mobile Slovensko, a.s, on provision of services of its network to customers of Telefónica O2 Slovakia s.r.o in the areas not covered by its own network. From the long-term perspective, the strategy will focus on the building of the Telefónica O2 Slovakia s.r.o. own network.

W Integration process

The integration process continues internally and as well externally through the implementation of ongoing integration projects. These include mainly sales channels and customer care integration, regional network operations integration, alignment of controlling, budget and reporting processes and cultural alignment.

At the same time the Group takes advantage of the global experience and close interaction with Telefónica, S.A., Telefónica O2 Europe plc and other Telefónica Group operating companies. The main activities continue to focus on the introduction and marketing of new services and products in both fixed and mobile segments, new convergent products, further operational efficiencies facilitated by a new organizational structure and synergies leading to revenue growth and OpEx and CapEx savings. The Company will monitor the development of the business in order to find out whether the currently used segments (fixed lines and mobile segment) are still relevant.

(1) Gamma building

In 2006, the Group entered an agreement to lease the Gamma Building to become the Company's headquarter from 2Q 2007. Moving the Company's headquarters will allow for the full physical integration of employees in one area during the ongoing integration process.

(2) Re-branding

The Company presents its services under the O_2 brand. This replaced two original brands, ČESKÝ TELECOM and former Eurotel, on 1 September 2006. The Company uses the O_2 brand for all products in the fixed as well as the mobile networks.

The change of the corporate identity to O_2 involved several areas, from re-branding of thousands of payphones, vehicles, the exteriors and interiors of buildings, and employee uniforms and identification cards to, for instance, logos on the displays of mobile telephones.

The new O_2 brand is being presented to the public by means of a classic marketing mix, including print and internet advertisements, billboards, and television spots including also non-traditional forms of communication, e.g. offering a download of a song from Leftfield that the Company is using in its TV campaign introducing the O_2 brand. In order to further improve customer care, an effort to simplify and clarify customers' communication with the firm is being made. Unified O_2 shops, one telephone contact to the firm, one internet address were introduced to achieve this.

Together with the brand, the Company also launched new services. As a first new product, television through fixed lines O_2 TV with its rich functionalities was introduced. Next offer, brand new mobile tariff programs, proved the company's plan to be as transparent as possible. The company's intention to provide convergent products started with combining services in the fixed and mobile networks in a way that allows for savings.

X Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, interest expense, other financial expense (which include primarily bank charges), fair value losses and gains on financial instruments and realized and unrealized exchange rate differences.

Notes to the consolidated financial statements

1 Segment information

The Group comprises two main business segments, as follows:

Fixed

Network communications services using a fixed network provided by former ČESKÝ TELECOM, a.s. and other consolidated subsidiaries

Mobile

Mobile communications services provided by former Eurotel and by Telefónica O2 Slovakia s.r.o.

Revenue of the Group is predominantly derived from domestic trading activities and as a result, segment reporting is only shown on the basis of business segments. With respect to the transfer of assets and liabilities (as detailed in General Information paragraph) and the deep integration process, the Group will analyse criteria for segment identification, which might lead to a change in the reported segments in the future years.

Year ended 31 December 2006	Fixed	Mobile	Group
Revenues	30,895	31,733	62,628
Inter-segment sales	(521)	(796)	(1,317)
Total consolidated revenues	**30,374**	**30,937**	**61,311**
Gains from sale of non-current assets	96	2	98
Work performed by the Group and capitalized	726	185	911
Costs	(17,926)	(17,552)	(35,478)
Inter-segment purchases	796	521	1,317
Total consolidated costs	**(17,130)**	**(17,031)**	**(34,161)**
Impairment charge	(253)	–	(253)
Depreciation	(9,813)	(4,225)	(14,038)
Amortisation	(990)	(1,718)	(2,708)
Total consolidated depreciation and amortization	**(10,803)**	**(5,943)**	**(16,746)**
Operating profit	**3,010**	**8,150**	**11,160**
Interest and other financial income (net)			(220)
Profit before tax			**10,940**
Tax			(2,920)
Profit after tax			**8,020**
Minority interest			–
Net profit			**8,020**
Assets (excluding Goodwill and non-current assets held for sale)	65,497	38,857	104,354
Goodwill on purchase of additional ownership interest in former Eurotel	–	13,320	13,320
Non-current assets held for sale	203	–	203
Total assets	**65,700**	**52,177**	**117,877**
Trade and other payables	(5,568)	(5,561)	(11,129)
Other liabilities	(15,719)	(2,548)	(18,267)
Total liabilities	**(21,287)**	**(8,109)**	**(29,396)**
Capital expenditure	3,209	3,291	6,500

Year ended 31 December 2005	Fixed	Mobile	Group
Revenues	32,278	30,029	62,307
Inter-segment sales	(415)	(852)	(1,267)
Total consolidated revenues	**31,863**	**29,177**	**61,040**
Gains from sale of non-current assets	116	–	116
Work performed by the Group and capitalized	366	228	594
Costs	(17,874)	(16,642)	(34,516)
Inter-segment purchases	852	415	1,267
Total consolidated costs	**(17,022)**	**(16,227)**	**(33,249)**
Impairment charge	(465)	(796)	(1,261)
Depreciation	(10,705)	(4,325)	(15,030)
Amortisation	(1,837)	(941)	(2,778)
Total consolidated depreciation and amortization	**(12,542)**	**(5,266)**	**(17,808)**
Operating profit	**2,316**	**7,116**	**9,432**
Interest and other financial income (net)			(684)
Profit before tax			**8,748**
Tax			(2,500)
Profit after tax			**6,248**
Minority interest			1
Net profit			**6,249**
Assets (excluding Goodwill and non-current assets held for sale)	79,150	31,381	110,531
Goodwill on purchase of additional ownership interest in former Eurotel	–	13,320	13,320
Non-current assets held for sale	360	–	360
Total assets	**79,510**	**44,701**	**124,211**
Trade and other payables	(4,921)	(4,713)	(9,634)
Other liabilities	(16,872)	(2,730)	(19,602)
Total liabilities	**(21,793)**	**(7,443)**	**(29,236)**
Capital expenditure	2,258	3,814	6,072

Inter-segment sales and purchases represent sales and purchases to the Group companies belonging to another segment.

Inter-segment pricing between the mobile and the fixed segment is based on rates agreed upon between former ČESKÝ TELECOM, a.s. and former Eurotel or based on a decision of the Czech Telecommunication Office (Český telekomunikační úřad). The rates applied in 2006 and 2005 were determined on the same basis as rates applicable for other mobile operators and are consistent with rates applied for pricing with other mobile operators. With respect to the transfer of assets and liabilities, the 2001 price amendment to an agreement governing interconnect arrangements with former Eurotel became irrelevant in 2006. After the transfer of assets and liabilities as of 1 July 2006, all inter-company transactions between fixed (ČESKÝ TELECOM, a.s.) and mobile (former Eurotel) segments became intra-company (inter-segments).

Capital expenditures comprise additions to property, plant and equipment and intangible assets.

2 Revenue and Internal expenses capitalized in fixed assets

	Year ended	
Revenue	31 December 2006	31 December 2005
Voice	23,462	23,839
Interconnection	9,444	9,154
Subscription charges	9,841	10,542
Connection charges	669	702
SMS & MMS & Value Added Services	4,813	4,537
Leased lines	2,330	2,615
Data services	1,839	1,732
Internet	5,051	4,422
IT and business solutions	751	345
Equipment and Activation Fee	2,172	2,357
Other Telco Revenues	500	478
Other revenues	439	317
Total revenues	**61,311**	**61,040**

Revenues from related parties are disclosed in Note 27.

The aggregate future minimum lease payments under non-cancellable operating leases relating to the buildings and other telecommunication equipment are as follows:

	31 December 2006
No later than 1 year	229
Later than 1 year and not later than 5 years	835
Later than 5 years	203
Total	**1,267**

	Year ended	
Internal expenses capitalized in fixed assets	31 December 2006	31 December 2005
Material	593	343
Labour	318	251
Total	**911**	**594**

3 Operating expenses

The following items have been included to arrive at operating profit:

	Year ended	
	31 December 2006	31 December 2005
Wages and salaries*	4,912	5,427
Redundancy payments	247	270
Social security contributions (Note 18)	1,650	1,830
Staff welfare costs	284	301
Total staff costs	**7,093**	**7,828**
Interconnection and roaming	10,010	9,701
Cost of goods sold	3,067	3,510
Other cost of sales	1,198	941
Other purchases	1,148	944
Marketing and sales	3,139	2,611
Call centres	95	–
Network & IT repairs and maintenance	2,594	2,413
Rentals, buildings and vehicles	1,652	1,609
Utilities supplies	746	604
Consultancy and professional fees	483	435
Other external services	1,796	1,669
Impairment charge for bad and doubtful debts and inventories	681	414
Taxes (other than income tax)	398	507
Other operating expenses	61	63
Total operating expenses	**34,161**	**33,249**

* Certain Group employees (including the Board of Directors) with specialised know how, or who have access to business secrets, or who are considered important to the development of the business, are bound by non-competition restrictions, for a maximum period of 12 months from the date of termination of their employment with the Group. The Group paid CZK 6 million in relation to such non-competition clauses in 2006 (2005: CZK 40 million).

Purchases from related parties are disclosed in Note 27.

4 Interest and other finance income (net)

	Year ended	
	31 December 2006	31 December 2005
Interest expense		
Interest incurred on loans and bonds	430	748
Interest income	(149)	(46)
Interest expense (net)	**281**	**702**
Other finance charges/(gains)	(40)	218
Fair value losses/(gains) on financial instruments:		
Derivative financial instruments	29	(119)
Net foreign exchange transaction gains	(50)	(117)
Other finance income (net)	**(61)**	**(18)**
Net finance costs	**220**	**684**

5 Tax

	Year ended	
	31 December 2006	31 December 2005
Total income tax expense is made up of:		
Current income tax charge	4,171	2,818
Deferred income tax credit (Note 17)	(1,251)	(318)
Taxes on income	**2,920**	**2,500**

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Group as follows:

	Year ended	
	31 December 2006	31 December 2005
Profit before tax	10,940	8,748
Income tax charge calculated at the statutory rate of 24% (2005: 26%)	2,626	2,275
Income not subjected to tax	1	(65)
Expenses not deductible for tax purposes	385	410
Other	(92)	(112)
Investments allowances	–	(8)
Taxes on income	**2,920**	**2,500**
Effective tax rate	27%	29%

6 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	Year ended	
	31 December 2006	31 December 2005
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders	8,020	6,249
Basic earnings per share (CZK)	25	19

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

7 Dividends

	2006	2005
Dividends (including withholding tax)	14,494	–

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2006. Approval of the 2006 profit and the decision regarding the amount of any dividend payment for the 2006 financial year will take place at the Annual General Shareholders Meeting scheduled for 26 April 2007.

8 Property, plant and equipment

	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress	Total
Year ended 31 December 2006						
Opening net book amount	14,494	47,141	22,355	2,001	2,012	88,003
Additions	615	464	2,983	847	4,942	9,851
Disposals and other movements	(4)	(4)	38	(14)	(4,885)	(4,869)
Assets classified as held for sale	54	–	–	1	–	55
Depreciation charge	(739)	(4,201)	(8,079)	(1,019)	–	(14,038)
Impairment charge	(201)	(5)	(5)	(2)	(34)	(247)
Closing net book amount	**14,219**	**43,395**	**17,292**	**1,814**	**2,035**	**78,755**
At 31 December 2006						
Cost	22,486	99,329	92,328	10,709	2,084	226,936
Accumulated depreciation and impairment allowance	(8,267)	(55,934)	(75,036)	(8,895)	(49)	(148,181)
Net book amount	**14,219**	**43,395**	**17,292**	**1,814**	**2,035**	**78,755**

	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress	Total
Year ended 31 December 2005						
Opening net book amount	15,665	50,745	28,610	2,731	1,594	99,345
Additions	361	633	2,761	579	4,736	9,070
Disposals and other movements	(117)	2	(129)	(15)	(4,301)	(4,560)
Assets classified as held for sale	(358)	–	(1)	(1)	–	(360)
Depreciation charge	(750)	(4,203)	(8,785)	(1,292)	–	(15,030)
Impairment charge	(307)	(36)	(101)	(1)	(17)	(462)
Closing net book amount	**14,494**	**47,141**	**22,355**	**2,001**	**2,012**	**88,003**
At 31 December 2005						
Cost	22,204	99,201	90,879	10,757	2,022	225,063
Accumulated depreciation and impairment allowance	(7,710)	(52,060)	(68,524)	(8,756)	(10)	(137,060)
Net book amount	**14,494**	**47,141**	**22,355**	**2,001**	**2,012**	**88,003**

As at 31 December 2006, the carrying value of non-depreciated assets amounted to CZK 460 million.

Land and buildings, plant and equipment with a carrying value of CZK 21 million (2005: CZK 1,220 million) were pledged as collateral for CZK 5,300 million of provided borrowings. The borrowings were fully paid off in 2005, but the cancellation of the pledge is still in process (see Note 16).

No borrowing costs were capitalized during the years 2006 and 2005.

The Group reports and classifies the following assets held for sale at the balance sheet date:

	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
Year ended 31 December 2006				
Opening net book amount	358	1	1	360
Disposals and other movements	(96)	–	–	(96)
Impairment charge	(6)	–	–	(6)
Assets re-classified as held for sale	(54)	–	(1)	(55)
Closing net book amount	**202**	**1**	**–**	**203**
At 31 December 2006				
Cost	904	190	7	1,101
Accumulated depreciation and impairment allowance	(702)	(189)	(7)	(898)
Net book amount	**202**	**1**	**–**	**203**

	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
Year ended 31 December 2005				
Opening net book amount	–	–	–	–
Assets re-classified as held for sale	358	1	1	360
Closing net book amount	**358**	**1**	**1**	**360**
At 31 December 2005				
Cost	769	5	7	781
Accumulated depreciation and impairment allowance	(411)	(4)	(6)	(421)
Net book amount	**358**	**1**	**1**	**360**

Assets intended for sale in most cases represent administration buildings with land, that became vacant due to the optimization of the Group's processes and which the Group will not use in the future and it is expected their sale will take place within one year.

The non-current assets classified as held for sale are presented in the fixed segment.

As at 31 December 2006, the total recognised loss from the impairment/decrease in value of assets classified as held for sale was CZK 41 million. With regard to assets for which a loss from decrease in value was recognised, no cancellation/reverse of the previously recognised impairment occurred.

Cost of fully depreciated property, plant and equipment was CZK 47,061 million as at 31 December 2006.

In 2006, the Group achieved a total gain from the sale of the above assets amounting to CZK 98 million and total losses in amount CZK 61 million. The total net sales were CZK 205 million and the carrying amount was CZK 168 million.

The impairment charge recorded in 2006 represents mainly correction of value of special constructions, which were idle.

9 Intangible assets

	Goodwill	Licences	Software	Other	Total
Year ended 31 December 2006					
Opening net book amount	13,320	5,494	3,405	627	22,846
Additions	–	120	1,384	–	1,504
Disposals and other movements	–	–	(14)	–	(14)
Amortisation charge	–	(404)	(1,677)	(627)	(2,708)
Impairment charge	–	–	–	–	–
Closing net book amount	**13,320**	**5,210**	**3,098**	**–**	**21,628**
At 31 December 2006					
Cost	13,320	6,193	22,258	2,829	44,600
Accumulated amortisation and impairment allowance	–	(983)	(19,160)	(2,829)	(22,972)
Net book amount	**13,320**	**5,210**	**3,098**	**–**	**21,628**
Year ended 31 December 2005					
Opening net book amount	13,320	5,668	4,318	1,702	25,008
Additions	–	–	1,416	–	1,416
Disposals and other movements	–	–	(1)	–	(1)
Amortisation charge	–	(174)	(2,315)	(289)	(2,778)
Impairment charge	–	–	(13)	(786)	(799)
Closing net book amount	**13,320**	**5,494**	**3,405**	**627**	**22,846**
At 31 December 2005					
Cost	13,320	6,073	21,225	2,829	43,447
Accumulated amortisation and impairment allowance	–	(579)	(17,820)	(2,202)	(20,601)
Net book amount	**13,320**	**5,494**	**3,405**	**627**	**22,846**

Details regarding the impairment loss that was recorded in 2005 are described in Note 10.

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks in the Czech Republic. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, former Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of ten years. Carrying value of GSM 900 license is as at 31 December 2006 CZK 695 million (2005: CZK 770 million) and carrying value of GSM 1800 license is CZK 559 million (2005: CZK 620 million). In 2002, former Eurotel renewed its 450 MHz license; the current license enables the mobile segment to offer any internationally recognized public mobile telecommunication services on frequency of 450 MHz. Mobile segment currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The license is currently valid for the remaining period of five years. Carrying value of NMT 450 license is CZK 65 million (2005: CZK 81 million). In December 2001, former Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, former Eurotel was provided with deferred payment terms by the Czech Telecommunication Office (CTU) to finance the license acquisition. In December 2003, former Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, former Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement. Carrying value of UMTS license is CZK 3,771 million (2005: CZK 4,023 million). UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

With respect to the operation launch in 2007, the license for GSM and UMTS networks awarded to Telefónica O2 Slovakia s.r.o on 7 September 2006 for SKK 150 million (EUR 4.1 million) has not been amortized as of 31 December 2006.

No borrowing costs were capitalized during the years 2006 and 2005.

Cost of fully amortised intangible assets was CZK 13,874 million as at 31 December 2006.

The caption Other includes brand names acquired through business combination in 2003 by the purchase of the remaining share in former Eurotel. These intangible assets were originally determined as having an indefinite useful life after adoption of revised IAS 38 from 1 January 2005, because there was no foreseeable limit to the period over which the asset was expected to generate net cash flows. After the acquisition by Telefónica, S.A. the Group reassessed its intangible assets previously acquired through business combination and reviewed the relating useful lives. The Group decided, as a result of this assessment, to change the useful lives of brand names with indefinite useful lives from indefinite to finite. This change was accounted for as a change in an accounting estimate and the revised useful lives were determined to be 30 months. From 1 July 2005, the date of change in indefinite useful life, the Group amortizes these brand names using the straight-line method. Upon the transfer of assets and liabilities and with respect to the re-branding process, the Group re-considered an estimate of useful life of former Eurotel related brand names and accelerated their amortization with final effect of their full amortization as at 31 December 2006.

All of the Group's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and revision of useful life.

10 Impairment of fixed assets

Intangible assets

Brand names acquired through business combination in 2003 with former Eurotel.
During the process of allocation of the cost of a business combination arising from the acquisition by Telefónica, S.A., the Group tested the recoverable amounts of previously acquired brand names. Considering that result the Group recognised immediately an impairment loss in the income statement in the amount of CZK 786 million in 2005 (see Note 9).

As at 30 June 2005 the carrying amount of brand names before the impairment charge was CZK 1,567 million (CZK 1,567 million as at 31 December 2004). Upon the transfer of assets and liabilities and with respect to the re-branding process, the Group re-considered an estimate of useful life of former Eurotel related brand names and accelerated their amortization with final effect of their full amortization as at 31 December 2006.

Fixed assets of the fixed line business

During 2003, external factors relating to the telecommunication market and regulatory environment namely uncertainty regarding tariff rebalancing, termination charges for internet dial-up interconnection charges and other regulatory decisions in the Czech Republic led the management to assess the recoverable amount of the fixed line segment assets. The fixed line segment assets constitute one cash-generating unit (the CGU).

As at 31 December 2006, the management of the Company reviewed the indicators which would indicate that the impairment allowance of fixed line business assets made in 2003 is no longer relevant and should be reversed. Upon the review, a recoverable amount of the fixed line business assets (impairment test model) was estimated. Based on this assessment performed, the management believes that the value of the existing fixed network assets is fairly stated and does not differ substantially from the assets' recoverable amount as at 31 December 2006.

11 Inventories

	31 December 2006	31 December 2005
Construction material	81	35
Cables	28	159
Other inventory including goods for resale	642	522
Finished products and work in progress	236	–
	987	**716**

The inventories noted above are stated net of an allowance of CZK 179 million (2005: CZK 187 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories carried at net realisable value amounts to CZK 9 million (2005: CZK 47 million). The amount of inventories recognised as an expense is CZK 4,212 million (2005: CZK 4,637 million).

12 Receivables and prepayments

	31 December 2006	31 December 2005
Domestic trade receivables (net)	6,065	6,238
Foreign currency trade receivables (net)	710	620
Other debtors (net)	880	449
Prepayments	681	706
Other financial assets – short-term	10	–
	8,346	**8,013**

Trade receivables are stated net of an allowance for impaired receivables of CZK 3,572 million (2005: CZK 3,218 million). In order to preserve the tax-deductible status of the bad debt expense, the Group's trade receivables are not written off and removed from the primary books and records until certain statutory collection requirements have been satisfied.

Receivables from related parties are disclosed in Note 27.

The Group's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Group's trade receivables.

As at 31 December 2006 and 2005 the Group has the following non-current balances, which are classified as other financial assets:

	31 December 2006	31 December 2005
Long-term credits	156	185
Advance payments for long-term expenses	221	227
Total	**377**	**412**

Long-term trade credits include interest bearing credit (interest 5.9%) amounting to CZK 78 million (2005: CZK 83 million).

13 Available-for-sale and held-to-maturity investments

Available-for-sale investments	2006	2005
At beginning of year	58	176
Revaluation deficit	(2)	(1)
Additions	3	4
Disposals	(3)	(121)
At end of year	**56**	**58**
Non-current	–	58
Current	56	–
Total	**56**	**58**

Held-to-maturity investments	2006	2005
At beginning of year	29	109
Exchange differences	(1)	(2)
Revaluation deficit	–	–
Additions	1	1
Matured	(2)	(79)
At end of year	**27**	**29**
Non-current	27	29
Current	–	–
Total	**27**	**29**

Available-for-sale investments, principally comprising marketable securities, are fair valued monthly and at the balance sheet date. For investments traded in active markets, the fair value is determined by reference to quoted bid prices. For other investments, the fair value is estimated by reference to the current market value of similar instruments or by reference to the discounted cash flows of the underlying net assets.

Held to maturity investments category comprise a debt instrument – a bond held in EUR with maturity date July 2008, which is carried at amortised cost.

14 Cash and cash equivalents

	31 December 2006	31 December 2005
Cash balances	334	322
Intra-group cash pooling	3,605	–
Short-term bank deposits and cash equivalents	3,522	3,317
Cash and cash equivalents	**7,461**	**3,639**

As at 31 December 2006 and 2005, the Group's cash equivalents partially consisted of short-term bank promissory notes that were economically equivalent to bank term deposits and interest bearing deposits maturing in three months or less.

During 2006 (since April 2006) the Group entered into mutual Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective operating free cash flow. The short-term deposits are based on the arm's length principle and classified as a cash equivalent.

For the purposes of the cash flow statement, the year-end cash and cash equivalents comprise the following components:

	31 December 2006	31 December 2005
Cash and cash equivalents	7,461	3,639
Bank overdrafts and other short-term borrowings (Note 16)	–	(101)
Balance at the end of period	**7,461**	**3,538**

15 Trade and other payables

	31 December 2006	31 December 2005
Trade creditors in local currency (net)	4,504	4,524
Trade creditors in foreign currencies (net)	855	766
Other taxes and social security	196	205
Deferred revenue	2,026	1,585
Employee wages and benefits	559	397
VAT payable	445	308
Other creditors	72	60
Accruals	2,472	1,789
	11,129	**9,634**
Other non-current liabilities	**807**	**1,265**

Payables to related parties are disclosed in Note 27.

Other non-current liabilities include primarily deferred revenues from connection fees, which are expected to be taken to income in more than 12 months from the balance sheet date.

16 Financial debts

	31 December 2006	31 December 2005
Bank loans and overdrafts in local currency (a)	–	101
International financial institution loans in foreign currencies (b)	–	–
Bank loans and overdrafts in foreign currencies (a)	3,163	3,337
Bonds in local currency (c)	5,993	5,987
Total borrowings	**9,156**	**9,425**
Accrued interest	189	193
Derivatives	18	13
Other financial debt	**207**	**206**
Total financial debt	**9,363**	**9,631**
Repayable:		
Within one year	**207**	**307**
Between one and two years	5,993	–
Between two and five years	–	5,987
After five years	3,163	3,337
Total non-current	**9,156**	**9,324**
Total financial debt	**9,363**	**9,631**

(a) Bank loans and overdrafts include overdrafts of CZK 0 million denominated in the local currency (2005: CZK 101 million) and CZK 0 million in foreign currencies (2005: CZK 0 million).

Short-term borrowings as at 31 December 2005 consisted of loans drawn under bilateral short-term facilities.

In November 2003, the Company raised a syndicated credit facility in the total amount of EUR 850 million equivalent, with a final maturity day on 21 November 2008. The purpose of the loan was to finance the acquisition of the remaining 49% ownership interest in former Eurotel and general corporate purposes of the Group. The loan was fully paid off during 2005. Therefore, as at 31 December 2006 the outstanding amount of the loans under the credit facility was EUR 0 million (2005: EUR 0 million) and CZK 0 million (2005: CZK 0 million). The terms and conditions of the credit facility agreement, inter alia, require the Group to maintain certain gearing and interest cover ratios of earnings before interest, tax, depreciation and amortisation to net borrowings and interest payable.

In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity day on 30 July 2012. In October 2005, the bank loan in foreign currency was partially repaid prior to its maturity date. The fees associated with this earlier repayment in the amount of CZK 70.6 million were immediately recognised in the income statement. As at 31 December 2006, the outstanding amount of the foreign currency loan amounts to EUR 115 million.

(b) In 2005, the International financial institution loans have been fully repaid prior to their maturity dates. The fees associated with this earlier repayment in the total amount of CZK 51.2 million were immediately recognised in the income statement.

(c) In 2003, the Company issued CZK 1,000 million of bonds (as additional issue to CZK 3,000 million of bonds from 2002) with an interest rate of 4.55% p.a. The bonds in the total amount of CZK 4,000 million were fully repaid on the maturity date in July 2005.

In 2003, the Company issued CZK 6,000 million of bonds with an interest rate 3.50% p.a. and a maturity date of 9 July 2008.

At 31 December 2006, the Group had approximately CZK 8,404 million of available undrawn credit facilities (2005: CZK 10,224 million).

Loans with a maturity within one year and denominated in a foreign currency have a total value of EUR 0 million (2005: EUR 0 million).

For all borrowings, interest has been charged at commercial rates.

The Group's loan interest rate allocation after taking into account interest rate swaps was as follows:

	31 December 2006	31 December 2005
At fixed rate	9,156	9,324
At floating rate	–	101
Total	**9,156**	**9,425**

The carrying amounts and fair values of bonds and bank loans are as follows:

31 December 2006	Carrying amounts	Fair values
Bank loans	3,163	3,557
Bonds	5,993	6,135
Total	**9,156**	**9,692**

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate that the Board of Directors expect would be available to the Group at the balance sheet date, except for the fair value of the issued bonds, which are based on actual bond market pricing. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	31 December 2006	31 December 2005
Bank loans and overdrafts in local currency	n/a	2.51%
International financial institution loans in foreign currencies	n/a	n/a
Bank loans and overdrafts in foreign currencies	6.64%	6.64%
Bonds in local currency	3.50%	3.50%

The Group meets the criteria for debt covenants (stipulated level of consolidated total net borrowings, EBITDA and tangible net worth) required by the creditors.

International financial institution loans in foreign currencies (now repaid) have been secured by the Czech Republic (represented by the Ministry of Finance of the Czech Republic) and as a result, certain movables and real estates have been pledged for the benefit of the Czech Republic (see Note 8).

The carrying value of assets pledged is as follows:

	31 December 2006	31 December 2005
Land and buildings	–	7
Plant and equipment	21	1,213
Total	**21**	**1,220**

The borrowings were fully paid off in 2005, but the cancellation of the pledge is still in a process.

Other loans are not secured.

17 Deferred income taxes

Deferred income taxes are calculated using currently enacted tax rates expected to apply when the asset is realized or the liability settled.

Both, short-term and long-term deferred taxes were calculated at 24% (24% in 2005).

	2006	2005
At 1 January	**5,721**	**6,041**
Income statement tax credit (Note 5)	(1,251)	(318)
Tax on fair value gains	(1)	(2)
At 31 December	**4,469**	**5,721**

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts, determined after offsetting, are shown in the consolidated balance sheet:

	31 December 2006	31 December 2005
Deferred tax assets	(1,509)	(1,493)
Deferred tax liabilities	5,978	7,214
Total	**4,469**	**5,721**

The deferred tax asset includes CZK 444 million (2005: CZK 462 million) recoverable in less than twelve months and CZK 1,065 million (2005: CZK 1,031 million) recoverable after more than twelve months. The deferred tax liability includes CZK 724 million (2005: CZK 915 million) payable in less than twelve months and CZK 5,254 million (2005: CZK 6,299 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Consolidated balance sheet		Consolidated income statement	
	2006	2005	2006	2005
Amount relating to the origination and reversal of temporary differences from:				
– property, plant and equipment and intangible assets	5,978	7,004	(1,026)	(599)
– trade receivables, inventories and other differences	(1,479)	(1,280)	(199)	281
Revaluations of cash flow hedges	(4)	(3)	–	–
Amount relating to unrecognised tax loss	(26)	–	(26)	–
Total	**4,469**	**5,721**	**(1,251)**	**(318)**

Deferred income tax related to items charged or credited directly to equity are as follows:

	2006	2005
Revaluation of cash flow hedges	(1)	(2)
Total	**(1)**	**(2)**

18 Government social security and pension schemes

The Group is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2006 and 2005, the Group paid contributions at a rate of 35% of gross salaries and is not required to make any contributions in excess of this statutory rate. The total amount charged to operating expenses in respect of this scheme was CZK 1,649 million in 2006 (2005: CZK 1,830 million). Employees contribute 12.5% (2005: 12.5%) of their gross salaries.

The Group has a voluntary pension plan for employees under which the Group makes contributions on behalf of the Group's employees to approved pension plan providers, under defined contribution schemes. The Group's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Group made contributions of CZK 53 million (2005: CZK 65 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2006 relating to employee retirement amounted to CZK 0.1 million (2005: CZK 0.1 million) and were charged as an operating expense.

All amounts discussed in the above note are included in staff costs (see Note 3).

19 Provisions for liabilities and charges

Short-term Provisions

	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Share–based compensation	Benefit loyalty provision	Other	Total
At 1 January 2005	**–**	**–**	**186**	**60**	**489**	**131**	**866**
Additions during the year	20	10	331	190	441	203	1,195
Reclassification	–	–	–	–	–	7	7
Utilised during the year	–	–	(398)	(250)	(474)	(323)	(1,445)
At 31 December 2005	**20**	**10**	**119**	**–**	**456**	**18**	**623**
Additions during the year	–	107	181	–	481	38	807
Reclassification	–	–	–	–	–	7	7
Utilised during the year	(6)	(98)	(117)	–	(373)	(8)	(602)
At 31 December 2006	**14**	**19**	**183**	**–**	**564**	**55**	**835**

Long-term Provisions

	Regulatory and court decisions	Employee related costs	Other	Total
At 1 January 2005	**1,566**	**–**	**–**	**1,566**
Additions during the year	576	–	4	580
Reclassification	–	–	12	12
Utilised during the year	(44)	–	(3)	(47)
At 31 December 2005	**2,098**	**–**	**13**	**2,111**
Additions during the year	295	72	–	367
Reclassification	–	–	(7)	(7)
Utilised during the year	(434)	–	–	(434)
At 31 December 2006	**1,959**	**72**	**6**	**2,037**

With the exception of the regulatory and court decisions and other small items for which the expected timing of payments is not certain all other provisions are expected to be utilised within next 12 months from the balance sheet date.

Benefit loyalty provision

Benefit loyalty provision covers the cost of equipment, accessories, gifts and services provided to participants in the mobile segment's loyalty program in exchange for credits awarded primarily for airtime minutes spent. The provision has been recognized based on past experience of the usage of these credits by loyalty program participants. Expected outflow of provided benefits is CZK 290 million (2005: CZK 242 million) within one year and CZK 274 million (2005: CZK 214 million) from one year up to three years.

The amount of a provision is the present value of the expenditures expected to be required to settle the obligation (CZK 580 million).

Employee-related costs

Provisions for employee-related costs include expected costs associated with performance bonuses and provision for termination payments.

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Group companies (see Note 21).

20 Financial instruments

Net fair values of derivative financial instruments

At the balance sheet date, the total net fair values of derivative financial instruments were as follows:

Contracts with positive fair value	31 December 2006	31 December 2005
Total	**–**	**–**

Contracts with negative fair value	31 December 2006	31 December 2005
Instruments not qualifying as hedges		
– Interest rate swaps	–	2
Cash flow hedges		
– Forward foreign exchange contracts	18	11
Total (Note 16)	**18**	**13**

21 Contingencies

The Group is involved in a variety of legal proceedings that arise from time to time in the ordinary course of business. The following is a discussion of the significant legal matters involving the Group:

Interconnect arrangements

The Company has not yet agreed a 2001 price amendment to an agreement with T-Mobile Czech Republic a.s. governing interconnect arrangements. Whilst in December 2003 the Czech Telecommunication Office (CTO) effectively ruled in favour of the amounts claimed (i.e. CZK 899 million for T-Mobile Czech Republic a.s., the outstanding amount is bearing interest of 0.05% per day), the management believes that the amounts are not substantiated and are without merit. The Company subsequently obtained adjournment of the decision execution and lodged an appeal. Based on the legal environment in the Czech Republic, management estimated maximum probable outflow related to the dispute with T-Mobile Czech Republic a.s. and such outflow is fully provided in the financial statements. The management is confident that all risks, which may arise as a result of the litigation, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) filed a petition at the Municipal Court in Prague against the Company for damages in the amount of CZK 538 million with appurtenances and for returning the unjustified enrichment of CZK 117 million with appurtenances. The Company is alleged to have failed to transmit the traffic to networks operated by other mobile operators according to respective interconnection agreements. The petition was only unofficially delivered from Vodafone Czech Republic, a.s. and was not served by the court. There was no further development in this respect in 2006. Furthermore, the Company is a defendant in a case filed by Vodafone Czech Republic, a.s. in May 2004 asserting causes for alleged breach of the antitrust law by former Eurotel (damages amounting to CZK 1,043 million). Both parties filed their expert opinions to the court, no hearing has been ordered until now. The management believes that all risks, which may arise as a result of Vodafone litigations, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

Office for the Protection of Economic Competition proceedings

The Company is subject to administrative proceeding by the Office for the Protection of Economic Competition (UOHS) relating to the alleged creation of unfair barriers against development on the market through the application of certain specific price plans for residential customers. UOHS rendered resolution dated 20 April 2005 imposing a fine to the Company in the total amount of CZK 210 million, which was consequently, after the Company completed and filed a protest, reduced to CZK 205 million. The Company lodged an appeal in January 2006 and requested adjournment of the decision execution. The Court rejected the Company's proposal and the Company lodged a complaint against this decision to the Supreme Administrative Court on 19 October 2006. The matter is fully provided in the financial statements.

Other legal matters

The Company is a defendant in a case filed by TELE2 s.r.o. on 3 February 2005 asserting causes for alleged breach of anti competition law by the Company in connection with offering pricing plans since January 2002. The amount of the claim is CZK 2,142 million with appurtenances. No hearing has been ordered in the matter yet. The Company provided to the court extensive defence along with proposed items of evidence proving the legal imperfectness of the sued court's conduct. The management is satisfied that the matter is adequately reflected in the financial statements and does not believe the resolution of this legal proceeding will have a material adverse effect on net income exceeding the amount of provision already made in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is prosecuted by AUGUSTUS spol. s r.o. for an alleged loss of profit in the principal amount of approximately CZK 183 million with appurtenances (totalling approximately additional CZK 257 million as of the end of 2006) relating to the years 1995–2001. Augustus claims that the Company illegitimately cancelled a contract for issue of phone cards, which was signed for unlimited period of time. Based on court decision, the Company paid an amount of the principal of CZK 83 million and the corresponding interest in August 2006. Both parties filed subsequently appeal against the court judgement. The management believes that all risks, which may arise as a result of this litigation, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is a defendant in several other legal cases out of which those that individually exceed CZK 5 million total to CZK 138 million with appurtenances. The management believes that the risk of loosing these cases is less than probable and no provision was made in the financial statements.

22 Commitments

Operating leases

The aggregate future minimum lease payments under operating leases are as follows:

	31 December 2006	31 December 2005
No later than 1 year	1,052	991
Later than 1 year and not later than 5 years	3,136	1,827
Later than 5 years	2,518	1,383
Total	**6,706**	**4,201**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2006 were CZK 1,102 million (2005: CZK 1,123 million). These lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Group's consolidated results of operations, financial position, or cash flow and therefore are not accounted for.

In 2004 the Group entered into a sale and lease back transaction and now leases the majority of its car fleet under operating leases. There are no contingent rent obligations. The lease arrangements include an option to renew the lease after the initial period.

Lease payments are fixed and determinable, however they may be increased to reflect inflation and other market conditions such as interest rates changes (e.g. an increase in PRIBOR by more than 2% over a half year). There are no significant restrictions imposed by these lease arrangements, such as those concerning dividends, additional debt and further leasing. Total future lease payments relating to this contract in 2006 were CZK 368 million (2005: CZK 229 million).

Capital commitments

	31 December 2006	31 December 2005
Capital expenditure contracted but not provided for in the financial statements	673	1,541

The majority of contracted amounts relate to the telecommunications network and service contracts.

23 Service concession arrangements

The Company performs communication activities under the Act on electronic communications based on a notification to and a certificate from the Czech Telecommunication Office. In accordance with Section 13 of the Act on electronic communications, on 12 August 2005, the Company delivered a notification to the Czech Telecommunication Office (further CTO) on the performance of a communication activity, which is under Section 8 of this Act a business activity in electronic communications. Relating documentation required by the Act on electronic communications was provided on 29 September 2005. Subsequently, on 11 October 2005, the CTO issued a certificate confirming that a notification on the performance of a communication activity was received. A notification of the changes has been filed before the transfer of assets and liabilities.

The communication activities include (territory of the Czech Republic):
a) public fixed and mobile network of electronic communications
b) public network for the transfer of radio and TV signal
c) public fixed and mobile telephone network
d) publicly accessible telephone services
e) other voice services
f) rent of circuits
g) transmission of radio and TV signal
h) transfers of data
i) internet access services.

In accordance with the Act on electronic communications, the CTO determined the scope and new detail conditions for the provision of each particular service within the universal service including the selection of providers. The CTO issued, based on the results of tenders, decisions according to which the Company was determined as the provider of the following particular services:

- Periodic issuance of telephone directories with numbers of participants of the publicly accessible telephone service and access of end users to these directories in accordance with Section 38, Para 2, letter c) of the Act on electronic communications (on 21 December 2005);
- Information service on the numbers of participants of the publicly accessible telephone service in accordance with Section 38, Para 2, letter d) of the Act on electronic communications (on 21 December 2005);
- Public pay telephones in accordance with Section 38, Para 2, letter e) of the Act on electronic communications (on 13 March 2006);
- Access for disabled to the public telephone service in accordance with Section 38, Para 2, letter f) of the Act on electronic communications (on 12 July 2006);
- Supplementary services in accordance with Section 38, Para 2, letter g) of the Act on electronic communications (on 28 July 2006);
- Special price plans in accordance with Section 38, Para 3 of the Act on electronic communications (on 1 September 2006); the Company is not the only provider.

CTO also published on 1 September 2006 its decision not to impose the duty to provide the USO service of connection at a fixed location to the public telephone network and the service of access to publicly available telephone services at a fixed location, mainly due to the high level of deployment of these services and high level of substitutability of mobile services.

Mobile segment:
The Company provides mobile services of electronic communications in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (GSM) and in the 450 MHz frequency band under the Nordic Mobile Telephone (NMT) standard (collectively, mobile services). In June 2005 all subscribers of a voice service in the NMT 450 Network were transferred to the GSM Network. The NMT 450 Network is used for broadband mobile access to Internet using CDMA2000 1*EV-DO (Code-Division Multiple Access Evolution Data Optimized CDMA) technology in the 450 MHz frequency band. Mobile segment operates services based on Universal Mobile Telecommunications System (UMTS) standard since 1 December 2005. Mobile license 450 MHz, mobile license GSM and UMTS have remaining life 5, 10 and 15 years, respectively. Relative to the current regulatory and business environment in the Czech Republic, contractual, legal, regulatory, competitive or other economic factors may limit the period during which the Company can benefit from the use of these licenses in the future.

The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, former Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of ten years. In 2002, former Eurotel renewed its 450 MHz license; the current license enables the Company to offer any internationally recognized public mobile telecommunication services on a frequency of 450 MHz. Mobile segment currently provides on this frequency broadband Internet access services using CDMA technology. The license is currently valid for the remaining period of five years.

In December 2001, former Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, former Eurotel was provided with deferred payment terms by the CTO to finance the license acquisition. In December 2003, former Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, former Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement.

No additional expenses connected with renewal of the individual licences, nor any limitations connected with the renewal of licences, are expected in accordance with the existing interpretation of regulatory provisions.

On 7 September 2006, Telefónica O2 Slovakia s.r.o. was granted a licence to provide public mobile telephone service as well as public data and multimedia services by the means of the public mobile telephone network and to operate the public electronic communication network – GSM and UMTS mobile telephone network within the area of the Slovak Republic. The licence has been granted for 20 years, i.e. till September 2026.

The following obligations were part of the licence:

- Putting into operation the own GSM network within 6 months (i.e. until 7 March 2007);
- Putting into operation the UMTS network within 12 months (i.e. until 7 September 2007);
- Putting into operation 400 GSM base stations and to cover 12% of population by the own network within 12 months;
- Putting into operation 800 GSM base stations and to cover 45% of population by the own network within 24 months.

24 Share capital and reserves

	31 December 2006	31 December 2005
Nominal value per ordinary share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per share with special rights (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares	32,209	32,209

* One share owned by the National Property Fund of the Czech Republic bore special decision-making rights in accordance with the statutes of the Company. These special rights included namely decisions regarding the liquidation of the Company, changes in its activities, sale or lease of the Company or of its assets. This share was assigned to Telefónica, S.A. within the transferred 51.1% stake in the Company (see General information). From this date, the share has not borne special decision-making rights.

At 31 December 2005, shareholdings in the Company were as follows:

Telefónica, S.A.	69.4%
Other shareholders	30.6%

At 31 December 2006, shareholdings in the Company were as follows:

Telefónica, S.A.	69.4%
Other shareholders	30.6%

Funds include a statutory reserve fund of CZK 6,262 million (2005: CZK 5,904 million) that is not distributable under ruling legislation.

25 Hedging reserve

Balance at 1 January 2005	(47)
Fair value losses in period	(36)
Fair value losses transfer to net profit	72
Deferred tax on fair value losses	–
Balance at 31 December 2005	**(11)**
Fair value losses in period	(34)
Fair value losses transfer to net profit	26
Deferred tax on fair value losses	1
Balance at 31 December 2006	**(18)**

26 Cash generated from operating activities

	Year ended	
	31 December 2006	31 December 2005
Net profit	8,020	6,248
Adjustments for:		
Tax (Note 5)	2,920	2,500
Depreciation (Note 8)	14,038	15,030
Amortisation (Note 9)	2,708	2,778
Impairment loss (Note 8, 9, 10)	253	1,261
Disposals of obsolete assets	49	76
Profit on sale of property, plant and equipment	(96)	(111)
Net interest and other charges	243	702
Foreign exchange (gains)/losses (net)	(203)	(347)
Fair value changes	29	(119)
Increase in provisions	(11)	73
Operating cash flow before working capital changes	**27,950**	**28,091**
Decrease/(increase) in trade and other receivables	(10)	(555)
Decrease/(increase) in inventories	(753)	(211)
(Decrease)/increase in trade and other payables	1,076	435
Cash generated from operations	**28,263**	**27,760**

27 Related party transactions

The acquisition process and the transfer of majority ownership of NPF was completed on 16 June 2005 by paying-off the balance of 90% purchase price by Telefónica, S.A, and NPF divested 51.1% shares in the Company. Telefónica effectively used its rights at the General Shareholders Meeting, which took place on 23 June 2005.

The intercompany transactions between the Group and the Telefónica Group companies are disclosed from the date Telefónica, S.A. gained effective control, i.e. 23 June 2005 to 31 December 2006. With respect to the majority ownership of NPF holding to 16 June 2005, all transactions between the Group and the NPF companies are disclosed only to that date.

The Group provides services to all related parties on normal commercial terms. Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest free (excl. financial assets used for financing) and the settlement occurs either in cash or by offsetting. The financial assets balances are tested for the impairment at the balance sheet date, and no allowance or write off incurred.

The following transactions were carried out with related parties:
I. Parent company:

	Year ended	
a) Dividend	31 December 2006	31 December 2005
Telefónica S.A.	**10,061**	**–**

II. Other related parties – Telefónica Group:

	Year ended	
a) Sales of services and goods	31 December 2006	31 December 2005
Telefónica companies	**520**	**61**

	Year ended	
b) Purchases of services and goods	31 December 2006	31 December 2005
Telefónica companies	**351**	**32**

	Year ended	
c) Capital purchases	31 December 2006	31 December 2005
Telefónica companies	**18**	**–**

	Year ended	
d) Receivables	31 December 2006	31 December 2005
Telefónica companies	**131**	**39**

	Year ended	
e) Payables	31 December 2006	31 December 2005
Telefónica companies	**74**	**8**

	Year ended	
f) Short-term receivables (interest)	31 December 2006	31 December 2005
Telefónica companies	**8**	**–**

	Year ended	
g) Interest income	31 December 2006	31 December 2005
Telefónica companies	**15**	**–**

	Year ended	
h) Cash equivalents	31 December 2006	31 December 2005
Telefónica companies	**3,605**	**–**

The list of the Telefónica companies with which the Group had any transaction in 2006 includes the following entities: Telefónica de España, S.A.U., O2 Germany GmBH& CO.OHG, Telefónica Deutschland GMBH, O2 (UK) Ltd., O2 Communications (Ireland) Ltd., Telefónica Servicios Integrales de Distribución, S.A.U, Atento Servicios Técnicos y Consultoría, S.L., Telefónica Móviles Españ, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A., Telefónica de Contenidos, S.A.U., Portugal Telecom, S.G.P.S., S.A., Telefónica Europe, B.V., Telefónica International Wholesale Services, S.L. and Telefónica Gestión de Servicios Compartidos, S.A.

III. Other related parties – State entities controlled by NPF*

	Year ended	
a) Sales of services and goods	31 December 2006	31 December 2005
State controlled entities	**–**	**56**

	Year ended	
b) Purchases of services and goods	31 December 2006	31 December 2005
State controlled entities	**–**	**116**

c) Receivables	Year ended 31 December 2006	31 December 2005
State controlled entities	**–**	**2**

d) Payables	Year ended 31 December 2006	31 December 2005
State controlled entities	**–**	**75**

* NPF did not hold any shares in the Company after 16 June 2005, and accordingly the respective related party sales and purchases have been prepared for period from 1 January 2005 to 16 June 2005. The state controlled entities include all companies that are owned by the State through NPF Czech Republic. Entities controlled by NPF consist of number of commercial (joint stock or limited liability) companies operating across different industries, and they do not include the government or governmental bodies. Accordingly, transactions with ministries and other state agencies are not treated as related party transactions.

IV. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Telefónica O2 Czech Republic, a.s., were provided with benefits as follows:

	Year ended 31 December 2006	31 December 2005
Salaries and other short-term benefits	86	254
Board share on profit	–	–
Stock appreciation rights	–	190
Non-competition clause	–	6
Termination benefits	–	58
Capital life insurance	–	16
Personal indemnification insurance	12	16
Total	**98**	**540**

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2005 and 2006.

No other loan was provided to related parties by the Group.

28 Principal subsidiary undertakings

Name	Group's interest	Country of incorporation	Activity
1. Telefónica O2 Services, spol. s r.o.	100%	Czech Republic	Network and consultancy services in telecommunications
2. SPT TELECOM (Czech Republic) Finance B.V.	100%	Netherlands	Financing other entities in the Group
3. CZECH TELECOM Germany GmbH	100%	Germany	Data transmission services
4. CZECH TELECOM Austria GmbH	100%	Austria	Data transmission services
5. Telefónica O2 Slovakia s.r.o.	100%	Slovakia	Mobile telephony, internet and data transmission services
6. CenTrade, a.s.	100%	Czech Republic	E-business company providing market place services

On 20 December 2001 former Eurotel acquired a 100% ownership interest in a Hungarian registered limited liability company, Trigo Global Services Ltd. (Trigo) for CZK 1 million. The subsidiary was engaged in the contracting of labour services to former Eurotel for periods prior to January 2004. In September 2004, Trigo commenced the process of voluntary liquidation. On 8 April 2005 the process of liquidation was finished and assets were transferred to former Eurotel (amounts of assets transferred are not material to the Group's consolidated results). Currency translation adjustment upon complete liquidation of the investment in Trigo, the amount attributable to that entity and accumulated in the translation adjustment component of equity (CZK 13 million) was removed from the separate component of equity and was reported as part of the gain on liquidation of the investment. At the date of liquidation goodwill was fully written off.

As of 1 January 2007, CenTrade, a.s. commenced the process of voluntary liquidation. The process is still in progress, the Company increased its investment and paid in capital which would aim to the smooth liquidation process.

29 Minority interest

	2006	2005
At 1 January	**–**	**6**
Elimination impact*	–	(5)
Share of net loss of subsidiaries	–	(1)
At 31 December	**–**	**–**

* Impact of the elimination of liquidated companies from consolidation.

30 Post balance sheet events

On 2 February 2007, Telefónica O2 Slovakia s.r.o started, in accordance with the license granted, its commercial operation for prepaid mobile services "O_2 Jednotky".

The Group is in process of implementing measures to increase efficiency which include also real estates usage optimisation. Real estates' optimisation focus amongst other actions on reduction of employees' territorial diversification as well as move into a new headquarter in 2007. There might be a potential to divest certain real estates as a consequence of the mentioned optimisation plan. The Group has engaged external advisors to assist with the analysis and process of the potential disposal. As a part of the process being carried out the advisors have introduced the selected properties available into the real estates market.

There were no other events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2006.

Financial Statements for the Year Ended 31 December 2006

General information

Telefónica O2 Czech Republic, a.s. (the Company) has a form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Olšanská 5/55, Prague 3, 130 34, Czech Republic. As of June 2005, the Company became a member of the Telefónica Group of companies (the Telefónica Group) with a parent company, Telefónica, S.A. (the Telefónica).

The Company's shares are traded on the Prague Stock Exchange and London Stock Exchange (GDRs).

The number of employees employed with the Company amounted in average to 9,816 in 2006 (2005: 10,506).

These financial statements were approved for issue by the Company's Board of Directors on 22 February 2007.

Transfer of assets and liabilities (Up-stream merger) and restructuring of the Company in 2006

On 27 April 2006, the General Shareholders Meeting approved a transfer of assets and liabilities of the former 100% subsidiary Eurotel Praha, spol. s r.o. (the former Eurotel) to ČESKÝ TELECOM, a.s. and approved an Agreement on transfer of assets and liabilities between ČESKÝ TELECOM, a.s. and former Eurotel. The General Shareholders Meeting further approved a change in the Articles of Association related to a transfer of the National Property Fund's stake in 2005.

In addition, the Company changed its registered name from ČESKÝ TELECOM, a.s. to Telefónica O2 Czech Republic, a.s. within the transfer of assets and liabilities process as a result of the Company's integration with the Telefónica Group.

As a result of the Decision of the General Shareholders Meeting of 27 April 2006, the following changes have been incorporated in the Company's Register with effective date 1 July 2006 and decisive date 1 January 2006:

- Dissolution of former Eurotel without liquidation and transfer of its assets and liabilities to its sole shareholder ČESKÝ TELECOM, a.s.
- Change of the registered name of ČESKÝ TELECOM, a.s. to Telefónica O2 Czech Republic, a.s.

Transfer of assets and liabilities (Up-stream merger) accounting

Pursuant to the Agreement on transfer of assets and liabilities in accordance with Section 153c in conjunction with Sections 220p and 220d of the Commercial Code signed on 3 May 2006, ČESKÝ TELECOM, a.s. acquired all the assets and liabilities of the former Eurotel with the decisive date of 1 January 2006.

In accordance with the requirements of the Commercial Code, an opening balance sheet was prepared as at 1 January 2006 and constituted an aggregation of balance sheet amounts and elimination of intercompany transactions between the two legacy legal entities: ČESKÝ TELECOM, a.s. and former Eurotel by using consistent accounting policies as presented in the separate financial statements of the Companies for the year ended 31 December 2005. The opening balance sheet was prepared solely in order to comply with the requirements of the Commercial Code as a result of the aforementioned transfer of assets and liabilities.

The carrying amounts of the former Eurotel's assets and liabilities (including goodwill) used in the preparation of the financial statements of ČESKÝ TELECOM, a.s. as at 31 December 2005 were used as the measurement basis in the opening balance sheet. Standard consolidation adjustments (being an elimination of respective intercompany balances, adjustments reflecting purchase accounting and certain accounting policy adjustments) were also performed when preparing the opening balance sheet.

Brand names acquired by ČESKÝ TELECOM, a.s. through business combination in 2003 by purchase of the remaining share in former Eurotel were originally determined as having an indefinite useful life after adoption of revised IAS 38 from 1 January 2005, because there was no foreseeable limit to the period over which the assets were expected to generate net cash flows. After the acquisition by Telefónica, S.A., the Company reassessed its intangible assets previously acquired through business combination and reviewed the relating useful lives. The Company decided, as a result of this assessment, to change the useful lives of brand names with indefinite useful lives from indefinite to finite. This change was accounted for as a change in an accounting estimate and the revised useful lives were determined to be 30 months. From 1 July 2005, the date of change in indefinite useful life the Company amortizes these brand names using the straight-line method. Upon the transfer of assets and liabilities in July 2006 and with respect to the re-branding process, the Company re-considered an estimate of useful life of former Eurotel related brand names and accelerated their amortization with final effect of a full write off as at 31 December 2006.

Assets and liabilities of other subsidiaries were not included in the opening balance sheet. These other subsidiaries are recognised in the opening balance sheet as Investment in subsidiaries.

Relationship with the Czech state, privatisation and acquisition process finalised in 2005

The Czech state, through the National Property Fund of the Czech Republic (the NPF), had been the majority shareholder of the Company until the take-over of Telefónica, S.A. and completion of the privatisation process in June 2005. As a majority shareholder, the NPF had the power to control certain decisions taken at the General Shareholders' Meetings, including the election of the members of the Supervisory Board and the approval of dividend payments.

The acquisition process was completed on 16 June 2005, once Telefónica, S.A. paid the remaining 90% of the purchase price, and the NPF transferred its 51.1% stake in the Company to Telefónica, S.A. Telefónica, S.A. then increased its stake in the Company from 51.1% to 69.4% of the common stock.

Telefónica, S.A. applied effectively its control at the General Shareholders Meeting, which took place on 23 June 2005. The Company was included in the Telefónica Group since finalisation of the take-over. Mutual transactions, representing generally supplies of telecommunication services take place amongst Telefónica companies. All these transactions are being made under common commercial terms and conditions that are not more preferable than those offered to other customers and suppliers.

The Company supplies telecommunication services to and acquires services from various state-owned entities, agencies and companies in which the Czech state holds the majority shareholding. All such transactions are made under normal commercial terms and conditions that are not more preferable than those available to other customers and suppliers. In aggregate, the state-owned entities, agencies and companies comprise one of the Company's largest customers. In providing services to these entities, agencies and companies, Telefónica O2 Czech Republic, a.s. conducts business with them as separate customers. Services provided to any individual governmental entity, agency or state-owned company do not represent a significant component of the Company's revenues.

Independent auditors' report to the shareholders of Telefónica O2 Czech Republic, a.s.

We have audited the accompanying financial statements of Telefónica O2 Czech Republic, a.s. (the Company), which comprise the balance sheet as at 31 December 2006 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 financial statements in order to design audit procedures that are appropriate for 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 financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Ernst & Young

Ernst & Young Audit & Advisory, s.r.o., člen koncernu
Licence No. 401
Represented by

Brian Welsh
Partner

Magdalena Souček
Auditor, Licence No. 1291

22 February 2007
Prague, Czech Republic

Income statement

	Notes	Year ended 31 December 2006	31 December 2005
Revenue	2	61,307	61,037
Gains from sale of non-current assets		98	116
Internal expenses capitalized in fixed assets	2	879	589
Operating expenses	3	(33,954)	(33,271)
Impairment loss	8,9,10	(253)	(1,261)
Depreciation and amortisation	8,9	(16,726)	(17,789)
Operating profit		**11,351**	**9,421**
Interest income	4	148	47
Interest expense	4	(431)	(748)
Other finance income (net)	4	26	47
Profit before income tax		**11,094**	**8,767**
Taxes on income	5	(2,772)	(2,665)
Profit for the year		**8,322**	**6,102**
Earnings per share (CZK) – basic*	6	26	19

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

Balance sheet

	Notes	31 December 2006		31 December 2005	
ASSETS					
Property, plant and equipment	8	78,686		87,973	
Intangible assets	9	21,508		22,846	
Available-for-sale investments	13	–		58	
Held-to-maturity investments	13	27		29	
Investment in subsidiaries and associate	28	77		78	
Other financial assets	12	376		412	
Non-current assets			**100,674**		**111,396**
Inventories	11	987		716	
Receivables and prepayments	12	8,579		8,579	
Available-for-sale investments	13	56		–	
Cash and cash equivalents	14	7,298		3,572	
Current assets			**16,920**		**12,867**
Non-current assets classified as held for sale	**8**		**203**		**360**
Total assets			**117,797**		**124,623**
EQUITY AND LIABILITIES					
Ordinary shares	24	32,209		32,209	
Share premium		30,816		30,816	
Retained earnings, funds and reserves		25,590		31,775	
Total equity			**88,615**		**94,800**
Long-term financial debts	16	9,156		9,324	
Deferred taxes	17	4,494		5,423	
Non-current provisions for liabilities and charges	19	2,037		2,111	
Non-current other liabilities	15	805		1,264	
Non-current liabilities			**16,492**		**18,122**
Short-term financial debts	16	207		307	
Trade and other payables	15	10,920		10,181	
Income tax liability		728		590	
Provisions for liabilities and charges	19	835		623	
Current liabilities			**12,690**		**11,701**
Total liabilities			**29,182**		**29,823**
Total equity and liabilities			**117,797**		**124,623**

These financial statements were approved by the Board of Directors on 22 February 2007 and were signed on its behalf by:

Jaime Smith Basterra
Chairman of the Board of Directors
and Chief Executive Officer

Ramon Ros Bigeriego
Member of the Board of Directors
and Chief Financial Officer

Statement of changes in shareholders' equity

	Notes	Share capital	Share premium	Hedging reserve	Foreign exchange translation reserve	Funds*	Retained earnings	Total
Balance at 1 January 2005		**32,209**	**30,816**	**(47)**	**13**	**5,627**	**20,056**	**88,674**
Fair value losses (net of tax) – cash flow hedges	26	–	–	36	–	–	–	36
Currency translation differences – amount arising in year		–	–	–	(13)	–	–	(13)
Changes in statutory reserves and other movements		–	–	–	–	405	(404)	1
Net income/(expense) recognised directly in equity		–	–	36	(13)	405	(404)	24
Net profit		–	–	–	–	–	6,102	6,102
Balance at 31 December 2005		**32,209**	**30,816**	**(11)**	**–**	**6,032**	**25,754**	**94,800**
Merger impact – funds		–	–	–	–	(121)	121	–
Balance at 1 January 2006 as restated		**32,209**	**30,816**	**(11)**	**–**	**5,911**	**25,875**	**94,800**
Fair value gains (net of tax) – cash flow hedges	26	–	–	(8)	–	–	–	(8)
Currency translation differences – amount arising in year		–	–	–	(2)	–	–	(2)
Changes in statutory reserves and other movements		–	–	1	(3)	358	(359)	(3)
Net income/ (expense) recognised directly in equity		–	–	(7)	(5)	358	(359)	(13)
Dividends declared in 2006	7	–	–	–	–	–	(14,494)	(14,494)
Net profit		–	–	–	–	–	8,322	8,322
Balance at 31 December 2006		**32,209**	**30,816**	**(18)**	**(5)**	**6,269**	**19,344**	**88,615**

* Refer Note 24 regarding amounts not available for distribution.

Cash flow statement

	Notes	Year ended 31 December 2006	31 December 2005
Cash flows from operating activities			
Cash generated from operations	26	28,176	27,734
Interest paid		(429)	(887)
Interest received		186	47
Income tax paid		(3,562)	(3,262)
Net cash from operating activities		**24,371**	**23,632**
Cash flows from investing activities			
Purchase of property, plant and equipment		(4,710)	(4,035)
Purchase of intangible assets		(1,323)	(1,156)
Proceeds from sales of property, plant and equipment		214	235
Proceeds from marketable securities		–	184
Cash purchase of financial investments		(40)	–
Grant of loan		(3,446)	–
Re-payment of loan		3,253	–
Net cash used in investing activities		**(6,052)**	**(4,772)**
Cash flows from financing activities			
Proceeds from borrowings		–	11,580
Repayment of borrowings		–	(27,393)
Dividends – paid		(14,494)	–
Net cash used in financing activities		**(14,494)**	**(15,813)**
Net increase/(decrease) in cash and cash equivalents		**3,825**	**3,047**
Cash and cash equivalents at beginning of year		3,471	425
Effects of exchange rate changes		2	(1)
Cash and cash equivalents at the year end	**14**	**7,298**	**3,471**

Accounting policies

A Basis of preparation

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

The 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 International Financial Reporting Interpretations Committee (IFRIC).

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll. requires the Company to prepare its financial statements in accordance with IFRS adopted by the EU (Regulation (EC) No 1606/2002). At this particular time, due to the endorsement process of the EU and the activities of the Company, there is no difference in the policies applied by the Company between IFRS and IFRS adopted by the EU.

The financial statements are the separate financial statements of the Company and meet requirements of IFRS with respect to the preparation of parent's separate financial statements. The Company also issued consolidated financial statements prepared for the same period in accordance with IFRS, which were approved for issue by the Board of Directors on 22 February 2007.

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

The preparation of financial statements in conformity with IFRS required the Company to use certain critical accounting estimates. It also required management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note T.

The amounts shown in these financial statements are presented in millions Czech Crowns (CZK), if not stated otherwise.

Adoption of IFRS standards and interpretations

In 2006, the Company applied the below stated IFRS, which are relevant to its operations:

IAS 1 (revised 2005)	Presentation of Financial Statements
IAS 2 (revised 2003)	Inventories
IAS 7 (revised 2005)	Cash flow statement
IAS 8 (revised 2003)	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003)	Events after Balance Sheet Date
IAS 11	Construction contracts
IAS 12	Income Taxes
IAS 14	Segment Reporting
IAS 16 (revised 2003)	Property, Plant and Equipment
IAS 17 (revised 2003)	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21 (revised 2005)	The effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24 (revised 2003)	Related Party Disclosures
IAS 27 (revised 2003)	Consolidated and Separate Financial Statements
IAS 28 (revised 2003)	Investments in Associates
IAS 32 (revised 2004)	Financial Instruments: Disclosure and Presentation
IAS 33 (revised 2003)	Earnings per Share
IAS 36 (revised 2004)	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38 (revised 2004)	Intangible Assets
IAS 39 (revised 2005)	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IFRS 2 (issued 2004)	Share-based Payments
IFRS 3 (issued 2004)	Business Combinations
IFRS 5 (issued 2004)	Non-current Assets Held for Sale and Discontinued Operations

IFRS 3 requires simultaneous adoption with IAS 36 and IAS 38.
IAS 39 requires simultaneous adoption with IAS 32.

IFRIC 1 (issued 2001)	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 4 (effective date 1 January 2006)	Determining whether an Arrangement contains a Lease

Out of the above mentioned standards and interpretations, in 2006 the Company newly adopted the following:

IAS 21 (revised 2005)

The Company adopted the amendments to IAS 21. As a result, all exchange differences arising from a monetary item that forms part of the Company's net investment in a foreign operation are recognised in a separate component of equity in the financial statements regardless of the currency in which the monetary item is denominated. This change had no impact on the financial statements of the Company.

IFRIC 4 (effective date 1 January 2006)

The adoption of this interpretation did not have any material effect relating to the Company's activities.

Standards and interpretations issued but not early adopted by the Company.

IFRS 7, IAS 30 and IAS 32 (issued in 2005, effective date 1 January 2007) Financial Instruments: Disclosures – the Company does not expect any material effect on the Balance Sheet and the Income Statement relating to the adoption of this standard from the effective date 1 January 2007. This adoption will affect certain disclosures in the notes to the financial statements.

Amendments to IAS 1 (issued 2005, effective date 1 January 2007) Presentation of financial statements, Capital disclosures – the Company does not expect any material effect on the Balance Sheet and the Income Statement relating to the adoption of this amendment from the effective date 1 January 2007. This adoption will affect certain disclosures in the notes to the financial statements.

IFRS 8 Operating Segments (effective date 1 January 2009) – the Company does not expect any material effect on the Balance Sheet and the Income Statement relating to the adoption of this standard from the effective date 1 January 2009. This adoption will affect certain disclosures in the notes to the consolidated financial statements.

IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective date 1 March 2006) – the interpretation does not apply to the Company's activities.

IFRIC 9 Reassessment of Embedded Derivatives (effective date 1 June 2006) – the Company does not expect any material effect relating to the adoption of this interpretation since the effective date 1 June 2006.

IFRIC 10 Interim Financial Reporting and Impairment (effective date 1 November 2006) – the Company does not expect any material effect relating to the adoption of this interpretation since the effective date 1 November 2006.

IFRIC 12 Service Concession Arrangements (effective date 1 January 2008) – the Company does not expect any material effect relating to the adoption of this interpretation from the effective date 1 January 2008.

IFRIC 8 Scope of IFRS 2 (effective date 1 May 2006)
IFRIC 11 IFRS 2 Group and Treasury Share Transactions (effective date 1 March 2007)
This adoption will affect certain disclosures in the notes to the financial statements.

The Company does not intend to early adopt any of those standards and interpretations before their effective date.

B Foreign currencies

(i) Functional and presentation currency
Items included in the financial statements of each entity included in the Company are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The financial statements are presented in Czech Crowns (CZK), which is the Company's functional and presentation currency.

(ii) Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Such balances of monetary items are translated at period-end exchange rates. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

C Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less impairment charges.

Property, plant and equipment include all costs directly attributable to bringing the asset to working condition for its intended use. With respect to the construction of the network, this comprises all expenditure up to the customers' premises, including the cost of contractors, materials, direct labour costs and interest cost incurred during the course of construction.

Repairs and maintenance are expensed as incurred.

Items of property, plant and equipment that are retired, are not intended for sale and are not expected to create any future economic benefits or are otherwise disposed of, are eliminated from the balance sheet, along with the corresponding accumulated depreciation. Any gain or loss arising from retirement or disposal is included in net operating income, i.e. net gain or loss is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is de-recognised or the date the asset is classified as held for sale.

Depreciation does not cease when the asset becomes temporarily idle or retired from active use unless the asset is fully depreciated.

Estimated useful lives adopted in these financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	5 to 25
Exchanges and related equipment	up to 10
Other fixed assets	2 to 10

Freehold land is not depreciated as it is deemed to have an indefinite life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater then its estimated recoverable amount (refer to Note F Impairment of assets).

D Intangible assets

Intangible assets include computer software, purchased goodwill, licenses, trade names, customer base and roaming contracts. Computer software mainly represents the external acquisition costs of the Company's information systems that are intended for use within the Company. Generally, costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Company and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally one to five years.

Acquired licenses are recorded at cost and amortised on a straight-line method basis over the remaining life of the license (i.e. over 15 to 20 years), from the start of commercial service, which best reflects the pattern by which the economic benefits of the intangible assets will be utilised by the Company.

Intangible assets with indefinite useful life are not amortised. They are subject to the regular impairment reviews (see Note 9 and Note 10).

The Company reviews at least at the balance sheet date the useful lives of intangible assets that are not amortised to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate.

On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

Intangible assets that are no longer in use and it is not expected any future economic benefits or that are disposed of for any other reason are de-recognised from the balance sheet together with corresponding accumulated depreciation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is de-recognised, the date the asset is classified as having the indefinite useful life or the date the asset is classified as held for sale.

E Non-current assets classified as held for sale

The Company classifies separately in the balance sheet a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups), its sale is highly probable and sale is expected within one year.

The Company measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Company recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as the impairment loss with impact in the income statement of the relevant period.

From the moment the asset is classified as held for sale and eventually revaluated, it ceases to be depreciated/amortised and impairment is only being determined.

Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in the income statement.

F Impairment of assets

Property, plant and equipment and other assets, including goodwill and intangible assets, are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, or at least on an annual basis for goodwill and for intangibles with an indefinite useful life and for intangibles not yet in use. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level, for which there are separately identifiable cash flows (cash-generating units).

G Investments and other financial assets

The Company classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets.

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2005 and 2006, the Company did not hold any financial assets in this category.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are measured at amortised cost using an effective interest rate method and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis, as required under IAS 39.

All purchases and sales of investments are recognised on the trade date, which is the date that the Company commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets at fair value through profit or loss and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective interest rate method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the income statement in the period in which they arise. On the contrary, unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in equity in the period in which they arise, except for impairment losses, until the financial asset is de-recognised, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Impairment of financial assets
The Company assesses at each balance sheet date whether financial assets or groups of financial assets are impaired.

(1) Assets carried at amortized costs
If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in the income statement.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial assets, whether significant or not, it is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement and only to the extent that the carrying amount of the financial asset does not exceed its amortised cost at the reversal date.

(2) Available-for-sale financial assets
If this asset is impaired, the cumulative loss that had been previously recognised (due to fair value revaluation) directly in equity shall be removed from equity and recognised in profit or loss even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from equity and recognised in profit or loss shall be the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in profit or loss.

Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the income statement.

De-recognition of financial assets
A financial asset is de-recognised when:

a) the rights to receive cash flow from the asset have expired,
b) the Company retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement, or
c) the Company has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

H Leases
Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating lea-

ses are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment that is required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Company bears substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of finance charges, are included in other long-term payables (depending on maturity). The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. If there is a reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

I Inventories

Inventory is stated at the lower of cost or net realisable value. Costs of inventories include the purchase price and related costs of acquisition (transport, customs duties and insurance). The cost of inventory is determined using weighted average cost. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

J Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the initial market rate of interest for similar borrowers. Cash flows relating to short-term receivables are usually not discounted. The amount of the allowance is recognized in the income statement.

K Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

L Financial debts

Borrowings are recognised initially at the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest rate method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings.

Borrowings are classified as current liabilities unless the Company has unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Interest costs on borrowings used to finance the acquisition and construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

M Current and deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Current income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Deferred income taxation is calculated using the liability method applied to all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates and laws expected to apply when the asset is realised or the liability is settled are used to determine the deferred income tax.

The principal temporary differences arise from differences in the tax and accounting values of property, plant and equipment, impairment of receivables and allowance for obsolete and slow moving inventories, non tax deductible allowances and unused tax credits.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Company accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in the income statement, any related tax effects are also recognised in the income statement. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity.

Deferred income tax assets and tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority. The same applies for offsetting of current tax assets and liabilities.

N Employee benefits

(1) Pension obligations

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates applicable during the period and are based on gross salary payments. The arrangements of the Government's health, retirement benefit and unemployment schemes correspond to the arrangements for defined contribution plans. The Company has no further payment obligations once the contributions have been paid. The expense for the contributions is charged to the income statement in the same period as the related salary expense. The Company also makes contributions to defined contribution schemes operated by external pension companies. These contributions are charged to the income statement in the period to which the contributions relate.

(2) Redundancy and termination benefits

Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Company recognises redundancy and termination benefits when it is demonstrably committed to terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after balance sheet date.

(3) Bonus plans

The Company recognises a liability for bonuses based on a formula that takes into consideration certain performance related measures, such as turnover or free cash flow, after certain adjustments. The Company recognises a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

O Share-based compensation

During 2006, the Company introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Certain compensation plans are settled in cash, while the others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price with the following accounting treatment:

Option plans that can be cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted.

In the cash-settled share option plan, the total cost of the rights to shares granted are expensed over the period during which terms the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Company revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through the income statement for the period, if appropriate. For 2006, the financial impact on the Company is, however, immaterial.

For the equity-settled share option plan, fair value at the grant date is measured using the binomial methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Company revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity. As the plan will be settled by a physical delivery of equity instruments of the parent, Telefónica, S.A., to the employees, the personnel expense accrued is recognised against equity. For 2006, the financial impact on the Company is, however, immaterial.

P Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Q Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Company, comprises goods sold and services provided. Revenues are measured at their fair value of the consideration received or receivable. The amount of revenue is recognised if it can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company. If necessary, revenue is split into separately identifiable components.

The Company offers customers free minutes for selected price based on chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Company is not obliged to reimburse the customer for unused minutes and the option of rolling over any unused minutes is valid for only one month.

The Company recognises revenue for free minutes in the period when the related services is provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

In assessing whether revenue should be recognised gross, i.e. with separate disclosure of costs to arrive at gross profit, or on a net basis, the Company considers these indicators of gross revenue reporting:
- the Company is the primary obligor in the arrangement,
- the Company has general inventory risk,
- the Company has price latitude,
- the Company changes the product or performs part of the service,
- the Company has discretion in supplier selection,
- the Company is involved in the determination of product or service specifications,
- the Company has credit risk,
- the Company has the ability to set the terms of the transaction,
- the Company has the managerial control over the transaction.

The relative strength of each indicator is considered when concluding which accounting treatment to use for principal/agency arrangement.

If a transaction is considered to meet conditions of an agency arrangement, the revenue is recognised only at the amount of the commission received/realised, e.g. premium rate lines.

Revenue from fixed price construction contracts (long-term contracts) is recognised on the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. An expected loss on the construction contract is recognised as an expense immediately, when it is probable that total contract costs will exceed total contract revenue.

The Company offers products, which may include deliverables such as a handset, activation and airtime. These are then defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

(1) Fixed line telephony revenues
Revenue is recognized as follows:

Domestic and international call revenues
Domestic and international call revenues are recognised in the income statement at the time the call is made.

Subscription revenues
Revenue from subscriptions is recognised in the income statement in the period in which the services are rendered.

Revenues from sales of prepaid cards
Prepaid call card sales are deferred until the customer uses the stored value on the card to pay for the relevant calls. The expiry date for prepaid cards is not longer than 36 months.

Connection fees
Connection fees, arising from the connection of the customers to the Company's network, are deferred and recognised in the income statement over the estimated average customer relationship period on the basis of degressive accounting method.

Equipment sales and other sale of goods
Revenue from the sale of telephone equipment and accessories and other sale of goods is recognised at the time of sale i.e. when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods.

Local loop unbundling
Revenue from access to the local loop unbundling is deferred in the income statement and recognised in the period in which the service is rendered. Regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the space (collocation) for an alternative operator is recognized upfront in the income statement when it occurs.

(2) Mobile telephony revenues
The Company earns mobile services revenue from customers usage of the Company's network, interconnection and roaming – collectively, "Mobile service revenue". The Company also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues
Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post--paid customers is accrued as their airtime and other services are used. Prepaid customers

recharge a credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognized as the airtime and other services are used. Upon termination of the customer contract or expiration of voucher (up to 24 months), all deferred revenue for unused airtime is recognized in income.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime and that are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

Equipment sales and mobile services
Monthly service revenues and revenues from handset sales are recognized as revenue when the product or service is delivered to the distributor or to the end customer. Resulting losses from sale of handsets at a discount are recognised at the date of sale.

Roaming revenues
Mobile segment derives roaming revenue as a result of airtime and other services used by the mobile segment's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled net on a regular basis.

Costs
Commissions and discounts directly related to the sale of equipment, SIM cards and activations are netted against revenue in the period the product is sold to the dealer, distributor or the end customer. Other commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

(3) Interconnect revenues
Interconnect revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but use the Company's network. These revenues are recognised in the income statement at the time when the call is received in the Company's network. The Company pays a proportion of the call revenue it collects from its customers to other domestic and foreign operators' for calls and other traffic that originate in the Company's network but use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet and data services
The Company earns revenue from providing Internet services. Revenue from such services is recognised at the time the service is provided.

(5) Dividend income
Dividend income is recognized when the right to receive payment is established.

(6) Interest
Revenue is recognised as interest accrues (using the effective interest method).

R Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

S Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives.

Financial risk management

The Company's activities expose it to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Company. The Company uses derivative financial instruments such as forward foreign exchange contracts, currency swaps, interest rate swaps, forward rate agreements and currency options to hedge certain exposures.

The Company does not conduct any speculative trading activities.

Risk management is carried out by the treasury department under approved policies. The Board provides written principles for overall risk management. In line with these principles, policies exist for specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign exchange risk
The Company is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the Euro and US Dollar. The treasury department is responsible for hedging the net position in each currency by using currency borrowings, external forward foreign exchange contracts, currency swaps and currency options.

The Company primarily hedges the foreign currency exposure of its contract commitments to purchase network technology and other operating expenses from European Union countries.

The forward contracts used in its program mature in 6 months or less, consistent with the related purchase commitments.

Additionally, the Company hedges the foreign currency exposure of its borrowings in foreign currencies. The Company's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes. The exchange rate derivatives (including forward foreign exchange contracts, currency swaps and currency options) are designed to match anticipated foreign currency transactions (interest rate payments or principal payments).

(ii) Interest rate risk
The Company's income and operating cash flows are substantially independent of changes in market interest rates. The Company sometimes borrows at variable rates and uses interest rate swaps and forward rate agreements as cash flow hedges of future interest payments, which have the economic effect of converting borrowings from floating rates to fixed rates. The interest rate swaps and forward rate agreements allow the Company to raise long-term borrowings at floating rates and swap them into fixed rates. Under the interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts.

(iii) Credit risk
Concentrations of credit risk, with respect to trade accounts receivable, are limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Company does not currently foresee higher credit risk associated with these receivables, repayment is significantly impacted by the financial stability of the national economy.

Derivative counterparties and cash transactions are limited to high credit quality financial institutions. The Company has policies that limit the amount of credit exposure to any one financial institution.

(iv) Liquidity risk
Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of money market (committed and uncommitted) credit facilities and the ability to close out market positions. The treasury department aims to maintain flexibility in funding by keeping money market credit lines available.

Accounting for derivative financial instruments and hedging activities
Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are re-measured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Company designates certain derivatives as either
(1) a hedge of the fair value of a recognised asset or liability (fair value hedge), or
(2) a hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective are recorded in the income statement, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective are recognised in equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity are transferred to the income statement and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects the income statement.

Certain derivative transactions, while providing effective economic hedges under the Company's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Company has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the fair value of such derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting under IAS 39, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the committed or forecasted transaction ultimately is recognised in the income statement. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

The Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The Company also documents its assessment, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 20. Movements on the hedging reserve in shareholder's equity are shown in Note 25.

Fair value estimation

Except for currency options, the fair values of the derivative financial instruments reflect estimates based on calculations performed using the Company's own discounted cash flow models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Company's bankers.

T Critical accounting estimates and judgments

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The estimates and assumptions that might have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next year are discussed below:

(1) Income taxes and deferred taxes

The Company created a provision for current income taxes and in consideration of the temporary differences also for deferred tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business and the measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of assets and liabilities. Where the final tax-deductible expenses are different from the amounts that were calculated, such differences will impact the current income and deferred tax provisions in the period in which such determination is made. The total amount of provision for current income taxes is CZK 3,687 million, advances paid for income taxes amount to CZK 2,959 million and the net deferred tax liability is CZK 4,494 million.

(2) Goodwill

The Company tests at each reporting date goodwill for an impairment. However goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. From 1 January 2005 the Company implemented IFRS 3 and accordingly ceased to amortize the goodwill. In accordance with the requirement of IAS 36, goodwill is tested annually for its recoverable amount, as well as when there are indications of impairment. The carrying amount of goodwill is CZK 13,320 million.

(3) Provisions and contingent liabilities

As set out in Note 21 the Company is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Company's treatment of obligations with uncertain timing and amount depends on the management's estimation of the amount and timing of the obligation and probability of an outflow of resources embodying economic benefits that will be required to settle the obligation (both legal or constructive). A provision is recognised when the Company has a present obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Contingent liabilities are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. Contingent liabilities are assessed continually to determine whether an outflow of resource embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

(4) Interconnect

The Company provides and enters into the contracts for interconnect services and the revenue is recognised on the basis of the reasonable estimation of expected amount. Such estimation is regularly reviewed, however the final agreement and invoicing can be with some operators stated on up to a yearly basis.

(5) Impairment of the fixed line business assets

The Company makes an assessment at each balance sheet date whether there is any indication that an impairment loss recognised for the fixed line business assets in prior years may no longer exist, may have decreased or may have increased. If any such indication exists, the Company estimates a recoverable amount of the assets and compares to the carrying value (net of the impairment allowance). In assessing whether there is any indication that the impairment loss recognised in the past may not longer exist, may have decreased or may have increased, the Company considers both external and internal indicators (declination of asset's market value, changes expected in the market, including technological changes etc.). Where an estimate of recoverable amount is performed, this involves the use for a number of management assumptions about future business performance, which may, ultimately, differ from reality.

Based on the assessment performed by the Company, no increase or decrease of the previously recognised impairment of fixed line business assets was recognised in 2006.

U Investments in subsidiary and associated undertakings

A subsidiary is an enterprise that is controlled by the Company, which means that the Company has the power to govern the financial and operating policies so as to obtain benefits from its activities.

An associated undertaking is an enterprise where the Company has significant influence, which is the power to participate in the financial and operating policy decisions, but not exercise control.

Equity investments in subsidiaries and associates are recorded at cost less a allowance for diminution in value.

No consolidation of subsidiaries or associates has been performed as these financial statements are presented on a stand-alone basis. In accordance with the requirements of the Act on Accounting, the Company prepares consolidated financial statements in accordance with IFRS.

V Change in accounting policy

Connection fees and related costs – 2005 change

During 2005, the Company changed its accounting policy for revenue recognition of the connection fees relating to the activation of the fixed line for all periods starting from 1 January 1996. Retrospective application of the new accounting policy for the periods before 1996 was impracticable because appropriately detailed information for these periods is not available. In previous periods, the Company had recognised such revenue in full in the income statement upon connection of the customers to the network. Since 2005, the Company has decided to defer these revenues over the estimated average customer relationship period and the management also judges that the new policy is preferable, gives more relevant information about the effects on transactions and will be consistent with the telecommunication industry practice. Such policy is also in accordance with the Telefónica Group policy.

Connection fees are deferred and recognised in the income statement over the estimated average customer relationship period on the basis of the degressive accounting method. For the periods starting 2006, the Company estimates the customer relationship period being 12 years (13 years as at 1 January 2005).

Together with the above-mentioned retrospective change in accounting policy for connection fees the Company identified associated connection costs that met the definition of subsequent costs increasing the carrying value of property, plant and equipment but were originally expensed by the Company. In 2005 the Company decided to retrospectively capitalise these costs as property, plant and equipment. The retrospective capitalization resulted in the increase in carrying amount of fixed assets and associated depreciation with the effect on opening 2004 and subsequent balances.

No substantial changes in accounting policies have been applied in 2006.

Under IFRS, the transfer of assets and liabilities transaction between the Company and the former Eurotel was considered to fall under the category of a common control transaction. The merger has been accounted for by using the pooling of interest method. As such the 2005 comparative information has been restated to reflect the position had the merger taken effect from 1 January 2005.

W 2005 Comparative figures

The transfer of assets and liabilities was reflected accordingly in the opening balances as at 1 January 2006 (an opening balance sheet was prepared as at 1 January 2006 that constituted an aggregation of balance sheet amounts after elimination of intercompany transactions between the Company and former Eurotel). Certain balances in the opening balance sheet prepared as at 1 January 2006 required additional adjustments, because the transfer of assets and liabilities changed the tax position of former Eurotel.

These adjustments resulted in an increase of the current income tax liability by CZK 465 million, decrease of deferred tax liability by CZK 297 million and decrease of equity by CZK 168 million.

In order to ensure figure comparativeness with previous period, the comparative information for 2005 has been restated and conform with the information from the opening balance sheet prepared as at 1 January 2006.

X Integration process

The integration process continues internally and as well externally through the implementation of ongoing integration projects. These include mainly sales channels and customer care integration, regional network operations integration, alignment of controlling, budget and reporting processes and cultural alignment.

At the same time the Company takes advantage of the global experience and close interaction with Telefónica, S.A., Telefónica O2 Europe plc and other Telefónica Group operating companies. The main activities continue to focus on the introduction and marketing of new services and products in both fixed and mobile segments, new convergent products, further operational efficiencies facilitated by a new organizational structure and synergies leading to revenue growth and OpEx and CapEx savings. The Company will monitor the development of the business in order to find out whether the currently used segments (fixed lines and mobile segment) are still relevant.

(1) Gamma building
In 2006, the Company entered into an agreement to lease the Gamma Building to become the Company's headquarter from 2Q 2007. Moving the Company's headquarters will allow for the full physical integration of employees in one area during the ongoing integration process.

(2) Re-branding
The Company presents its services under the O_2 brand. This replaced two original brands, ČESKÝ TELECOM and Eurotel, on 1 September 2006. The company uses the O_2 brand for all products in the fixed as well as the mobile networks.

The change of the corporate identity to O_2 involved several areas, from re-branding of thousands of payphones, vehicles, the exteriors and interiors of buildings, and employee uniforms and identification cards to, for instance, logos on the displays of mobile telephones.

The new O_2 brand is being presented to the public by means of a classic marketing mix, including print and internet advertisements, billboards, and television spots including also non-traditional forms of communication, e.g. offering a download of a song from Leftfield that the Company is using in its TV campaign introducing the O_2 brand. In order to further improve customer care, an effort to simplify and clarify customers' communication with the firm is being made. Unified O_2 shops, one telephone contact to the firm, one internet address were introduced to achieve this.

Together with the brand, the Company also launched new services. As a first new product, television through fixed lines O_2 TV with its rich functionalities was introduced. Next offer, brand new mobile tariff programs, proved the Company's plan to be as transparent as possible. The Company's intention to provide convergent products started with combining services in the fixed and mobile networks in a way that allows for savings.

Y Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, interest expense, other financial expense (which include primarily bank charges), fair value losses and gains on financial instruments and realized and unrealized exchange rate differences.

Notes to the financial statements

1 Segment information

The Company comprises two main business segments, as follows:

Fixed

Network communications services using a fixed network provided by former ČESKÝ TELECOM, a.s.

Mobile

Mobile communications services provided by former Eurotel.

Revenue of the Company is predominantly derived from domestic trading activities and as a result, segment reporting is only shown on the basis of business segments. With respect to the transfer of assets and liabilities (as detailed in General Information paragraph) and the deep integration process, the Company will analyse criteria for segment identification, which might lead to a change in the reported segments in the future years.

Year ended 31 December 2006	Fixed	Mobile	Company
Revenues	30,891	31,733	62,624
Inter-segment sales	(521)	(796)	(1,317)
Total revenues	**30,370**	**30,937**	**61,307**
Gains from sale of non-current assets	96	2	98
Work performed by the Company and capitalized	694	185	879
Costs	(17,988)	(17,283)	(35,271)
Inter-segment purchases	796	521	1,317
Total costs	**(17,192)**	**(16,762)**	**(33,954)**
Impairment charge	(253)	–	(253)
Depreciation	(9,793)	(4,225)	(14,018)
Amortisation	(990)	(1,718)	(2,708)
Total depreciation and amortization	**(10,783)**	**(5,943)**	**(16,726)**
Operating profit	**2,932**	**8,419**	**11,351**
Interest and other financial income (net)			(257)
Profit before tax			**11,094**
Tax			(2,772)
Net profit			**8,322**
Assets (excluding Goodwill and non-current assets held for sale)	65,412	38,862	104,274
Goodwill on purchase of additional ownership interest in former Eurotel	–	13,320	13,320
Non-current assets held for sale	203	–	203
Total assets	**65,615**	**52,182**	**117,797**
Trade and other payables	(5,569)	(5,351)	(10,920)
Other liabilities	(15,714)	(2,548)	(18,262)
Total liabilities	**(21,283)**	**(7,899)**	**(29,182)**
Capital expenditure	3,149	3,170	6,319

Year ended 31 December 2005	Fixed	Mobile	Company
Revenues	32,275	30,029	62,304
Inter-segment sales	(415)	(852)	(1,267)
Total revenues	**31,860**	**29,177**	**61,037**
Gains from sale of non-current assets	116	–	116
Work performed by the Company and capitalized	361	228	589
Costs	(17,896)	(16,642)	(34,538)
Inter-segment purchases	852	415	1,267
Total costs	**(17,044)**	**(16,227)**	**(33,271)**
Impairment charge	(465)	(796)	(1,261)
Depreciation	(10,686)	(4,325)	(15,011)
Amortisation	(1,837)	(941)	(2,778)
Total depreciation and amortization	**(12,523)**	**(5,266)**	**(17,789)**
Operating profit	**2,305**	**7,116**	**9,421**
Interest and other financial income (net)			(654)
Profit before tax			**8,767**
Tax			(2,665)
Net profit			**6,102**

Assets (excluding Goodwill and non-current assets held for sale)	78,635	32,308	110,943
Goodwill on purchase of additional ownership interest in former Eurotel	–	13,320	13,320
Non-current assets held for sale	360	–	360
Total assets	**78,995**	**45,628**	**124,623**
Trade and other payables	(4,918)	(5,263)	(10,181)
Other liabilities	(16,868)	(2,774)	(19,642)
Total liabilities	**(21,786)**	**(8,037)**	**(29,823)**

Capital expenditure	2,249	3,814	6,063

Inter-segment pricing between the mobile and the fixed segment is based on rates agreed upon between former ČESKÝ TELECOM, a.s. and former Eurotel, or based on a decision of the Czech Telecommunication Office (Český telekomunikační úřad). The rates applied in 2006 and 2005 were determined on the same basis as rates applicable for other mobile operators and are consistent with rates applied for pricing with other mobile operators. With respect to the transfer of assets and liabilities, the 2001 price amendment to an agreement governing interconnect arrangements with former Eurotel became irrelevant in 2006. After the transfer of assets and liabilities as of 1 July 2006, all inter-company transactions between fixed (former ČESKÝ TELECOM, a.s.) and mobile (former Eurotel) segments became intra-company (inter-segments).

Capital expenditures comprise additions to property, plant and equipment and intangible assets.

2 Revenue and Internal expenses capitalized in fixed assets

	Year ended	
Revenue	31 December 2006	31 December 2005
Voice	23,463	23,839
Interconnection	9,444	9,154
Subscription charges	9,841	10,542
Connection charges	669	702
SMS & MMS & Value Added Services	4,813	4,537
Leased lines	2,330	2,615
Data services	1,839	1,732
Internet	5,051	4,422
IT and business solutions	740	346
Equipment and Activation Fee	2,163	2,352
Other Telco Revenues	511	479
Other revenues	443	317
Total revenues	**61,307**	**61,037**

Revenues from related parties are disclosed in Note 27.

The aggregate future minimum lease payments under non-cancellable operating leases relating to the buildings and other telecommunication equipment are as follows:

	31 December 2006
No later than 1 year	229
Later than 1 year and not later than 5 years	835
Later than 5 years	203
Total	**1,267**

	Year ended	
Internal expenses capitalized in fixed assets	31 December 2006	31 December 2005
Material	593	338
Labour	286	251
Total	**879**	**589**

3 Operating expenses

The following items have been included to arrive at operating profit:

	Year ended 31 December 2006	Year ended 31 December 2005
Wages and salaries*	4,861	5,403
Redundancy payments	247	270
Social security contributions (Note 18)	1,632	1,822
Staff welfare costs	283	301
Total staff costs	**7,023**	**7,796**
Interconnection and roaming	10,010	9,701
Cost of goods sold	3,057	3,506
Other cost of sales	1,255	941
Other purchases	1,195	942
Marketing and sales	3,114	2,610
Call centers	93	–
Network & IT repairs and maintenance	2,620	2,408
Rentals, buildings and vehicles	1,646	1,598
Utilities supplies	746	604
Consultancy and professional fees	347	434
Other external services	1,675	1,748
Impairment charge for bad and doubtful debts and inventories	714	414
Taxes (other than income tax)	398	507
Other operating expenses	61	62
Total operating expenses	**33,954**	**33,271**

*Certain Company employees (including the Board of Directors) with specialised know how, or who have access to business secrets, or who are considered important to the development of the business, are bound by non-competition restrictions, for a maximum period of 12 months from the date of termination of their employment with the Company. The Company paid CZK 6 million in relation to such non-competition clauses in 2006 (2005: CZK 40 million).

Purchases from related parties are disclosed in Note 27.

4 Interest and other finance income (net)

	Year ended 31 December 2006	Year ended 31 December 2005
Interest expense		
Interest incurred on loans and bonds	431	748
Interest income	(148)	(47)
Interest expense (net)	**283**	**701**
Other finance charges/(gains)	(4)	189
Fair value losses/(gains) on financial instruments:		
Derivative financial instruments	29	(119)
Net foreign exchange transaction gains	(51)	(117)
Other finance income (net)	**(26)**	**(47)**
Net finance costs	**257**	**654**

5 Tax

	Year ended 31 December 2006	Year ended 31 December 2005
Total income tax expense is made up of:		
Current income tax charge	3,700	3,280
Deferred income tax credit (Note 17)	(928)	(615)
Taxes on income	**2,772**	**2,665**

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Company as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Profit before tax	11,094	8,767
Income tax charge calculated at the statutory rate of 24% (2005: 26%)	2,663	2,279
Income not subjected to tax	1	(65)
Expenses not deductible for tax purposes	223	571
Other	(115)	(112)
Investments allowances	–	(8)
Taxes on income	**2,772**	**2,665**
Effective tax rate	25%	30%

6 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	Year ended	
	31 December 2006	31 December 2005
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders	8,322	6,102
Basic earnings per share (CZK)	26	19

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

7 Dividends

	2006	2005
Dividends (including withholding tax)	14,494	–

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2006. Approval of the 2006 profit and the decision regarding the amount of any dividend payment for the 2006 financial year will take place at the Annual General Shareholders Meeting scheduled for 26 April 2007.

8 Property, plant and equipment

	Land and buildings	Ducts, cables and related plant	Communicationexchanges and related equipment	Other fixed assets	Capital work in progress	Total
Year ended 31 December 2006						
Opening net book amount	14,494	47,141	22,355	1,971	2,012	87,973
Additions	615	464	2,978	841	4,882	9,780
Disposals and other movements	(4)	(4)	16	9	(4,874)	(4,857)
Assets classified as held for sale	54	–	–	1	–	55
Depreciation charge	(739)	(4,201)	(8,061)	(1,017)	–	(14,018)
Impairment charge	(201)	(5)	(5)	(2)	(34)	(247)
Closing net book amount	**14,219**	**43,395**	**17,283**	**1,803**	**1,986**	**78,686**
At 31 December 2006						
Cost	22,486	99,329	92,253	10,692	2,035	226,795
Accumulated depreciation and impairment allowance	(8,267)	(55,934)	(74,970)	(8,889)	(49)	(148,109)
Net book amount	**14,219**	**43,395**	**17,283**	**1,803**	**1,986**	**78,686**

	Land and buildings	Ducts, cables and related plant	Communicationexchanges and related equipment	Other fixed assets	Capital work in progress	Total
Year ended 31 December 2005						
Opening net book amount	15,665	50,745	28,610	2,691	1,594	99,305
Additions	361	633	2,761	570	4,736	9,061
Disposals and other movements	(117)	2	(129)	(15)	(4,301)	(4,560)
Assets classified as held for sale	(358)	–	(1)	(1)	–	(360)
Depreciation charge	(750)	(4,203)	(8,785)	(1,273)	–	(15,011)
Impairment charge	(307)	(36)	(101)	(1)	(17)	(462)
Closing net book amount	**14,494**	**47,141**	**22,355**	**1,971**	**2,012**	**87,973**
At 31 December 2005						
Cost	22,204	99,201	90,879	10,652	2,022	224,958
Accumulated depreciation and impairment allowance	(7,710)	(52,060)	(68,524)	(8,681)	(10)	(136,985)
Net book amount	**14,494**	**47,141**	**22,355**	**1,971**	**2,012**	**87,973**

As at 31 December 2006, the carrying value of non-depreciated assets amounted to CZK 460 million.

Land and buildings, plant and equipment with a carrying value of CZK 21 million (2005: CZK 1,220 million) were pledged as collateral for CZK 5,300 million of provided borrowings. The borrowings were fully paid off in 2005, but the cancellation of the pledge is still in process (see Note 16).

No borrowing costs were capitalized during the years 2006 and 2005.

The Company reports and classifies the following assets held for sale at the balance sheet date:

	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
Year ended 31 December 2006				
Opening net book amount	358	1	1	360
Disposals and other movements	(96)	–	–	(96)
Impairment charge	(6)	–	–	(6)
Assets re-classified as held for sale	(54)	–	(1)	(55)
Closing net book amount	**202**	**1**	**–**	**203**
At 31 December 2006				
Cost	904	190	7	1,101
Accumulated depreciation and impairment allowance	(702)	(189)	(7)	(898)
Net book amount	**202**	**1**	**–**	**203**

	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
Year ended 31 December 2005				
Opening net book amount	–	–	–	–
Assets re-classified as held for sale	358	1	1	360
Closing net book amount	**358**	**1**	**1**	**360**
At 31 December 2005				
Cost	769	5	7	781
Accumulated depreciation and impairment allowance	(411)	(4)	(6)	(421)
Net book amount	**358**	**1**	**1**	**360**

Assets intended for sale in most cases represent administration buildings with land, that became vacant due to the optimization of the Company's processes and which the Company will not use in the future and it is expected their sale will take place within one year.

The non-current assets classified as held for sale are presented in the fixed segment.

As at 31 December 2006, the total recognised loss from the impairment/decrease in value of assets classified as held for sale was CZK 41 million. With regard to assets for which a loss from decrease in value was recognised, no cancellation/reverse of the previously recognised impairment occurred.

Cost of fully depreciated property, plant and equipment was CZK 47,049 million as at 31 December 2006.

In 2006, the Company achieved a total gain from the sale of the Group assets amounting to CZK 98 million and total losses in amount CZK 61 million. The total net sales were CZK 205 million and the carrying amount was CZK 168 million.

The impairment charge recorded in 2006 represents mainly correction of value of special constructions, which were idle.

9 Intangible assets

	Goodwill	Licences	Software	Other	Total
Year ended 31 December 2006					
Opening net book amount	13,320	5,494	3,405	627	22,846
Additions	–	–	1,384	–	1,384
Disposals and other movements	–	–	(14)	–	(14)
Amortisation charge	–	(404)	(1,677)	(627)	(2,708)
Impairment charge	–	–	–	–	–
Closing net book amount	**13,320**	**5,090**	**3,098**	**–**	**21,508**
At 31 December 2006					
Cost	13,320	6,073	21,931	2,829	44,153
Accumulated amortisation and impairment allowance	–	(983)	(18,833)	(2,829)	(22,645)
Net book amount	**13,320**	**5,090**	**3,098**	**–**	**21,508**
Year ended 31 December 2005					
Opening net book amount	13,320	5,668	4,318	1,702	25,008
Additions	–	–	1,416	–	1,416
Disposals and other movements	–	–	(1)	–	(1)
Amortisation charge	–	(174)	(2,315)	(289)	(2,778)
Impairment charge	–	–	(13)	(786)	(799)
Closing net book amount	**13,320**	**5,494**	**3,405**	**627**	**22,846**
At 31 December 2005					
Cost	13,320	6,073	21,225	2,829	43,447
Accumulated amortisation and impairment allowance	–	(579)	(17,820)	(2,202)	(20,601)
Net book amount	**13,320**	**5,494**	**3,405**	**627**	**22,846**

Details regarding the impairment loss that was recorded in 2005 are described in Note 10.

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, former Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of ten years. Carrying value of GSM 900 license is as at 31 December 2006 CZK 695 million (2005: CZK 770 million) and carrying value of GSM 1800 license is CZK 559 million (2005: CZK 620 million). In 2002, former Eurotel renewed its 450 MHz license; the current license enables the mobile segment to offer any internationally recognized public mobile telecommunication services on frequency of 450 MHz. Mobile segment currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The license is currently valid for the remaining period of five years. Carrying value of NMT 450 license is CZK 65 million (2005: CZK 81 million). In December 2001, former Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, former Eurotel was provided with deferred payment terms by the Czech Telecommunication Office (CTU) to finance the license acquisition. In December 2003, former Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, former Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement. Carrying value of UMTS license is CZK 3,771 million (2005: CZK 4,023 million). UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

No borrowing costs were capitalized during the years 2006 and 2005.

Cost of fully amortised intangible assets was CZK 13,569 million as at 31 December 2006.

The caption Other includes brand names acquired through business combination in 2003 by the purchase of the remaining share in former Eurotel. These intangible assets were originally determined as having an indefinite useful life after adoption of revised IAS 38 from 1 January 2005, because there was no foreseeable limit to the period over which the asset was expected to generate net cash flows. After the acquisition by Telefónica, S.A. the Company reassessed its intangible assets previously acquired through business combination and reviewed the relating useful lives. The Company decided, as a result of this assessment, to change the useful lives of brand names with indefinite useful lives from indefinite to finite. This change was accounted for as a change in an accounting estimate and the revised useful lives were determined to be 30 months. From 1 July 2005, the date of change in indefinite useful life, the Company amortizes these brand names using the straight-line method. Upon the transfer of assets and liabilities and with respect to the re-branding process, the Company re-considered an estimate of useful life of former Eurotel related brand names and accelerated their amortization with final effect of their full amortization as at 31 December 2006.

All of the Company's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and revision of useful life.

10 Impairment of fixed assets

Intangible assets

Brand names acquired through business combination in 2003 with former Eurotel. During the process of allocation of the cost of a business combination arising from the acquisition by Telefónica, S.A., the Company tested the recoverable amounts of previously acquired brand names. Considering that result the Company recognised immediately an impairment loss in the income statement in the amount of CZK 786 million in 2005 (see Note 9).

As at 30 June 2005 the carrying amount of brand names before the impairment charge was CZK 1,567 million (CZK 1,567 million as at 31 December 2004). Upon the transfer of assets and liabilities and with respect to the re-branding process, the Company re-considered an estimate of useful life of former Eurotel related brand names and accelerated their amortization with final effect of their full amortization as at 31 December 2006.

Fixed assets of the fixed line segment

During 2003, external factors relating to the telecommunication market and regulatory environment namely uncertainty regarding tariff rebalancing, termination charges for internet dial-up interconnection charges and other regulatory decisions in the Czech Republic led the management to assess the recoverable amount of the fixed line segment assets. The fixed line segment assets constitute one cash-generating unit (the CGU).

As at 31 December 2006, the management of the Company reviewed the indicators which would indicate that the impairment allowance of fixed line business assets made in 2003 is no longer relevant and should be reversed. Upon the review, a recoverable amount of the fixed line business assets (impairment test model) was estimated. Based on this assessment performed, the management believes that the value of the existing fixed network assets is fairly stated and does not differ substantially from the assets' recoverable amount as at 31 December 2006.

11 Inventories

	31 December 2006	31 December 2005
Construction material	81	35
Cables	28	159
Other inventory including goods for resale	642	522
Finished products and work in progress	236	–
	987	**716**

The inventories noted above are stated net of an allowance of CZK 179 million (2005: CZK 187 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories carried at net realisable value amounts to CZK 9 million (2005: CZK 47 million). The amount of inventories recognised as an expense is CZK 4,197 million (2005: CZK 4,631 million).

12 Receivables and prepayments

	31 December 2006	31 December 2005
Domestic trade receivables (net)	6,149	6,804
Foreign currency trade receivables (net)	710	620
Other debtors (net)	873	437
Prepayments	671	701
Other financial assets – short-term	176	17
	8,579	**8,579**

Trade receivables are stated net of an allowance for impaired receivables of CZK 3,605 million (2005: CZK 3,218 million). In order to preserve the tax-deductible status of the bad debt expense, the Company's trade receivables are not written off and removed from the primary books and records until certain statutory collection requirements have been satisfied.

Receivables from related parties are disclosed in Note 27.

The Company's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Company's trade receivables.

As at 31 December 2006 and 2005 the Company has the following non-current balances, which are classified as other financial assets:

	31 December 2006	31 December 2005
Long-term credits	156	185
Advance payments for long-term expenses	220	227
Total	**376**	**412**

Long-term trade credits include interest bearing credit (interest 5.9%) amounting to CZK 78 million (2005: CZK 83 million).

13 Available-for-sale and held-to-maturity investments

Available-for-sale investments	2006	2005
At beginning of year	58	176
Revaluation deficit	(2)	(1)
Additions	3	4
Disposals	(3)	(121)
At end of year	**56**	**58**
Non-current	–	58
Current	56	–
Total	**56**	**58**

Held-to-maturity investments	2006	2005
At beginning of year	29	109
Exchange differences	(1)	(2)
Revaluation deficit	–	–
Additions	1	1
Matured	(2)	(79)
At end of year	**27**	**29**
Non-current	27	29
Current	–	–
Total	**27**	**29**

Available-for-sale investments, principally comprising marketable securities, are fair valued monthly and at the balance sheet date. For investments traded in active markets, the fair value is determined by reference to quoted bid prices. For other investments, the fair value is estimated by reference to the current market value of similar instruments or by reference to the discounted cash flows of the underlying net assets.

Held to maturity investments category comprise a debt instrument – a bond held in EUR with maturity date July 2008, which is carried at amortised cost.

14 Cash and cash equivalents

	31 December 2006	31 December 2005
Cash balances	178	270
Intra-group cash pooling	3,605	–
Short-term bank deposits and cash equivalents	3,515	3,302
Cash and cash equivalents	**7,298**	**3,572**

As at 31 December 2006 and 2005, the Company's cash equivalents partially consisted of short-term bank promissory notes that were economically equivalent to bank term deposits and interest bearing deposits maturing in three months or less.

During 2006 (since April 2006) the Company entered into mutual Telefónica Group cash--pooling, which enables the Telefónica Group good financial governance and effective operating free cash flow. The short-term deposits are based on the arm's length principle and classified as a cash equivalent.

For the purposes of the cash flow statement, the year-end cash and cash equivalents comprise the following components:

	31 December 2006	31 December 2005
Cash and cash equivalents	7,298	3,572
Bank overdrafts and other short-term borrowings (Note 16)	–	(101)
Balance at the end of period	**7,298**	**3,471**

15 Trade and other payables

	31 December 2006	31 December 2005
Trade creditors in local currency (net)	4,535	4,535
Trade creditors in foreign currencies (net)	638	766
Other taxes and social security	192	202
Deferred revenue	2,026	1,585
Employee wages and benefits	554	394
VAT payable	442	307
Other creditors	70	60
Accruals	2,463	2,332
	10,920	**10,181**
Other non-current liabilities	**805**	**1,264**

Payables to related parties are disclosed in Note 27.

Other non-current liabilities include primarily deferred revenues from connection fees, which are expected to be taken to income in more than 12 months from the balance sheet date.

16 Financial debts

	31 December 2006	31 December 2005
Bank loans and overdrafts in local currency (a)	–	101
International financial institution loans in foreign currencies (b)	–	–
Bank loans and overdrafts in foreign currencies (a)	3,163	3,337
Bonds in local currency (c)	5,993	5,987
Total borrowings	**9,156**	**9,425**
Accrued interest	189	193
Derivatives	18	13
Other financial debt	**207**	**206**
Total financial debt	**9,363**	**9,631**
Repayable:		
Within one year	**207**	**307**
Between one and two years	5,993	–
Between two and five years	–	5,987
After five years	3,163	3,337
Total non-current	**9,156**	**9,324**
Total financial debt	**9,363**	**9,631**

(a) Bank loans and overdrafts include overdrafts of CZK 0 million denominated in the local currency (2005: CZK 101 million) and CZK 0 million in foreign currencies (2005: CZK 0 million).

Short-term borrowings as at 31 December 2005 consisted of loans drawn under bilateral short-term facilities.

In November 2003, the Company raised a syndicated credit facility in the total amount of EUR 850 million equivalent, with a final maturity day on 21 November 2008. The purpose of the loan was to finance the acquisition of the remaining 49% ownership interest in former Eurotel and general corporate purposes of the Company. The loan was fully paid off during 2005. Therefore, as at 31 December 2006 the outstanding amount of the loans under the credit facility was EUR 0 million (2005: EUR 0 million) and CZK 0 million (2005: CZK 0 million). The terms and conditions of the credit facility agreement, inter alia, require the Company to maintain certain gearing and interest cover ratios of earnings before interest, tax, depreciation and amortisation to net borrowings and interest payable.

In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity day on 30 July 2012. In October 2005, the bank loan in foreign currency was partially repaid prior to its maturity date. The fees associated with this earlier repayment in the amount of CZK 70.6 million were immediately recognised in the income statement. As at 31 December 2006, the outstanding amount of the foreign currency loan amounts to EUR 115 million.

(b) In 2005, the International financial institution loans have been fully repaid prior to their maturity dates. The fees associated with this earlier repayment in the total amount of CZK 51.2 million were immediately recognised in the income statement.

(c) In 2003, the Company issued CZK 1,000 million of bonds (as additional issue to CZK 3,000 million of bonds from 2002) with an interest rate of 4.55% p.a. The bonds in the total amount of CZK 4,000 million were fully repaid on the maturity date in July 2005.

In 2003, the Company issued CZK 6,000 million of bonds with an interest rate 3.50% p.a. and a maturity date of 9 July 2008.

At 31 December 2006, the Company had approximately CZK 8,290 million of available undrawn credit facilities (2005: CZK 10,224 million).

Loans with a maturity within one year and denominated in a foreign currency have a total value of EUR 0 million (2005: EUR 0 million).

For all borrowings, interest has been charged at commercial rates.

The Company's loan interest rate allocation after taking into account interest rate swaps was as follows:

	31 December 2006	31 December 2005
At fixed rate	9,156	9,324
At floating rate	–	101
Total	**9,156**	**9,425**

The carrying amounts and fair values of bonds and bank loans are as follows:

31 December 2006	Carrying amounts	Fair values
Bank loans	3,163	3,557
Bonds	5,993	6,135
Total	**9,156**	**9,692**

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate that the Board of Directors expect would be available to the Company at the balance sheet date, except for the fair value of the issued bonds, which are based on actual bond market pricing. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	31 December 2006	31 December 2005
Bank loans and overdrafts in local currency	n/a	2.51%
International financial institution loans in foreign currencies	n/a	n/a
Bank loans and overdrafts in foreign currencies	6.64%	6.64%
Bonds in local currency	3.50%	3.50%

The Company meets the criteria for debt covenants (stipulated level of consolidated total net borrowings, EBITDA and tangible net worth) required by the creditors.

International financial institution loans in foreign currencies (now repaid) have been secured by the Czech Republic (represented by the Ministry of Finance of the Czech Republic) and as a result, certain movables and real estates have been pledged for the benefit of the Czech Republic (see Note 8).

The carrying value of assets pledged is as follows:

	31 December 2006	31 December 2005
Land and buildings	–	7
Plant and equipment	21	1,213
Total	**21**	**1,220**

The borrowings were fully paid off in 2005, but the cancellation of the pledge is still in a process.

Other loans are not secured.

17 Deferred income taxes

Deferred income taxes are calculated using currently enacted tax rates expected to apply when the asset is realized or the liability settled.

Both, short-term and long-term deferred taxes were calculated at 24% (24% in 2005).

	2006	2005
At 1 January	**5,423**	**6,040**
Income statement tax credit (Note 5)	(928)	(615)
Tax on fair value gains	(1)	(2)
At 31 December	**4,494**	**5,423**

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts, determined after offsetting, are shown in the balance sheet:

	31 December 2006	31 December 2005
Deferred tax assets	(1,483)	(1,405)
Deferred tax liabilities	5,977	6,828
Total	**4,494**	**5,423**

The deferred tax asset includes CZK 444 million (2005: CZK 462 million) recoverable in less than twelve months and CZK 1,039 million (2005: CZK 943 million) recoverable after more than twelve months. The deferred tax liability includes CZK 723 million (2005: CZK 598 million) payable in less than twelve months and CZK 5,254 million (2005: CZK 6,230 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Balance sheet		Income statement	
	2006	2005	2006	2005
Amount relating to the origination and reversal of temporary differences from:				
– property, plant and equipment and intangible assets	5,977	6,706	(1,026)	(600)
– trade receivables, inventories and other differences	(1,479)	(1,280)	98	(27)
Revaluations of cash flow hedges	(4)	(3)	–	–
Amount relating to changes in tax rates	–	–	–	12
Total	**4,494**	**5,423**	**(928)**	**(615)**

Deferred income tax related to items charged or credited directly to equity are as follows:

	2006	2005
Revaluation of cash flow hedges	(1)	(2)
Total	**(1)**	**(2)**

18 Government social security and pension schemes

The Company is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2006 and 2005, the Company paid contributions at a rate of 35% of gross salaries and is not required to make any contributions in excess of this statutory rate. The total amount charged to operating expenses in respect of this scheme was CZK 1,632 million in 2006 (2005: CZK 1,822 million). Employees contribute 12.5% (2005: 12.5%) of their gross salaries.

The Company has a voluntary pension plan for employees under which the Company makes contributions on behalf of the Company's employees to approved pension plan providers, under defined contribution schemes. The Company's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Company made contributions of CZK 53 million (2005: CZK 65 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2005 relating to employee retirement amounted to CZK 0.1 million (2005: CZK 0.1 million) and were charged as an operating expense.

All amounts discussed in the above note are included in staff costs (see Note 3).

19 Provisions for liabilities and charges

Short-term Provisions

	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Share-based compensation	Benefit loyalty provision	Other	Total
At 1 January 2005	**–**	**–**	**186**	**60**	**489**	**131**	**866**
Additions during the year	20	10	331	190	441	203	1,195
Reclassification	–	–	–	–	–	7	7
Utilised during the year	–	–	(398)	(250)	(474)	(323)	(1,445)
At 31 December 2005	**20**	**10**	**119**	**–**	**456**	**18**	**623**
Additions during the year	–	107	181	–	481	38	807
Reclassification	–	–	–	–	–	7	7
Utilised during the year	(6)	(98)	(117)	–	(373)	(8)	(602)
At 31 December 2006	**14**	**19**	**183**	**–**	**564**	**55**	**835**

Long-term Provisions

	Regulatory and court decisions	Employee related costs	Other	Total
At 1 January 2005	**1,566**	**–**	**–**	**1,566**
Additions during the year	576	–	4	580
Reclassification	–	–	12	12
Utilised during the year	(44)	–	(3)	(47)
At 31 December 2005	**2,098**	**–**	**13**	**2,111**
Additions during the year	295	72	–	367
Reclassification	–	–	(7)	(7)
Utilised during the year	(434)	–	–	(434)
At 31 December 2006	**1,959**	**72**	**6**	**2,037**

With the exception of the regulatory and court decisions and other small items for which the expected timing of payments is not certain all other provisions are expected to be utilised within next 12 months from the balance sheet date.

Benefit loyalty provision

Benefit loyalty provision covers the cost of equipment, accessories, gifts and services provided to participants in the mobile segment's loyalty program in exchange for credits awarded primarily for airtime minutes spent. The provision has been recognized based on past experience of the usage of these credits by loyalty program participants. Expected outflow of provided benefits is CZK 290 million (2005: CZK 242 million) within one year and CZK 274 million (2005: CZK 214 million) from one year up to three years.

The amount of a provision is the present value of the expenditures expected to be required to settle the obligation (CZK 580 million).

Employee-related costs

Provisions for employee-related costs include expected costs associated with performance bonuses and provision for termination payments.

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 21).

20 Financial instruments

Net fair values of derivative financial instruments

At the balance sheet date, the total net fair values of derivative financial instruments were as follows:

Contracts with positive fair value	31 December 2006	31 December 2005
Total	**–**	**–**

Contracts with negative fair value	31 December 2006	31 December 2005
Instruments not qualifying as hedges		
– Interest rate swaps	–	2
Cash flow hedges		
– Forward foreign exchange contracts	18	11
Total (Note 16)	**18**	**13**

21 Contingencies

The Company is involved in a variety of legal proceedings that arise from time to time in the ordinary course of business. The following is a discussion of the significant legal matters involving the Company:

Interconnect arrangements

The Company has not yet agreed a 2001 price amendment to an agreement with T-Mobile Czech Republic a.s. governing interconnect arrangements. Whilst in December 2003 the Czech Telecommunication Office (CTU) effectively ruled in favour of the amounts claimed (i.e. CZK 899 million for T-Mobile Czech Republic a.s., the outstanding amount is bearing interest of 0.05% per day), the management believes that the amounts are not substantiated and are without merit. The Company subsequently obtained adjournment of the decision execution and lodged an appeal. Based on the legal environment in the Czech Republic, management estimated maximum probable outflow related to the dispute with T-Mobile Czech Republic a.s. and such outflow is fully provided in the financial statements. The management is confident that all risks, which may arise as a result of the litigation, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) filed a petition at the Municipal Court in Prague against the Company for damages in the amount of CZK 538 million with appurtenances and for returning the unjustified enrichment of CZK 117 million with appurtenances. The Company is alleged to have failed to transmit the traffic to networks operated by other mobile operators according to respective interconnection agreements. The petition was only unofficially delivered from Vodafone Czech Republic, a.s. and was not served by the court. There was no further development in this respect in 2006. Furthermore, the Company is a defendant in a case filed by Vodafone Czech Republic, a.s. in May 2004 asserting causes for alleged breach of the antitrust law by former Eurotel (damages amounting to CZK 1,043 million). Both parties filed their expert opinions to the court, no hearing has been ordered until now. The management believes that all risks, which may arise as a result of Vodafone litigations, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

Office for the Protection of Economic Competition proceedings

The Company is subject to administrative proceeding by the Office for the Protection of Economic Competition (UOHS) relating to the alleged creation of unfair barriers against development on the market through the application of certain specific price plans for residential customers. UOHS rendered resolution dated 20 April 2005 imposing a fine to the Company in the total amount of CZK 210 million, which was consequently, after the Company completed and filed a protest, reduced to CZK 205 million. The Company lodged an appeal in January 2006 and requested adjournment of the decision execution. The Court rejected the Company's proposal and the Company lodged a complaint against this decision to the Supreme Administrative Court on 19 October 2006. The matter is fully provided in the financial statements.

Other legal matters

The Company is a defendant in a case filed by TELE2 s.r.o. on 3 February 2005 asserting causes for alleged breach of anti competition law by the Company in connection with offering pricing plans since January 2002. The amount of the claim is CZK 2,142 million with appurtenances. No hearing has been ordered in the matter yet. The Company provided to the court extensive defence along with proposed items of evidence proving the legal imperfectness of the sued court's conduct. The management is satisfied that the matter is adequately reflected in the financial statements and does not believe the resolution of this legal proceeding will have a material adverse effect on net income exceeding the amount of provision already made in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is prosecuted by AUGUSTUS spol. s r.o. for an alleged loss of profit in the principal amount of approximately CZK 183 million with appurtenances (totalling approximately additional CZK 257 million as of the end of 2006) relating to the years 1995–2001. Augustus claims that the Company illegitimately cancelled a contract for issue of phone cards, which was signed for unlimited period of time. Based on court decision, the Company paid an amount of the principal of CZK 83 million and the corresponding interest in August 2006. Both parties filed subsequently appeal against the court judgement. The management believes that all risks, which may arise as a result of this litigation, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is a defendant in several other significant legal cases out of which those that individually exceed CZK 5 million total to CZK 138 million with appurtenances. The management believes that the risk of loosing these cases is less than probable and no provision was made in the financial statements.

22 Commitments

Operating leases

The aggregate future minimum lease payments under operating leases are as follows:

	31 December 2006	31 December 2005
No later than 1 year	1,026	991
Later than 1 year and not later than 5 years	3,052	1,827
Later than 5 years	2,431	1,383
Total	**6,509**	**4,201**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2006 were CZK 1,102 million (2005: CZK 1,157 million). These lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Company's results of operations, financial position, or cash flow and therefore are not accounted for.

In 2004 the Company entered into a sale and lease back transaction and now leases the majority of its car fleet under operating leases. There are no contingent rent obligations. The lease arrangements include an option to renew the lease after the initial period. Lease payments are fixed and determinable, however they may be increased to reflect inflation and other market conditions such as interest rates changes (e.g. an increase in PRIBOR by more than 2% over a half year). There are no significant restrictions imposed by these lease arrangements, such as those concerning dividends, additional debt and further leasing. Total future lease payments relating to this contract in 2006 were CZK 368 million (2005: CZK 229 million).

Capital commitments

	31 December 2006	31 December 2005
Capital expenditure contracted but not provided for in the financial statements	622	1,541

The majority of contracted amounts relate to the telecommunications network and service contracts.

23 Service concession arrangements

The Company performs communication activities under the Act on electronic communications based on a notification to and a certificate from the Czech Telecommunication Office. In accordance with Section 13 of the Act on electronic communications, on 12 August 2005, the Company delivered a notification to the Czech Telecommunication Office (further CTO) on the performance of a communication activity, which is under Section 8 of this Act a business activity in electronic communications. Relating documentation required by the Act on electronic communications was provided on 29 September 2005. Subsequently, on 11 October 2005, the CTO issued a certificate confirming that a notification on the performance of a communication activity was received. A notification of the changes has been filed before the transfer of assets and liabilities.

The communication activities include (territory of the Czech Republic):
a) public fixed and mobile network of electronic communications
b) public network for the transfer of radio and TV signal
c) public fixed and mobile telephone network
d) publicly accessible telephone services
e) other voice services
f) rent of circuits
g) transmission of radio and TV signal
h) transfers of data
i) internet access services.

In accordance with the Act on electronic communications, the CTO determined the scope and new detail conditions for the provision of each particular service within the universal service including the selection of providers. The CTO issued, based on the results of tenders, decisions according to which the Company was determined as the provider of the following particular services:

- Periodic issuance of telephone directories with numbers of participants of the publicly accessible telephone service and access of end users to these directories in accordance with Section 38, Para 2, letter c) of the Act on electronic communications (on 21 December 2005);
- Information service on the numbers of participants of the publicly accessible telephone service in accordance with Section 38, Para 2, letter d) of the Act on electronic communications (on 21 December 2005);
- Public pay telephones in accordance with Section 38, Para 2, letter e) of the Act on electronic communications (on 13 March 2006);
- Access for disabled to the public telephone service in accordance with Section 38, Para 2, letter f) of the Act on electronic communications (on 12 July 2006);
- Supplementary services in accordance with Section 38, Para 2, letter g) of the Act on electronic communications (on 28 July 2006);
- Special price plans in accordance with Section 38, Para 3 of the Act on electronic communications (on 1 September 2006); the Company is not the only provider.

CTO also published on 1 September 2006 its decision not to impose the duty to provide the USO service of connection at a fixed location to the public telephone network and the service of access to publicly available telephone services at a fixed location, mainly due to the high level of deployment of these services and high level of substitutability of mobile services.

Mobile segment

The Company provides mobile services of electronic communications in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (GSM) and in the 450 MHz frequency band under the Nordic Mobile Telephone (NMT) standard (collectively, mobile services). In June 2005 all subscribers of a voice service in the NMT 450 Network were transferred to the GSM Network. The NMT 450 Network is used for broadband mobile access to Internet using CDMA2000 1*EV-DO (Code-Division Multiple Access Evolution Data Optimized CDMA) technology in the 450 MHz frequency band. Mobile segment operates services based on Universal Mobile Telecommunications System (UMTS) standard since 1 December 2005. Mobile license 450 MHz, mobile license GSM and UMTS have remaining life 5, 10 and 15 years, respectively. Relative to the current regulatory and business environment in the Czech Republic, contractual, legal, regulatory, competitive or other economic factors may limit the period during which the Company can benefit from the use of these licenses in the future.

The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, former Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of ten years. In 2002, former Eurotel renewed its 450 MHz license; the current license enables the Company to offer any internationally recognized public mobile telecommunication services on a frequency of 450 MHz. Mobile segment currently provides on this frequency broadband Internet access services using CDMA technology. The license is currently valid for the remaining period of five years.

In December 2001, former Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, former Eurotel was provided with deferred payment terms by the CTO to finance the license acquisition. In December 2003, former Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, former Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement.

No additional expenses connected with renewal of the individual licences, nor any limitations connected with the renewal of licences, are expected in accordance with the existing interpretation of regulatory provisions.

24 Share capital and reserves

	31 December 2006	31 December 2005
Nominal value per ordinary share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per share with special rights (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares	32,209	32,209

* One share owned by the National Property Fund of the Czech Republic bore special decision-making rights in accordance with the statutes of the Company. These special rights included namely decisions regarding the liquidation of the Company changes in its activities, sale or lease of the Company or of its assets. This share was assigned to Telefónica, S.A. within the transferred 51.1% stake in the Company (see General information). From this date, the share has not borne special decision-making rights.

At 31 December 2005, shareholdings in the Company were as follows:

Telefónica, S.A.	69.4%
Other shareholders	30.6%

At 31 December 2006, shareholdings in the Company were as follows:

Telefónica, S.A.	69.4%
Other shareholders	30.6%

Funds include a statutory reserve fund of CZK 6,261 million (2005: CZK 5,903 million) that is not distributable under ruling legislation.

25 Hedging reserve

Balance at 1 January 2005	(47)
Fair value losses in period	(36)
Fair value losses transfer to net profit	72
Deferred tax on fair value losses	–
Balance at 31 December 2005	**(11)**
Fair value losses in period	(34)
Fair value losses transfer to net profit	26
Deferred tax on fair value losses	1
Balance at 31 December 2006	**(18)**

26 Cash generated from operating activities

	Year ended	
	31 December 2006	31 December 2005
Net profit	8,322	6,102
Adjustments for:		
Tax (Note 5)	2,772	2,665
Depreciation (Note 8)	14,018	15,011
Amortisation (Note 9)	2,708	2,778
Impairment loss (Note 8, 9, 10)	253	1,261
Disposals of obsolete assets	49	76
Profit on sale of property, plant and equipment	(96)	(111)
Net interest and other charges	245	701
Foreign exchange (gains)/losses (net)	(203)	(347)
Fair value changes	29	(119)
Increase in provisions	62	43
Operating cash flow before working capital changes	**28,159**	**28,060**
Decrease/(increase) in trade and other receivables	(98)	(538)
Decrease/(increase) in inventories	(753)	(211)
(Decrease)/increase in trade and other payables	868	423
Cash generated from operations	**28,176**	**27,734**

27 Related party transactions

The acquisition process and the transfer of majority ownership of NPF was completed on 16 June 2005 by paying-off the balance of 90% purchase price by Telefónica, S.A, and NPF divested 51.1% shares in the Company. Telefónica effectively used its rights at the General Shareholders Meeting, which took place on 23 June 2005.

The intercompany transactions between the Company and the Telefónica Group companies are disclosed from the date Telefónica, S.A. gained effective control, i.e. 23 June 2005 to 31 December 2006. With respect to the majority ownership of NPF holding to 16 June 2005, all transactions between the Company and the NPF companies are disclosed only to that date.

The Company provides services to all related parties on normal commercial terms. Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest free (excl. financial assets used for financing) and the settlement occurs either in cash or by offsetting. The financial assets balances are tested for the impairment at the balance sheet date, and no allowance or write off incurred.

The following transactions were carried out with related parties:
I. Parent company:

a) Dividend	Year ended 31 December 2006	31 December 2005
Telefónica S.A.	**10,061**	**–**

II. Other related parties – Telefónica Group:

a) Sales of services and goods	Year ended 31 December 2006	31 December 2005
Telefónica companies	**597**	**81**

b) Purchases of services and goods	Year ended 31 December 2006	31 December 2005
Telefónica companies	**564**	**147**

c) Capital purchases	Year ended 31 December 2006	31 December 2005
Telefónica companies	**18**	**–**

d) Receivables	Year ended 31 December 2006	31 December 2005
Telefónica companies	**195**	**59**

e) Payables	Year ended 31 December 2006	31 December 2005
Telefónica companies	**117**	**25**

f) Short-term receivables (interest)	Year ended 31 December 2006	31 December 2005
Telefónica companies	**10**	**–**

g) Interest income	Year ended 31 December 2006	31 December 2005
Telefónica companies	**18**	**–**

h) Cash equivalents	Year ended 31 December 2006	31 December 2005
Telefónica companies	**3,605**	**–**

The list of the Telefónica companies with which the Group had any transaction in 2006 includes the following entities: Telefónica de España, S.A.U., O2 Germany GmBH& CO.OHG, Telefónica Deutschland GMBH, O2 (UK) Ltd., O2 Communications (Ireland) Ltd., Telefónica Servicios Integrales de Distribución, S.A.U, Atento Servicios Técnicos y Consultoría, S.L., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A., Telefónica de Contenidos, S.A.U., Portugal Telecom, S.G.P.S., S.A., Telefónica Europe, B.V., Telefónica International Wholesale Services, S.L., Telefónica Gestión de Servicios Compartidos, S.A., Telefónica O2 Services, spol. s r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica O2 Slovakia s.r.o. and CenTrade, a.s.

III. Other related parties – State entities controlled by NPF*

a) Sales of services and goods	Year ended 31 December 2006	31 December 2005
State controlled entities	**–**	**56**

b) Purchases of services and goods	Year ended 31 December 2006	31 December 2005
State controlled entities	**–**	**116**

c) Receivables	Year ended 31 December 2006	31 December 2005
State controlled entities	**–**	**2**

d) Payables	Year ended 31 December 2006	31 December 2005
State controlled entities	**–**	**75**

* NPF did not hold any shares in the Company after 16 June 2005, and accordingly the respective related party sales and purchases have been prepared for period from 1 January 2005 to 16 June 2005. The state controlled entities include all companies that are owned by the State through NPF Czech Republic. Entities controlled by NPF consist of number of commercial (joint stock or limited liability) companies operating across different industries, and they do not include the government or governmental bodies. Accordingly, transactions with ministries and other state agencies are not treated as related party transactions.

IV. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Telefónica O2 Czech Republic, a.s., were provided with benefits as follows:

	Year ended 31 December 2006	31 December 2005
Salaries and other short-term benefits	86	254
Board share on profit	–	–
Stock appreciation rights	–	190
Non-competition clause	–	6
Termination benefits	–	58
Capital life insurance	–	16
Personal indemnification insurance	12	16
Total	**98**	**540**

b) Loans to related parties

There were no loans to members of Board of Directors and Supervisory Board in 2005 and 2006.

No other loan was provided to related parties by the Company.

28 Principal subsidiary undertakings

Name	Company's interest	Country of incorporation	Activity
1. Telefónica O2 Services, spol. s r.o.	100%	Czech Republic	Network and consultancy services in telecommunications
2. SPT TELECOM Finance B.V. (Czech Republic)	100%	Netherlands	Financing other entities in the Company
3. CZECH TELECOM Germany GmbH	100%	Germany	Data transmission services
4. CZECH TELECOM Austria GmbH	100%	Austria	Data transmission services
5. Telefónica O2 Slovakia s.r.o.	100%	Slovakia	Mobile telephony, internet and data transmission services
6. CenTrade, a.s.	100%	Czech Republic	E-business company providing market place services

On 20 December 2001 former Eurotel acquired a 100% ownership interest in a Hungarian registered limited liability company, Trigo Global Services Ltd. (Trigo) for CZK 1 million. The subsidiary was engaged in the contracting of labour services to former Eurotel for periods prior to January 2004. In September 2004, Trigo commenced the process of voluntary liquidation. On 8 April 2005 the process of liquidation was finished and assets were transferred to former Eurotel (amounts of assets transferred are not material to the Company's results). Currency translation adjustment upon complete liquidation of the investment in Trigo, the amount attributable to that entity and accumulated in the translation adjustment component of equity (CZK 13 million) was removed from the separate component of equity and was reported as part of the gain on liquidation of the investment. At the date of liquidation goodwill was fully written off.

As of 1 January 2007, CenTrade, a.s. commenced the process of voluntary liquidation. The process is still in progress, the Company increased its investment and paid in capital which would aim to the smooth liquidation process.

29 Post balance sheet events

In February 2007, management of the Company approved an intention to provide Orange Slovensko, a.s. and T-Mobile Slovensko, a.s. with a guarantee for potential commitments incurred towards Telefónica O2 Slovakia s.r.o. from these companies based on the mutually concluded interconnection agreements.

The Company is in process of implementing measures to increase efficiency which include also real estates usage optimisation. Real estates' optimisation focus amongst other actions on reduction of employees' territorial diversification as well as move into a new headquarter in 2007. There might be a potential to divest certain real estates as a consequence of the mentioned optimisation plan. The Company has engaged external advisors to assist with the analysis and process of the potential disposal. As a part of the process being carried out the advisors have introduced the selected properties available into the real estates market.

There were no other events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2006.


05

Information on the listed security issuer

Information on the listed security issuer

Information on the listed security issuer

The overall voice traffic generated by our customers grew in 2006 by 6.9%.

Note: This section of the Annual Report contains information for the year 2006 which is not contained in the other sections of the Annual Report, as required by the Act No. 256/2004 Coll., on capital markets undertakings, as amended, Act No. 563/1991 Coll., on accounting, as amended, and the Act No. 513/1991 Coll., the Commercial Code, as amended.

Basic information:

Corporate name:	Telefónica O2 Czech Republic, a.s. (Telefónica O2, the Company)
Registered address:	Olšanská 55/5, 130 34 Prague 3
Company identification number:	60193336
Taxpayer registration number:	CZ60193336
Date of incorporation:	16 December 1993
Legally existing from:	1 January 1994
Duration of the company:	the company was founded for an indefinite period of time
Legal form:	joint-stock company
Statute of law under which the Company was incorporated:	provisions of Section 171(1) and Section 172 (2) and (3) of the Commercial Code
Commercial court:	Prague Municipal Court
Commercial court record number:	Section B, Enclosure 2322

By decision of the Prague Municipal Court of 20 June 2006, which came into legal force on 21 June 2006, the corporate name of ČESKÝ TELECOM, a.s., changed to Telefónica O2 Czech Republic, a.s., with effect from 1 July 2006. As of the same date, Eurotel Praha, spol. s r.o., was wound up without liquidation and its equity was transferred to the sole member, Telefónica O2 Czech Republic, a.s. (formerly ČESKÝ TELECOM, a.s.).

Details on issuer's dependency on patents or licenses, industrial, commercial or financial contracts which have a significant bearing on the issuer's business:

1) Patents and licenses

The Company has licence agreements for the following software products: application middleware (Oracle, BEA), database environment (ORACLE, Microsoft), operating systems (Hewlett-Packard, SUN and Microsoft), workstation software (Microsoft), CRM using Siebel SW (Oracle), customer care and billing software (Amdocs) and BSS (SAP).

2) Industrial and commercial contracts
The Company maintains a diverse portfolio of technology suppliers. The main objective of the Company with respect to the contracted suppliers is to have competition on the supply side. All principal technology supply contracts are awarded by tender.

At present, the main suppliers of technology and related services to the Company are IBM Česká republika, Alcatel Czech, AutoCont CZ, Vegacom, Siemens, Accenture Central Europe B.V., DNS, NextiraOne Czech, Amdocs Development Limited, Hewlett-Packard, LHS, Huawei Technologies Co, Nortel Networks, Ericsson, Nokia Czech Republic and Lucent Technologies Czech Republic.

3) Financial contracts
See Section Financial debts which forms a part of the Financial Statements for the year ended 31 December 2006 on page 165 of this Annual Report.

Investments
Main investments made by Telefónica O2 in the last two accounting periods (in CZK millions):

	2006	2005
Network & Operations	4,363	3,790
Customer Solutions	347	520
IT and Products	1,313	1,584
Real Estate & Logistics	134	169
Point of Sale Redesign & Re-branding	69	0
Investments related to Telefónica O2 Slovakia made in the Czech Republic	93	0
Total	6,319	6,063

All major investments were made in the Czech Republic and were financed from own capital and from borrowings.

As in the previous years, also in 2006 the standard investment policy, which clearly favours the development of progressive, customer-oriented technologies, was implemented. The structure of investment expenditures reflected the current demands of customers for the provision of dynamic services with a high comfort of use. High-speed internet, generally, was a pronounced success, largely due to the increase in the numbers of ADSL, IPTV, CDMA and UMTS customers. In 2006, Telefónica O2 recorded increases in all the above categories. This fact reflected also in the structure of investments: 290% increase in IPTV-related investments (implementation of the full IPTV platform), 244% increase in ADSL-related investments (reinforcement of IP technologies and DWDM installation) and 149% increase in the CDMA area (strengthening of capacities).

The award of the mobile licence in Slovakia to Telefónica O2 spurred investments which were necessary for the launch of the commercial service in 2007. A part of the investments was made in the Czech Republic, due to the selected technical solution. In the area of regulatory compliance in the fixed line segment, investments were made in order to accommodate the regulatory requirements.

Financial investments of the Company in the last two accounting periods (in CZK millions)

	2006	2005
Financial investments	40	0

Principal future investments
In the period 2007–2009, the investment line which is now the standard for the telecommunications sector will be followed, with a stress on efficiency and implementation of new technologies, in pursuit of the main strategic goal – maintaining the leadership on the Czech telecommunications market and gaining a strong position in Slovakia. Our efforts will focus on improving customer experience in the field of data transmission, and in particular on launching new Voice over IP services, new value added mobile services and on securing a strong foothold in the Slovak mobile market. As regards compliance with the regulatory requirements, investments will be made as required by the regulator under the Electronic Communications Act.

Information on the research and development policy in the current accounting period
In 2006, Telefónica O2 spent in total CZK 17,493 thousand on development. The development costs include externally developed information systems and technology, data and system architecture and applications integration.

Number of employees

(as at 31 December 2006)

Organisation unit	
Division Business Customers	1,083
Division Residential Customers	2,453
Division Operations	4,459
Wholesale	49
Regulation and Interconnect	22
Strategy and Product Development	114
Human Resources and Support Services	483
Division Finance	466
Transformation and Convergence	52
Legal Affairs	38
Internal Audit and Risk Management	20
Public Affairs	23
Top Management Support Office	3
Total	**9,265**

With regard to the different organisation of ČESKÝ TELECOM, a.s. and Eurotel Praha, spol. s r.o. as at 31 December 2005, its is not possible to publish comparable data as at the date in question. As at 31 December 2005, ČESKÝ TELECOM, a.s. and Eurotel Praha, spol. s r.o. had 7,524 and 2,490 employees, respectively.

Financial debts

Financial debts broken down to short and long term (in CZK millions):

	As at 31 December 2006
Short-term (maturing within 1 year)	207
Long-term	9 156
Total	**9 363**

Loans and bonds issued:

	Currency	Total loan in the currency	Outstanding in the currency as at 31 December 2006	Outstanding in CZK as at 31 December 2006	Redemption
Private Placement – debt instrument	EUR	115,040,673	115,040,673	3,163,043,312	2012
Bond issue (Dluhopisy 3,50 % / 2008) [1]	CZK	6,000,000,000	5,992,483,042	5,992,483,042	2008
Syndicated loan [2]	EUR	145,273,206	0	0	2008
	CZK	3,360,000,000	0	0	

EUR/CZK exchange used in the table for conversion purposes (as at 31 December 2006) is CZK 27.495/EUR.

[1] Česká spořitelna, a.s., Československá obchodní banka, a.s., and HVB Bank Czech Republic a.s. were the lead co-managers of the bond issue.

[2] Lead co-arrangers of the syndicated loan: Bank Austria Creditanstalt AG, Československá obchodní banka, a.s., CITIBANK, N.A., J.P. MORGAN PLC, KBC BANK, N.V. and SANPAOLO IMI S.p.A., agent: CITIBANK a.s. The syndicated loan is a revolving loan which may be drawn 1 month at the latest prior to its final maturity in 2008.

The loans are repaid in accordance with the relevant loan agreements or the Terms and Conditions of Issue. As at 31 December 2006, Telefónica O2 had no overdue loan obligations.

Commercial undertakings in which the Telefónica O2 directly owns more than 10% of the registered/share capital
(as at 31 December 2006)

Companies incorporated in the Czech Republic

Corporate name	Registered address	Object	Identification number	Registered/share capital	Share of the issuer in the registered/share capital in %
AUGUSTUS, spol. s r.o.	Na zájezdu 5 100 00 Prague 10	Consulting and brokerage activity in non-telecommunication disciplines	49356160	CZK 166,000	39.57%
CenTrade, a.s.	Prague 3 Olšanská 55/5 130 00	E-business and electronic marketplace services	26513731	CZK 2,000,000	100%
První certifikační autorita, a.s.	Prague 9 Podvinný mlýn 2178/6 190 00	Certification services in the area of electronic signature	26439395	CZK 20,000,000	23.25%
Telefónica O2 Services, spol. s r.o.	Prague 10 – Vršovice Kodaňská 1392/97 101 00	Data services and telecommunications consulting	45797111	CZK 10,000,000	100%

Companies incorporated in other countries

Corporate name	Registered address	Object	Identification number	Registered/share capital	Share of the issuer in the registered/share capital in %
SPT TELECOM (Czech Republic) Finance B.V.	Drentestraat 24 1083 HK Amsterdam Netherlands	Financing of other Group members		EUR 18,151	100%
CZECH TELECOM Austria GmbH.	Shuttleworthsstrasse 4–8 Bld. 50, 1210 Wien Austria	Data transmission services	FN 229578s	EUR 35,000	100%
CZECH TELECOM Germany GmbH.	Hanauer Landstrasse 300a 60314 Frankfurt am Main Germany	Data transmission services	HRB 51503	EUR 25,000	100%
Telefónica O2 Slovakia s.r.o.	Kutlíkova 17 852 50 Bratislava 5-Petržalka Slovakia	Operation of a public telecommunications network; provision of a public telecommunications service and the service of leased lines	35848863	SKK 200,000	100%

Changes in 2006

The Company, being the only shareholder of CenTrade, a.s., exercised its powers of the General Meeting and on 15 December 2005 decided to decrease the share capital of the company from CZK 600,000,000 to CZK 2,000,000, to pay for the loss made by CenTrade in the period 2002–2004. The share capital was decreased by way of changing the nominal value of each share from CZK 600,000 to CZK 2,000. Further, Telefónica O2 decided on 25 October 2006 to increase the share capital of CenTrade by CZK 40,000,000 by way of subscription of 20,000 of new ordinary documentary registered shares in the nominal value of CZK 2,000 per share. All new shares were subscribed by Telefónica O2, the sole shareholder of CenTrade, based on an agreement for subscription of shares concluded on 23 November 2006. On 11 December 2006, the Board of Directors of Telefónica O2 resolved to liquidate CenTrade, a.s., and for the company to be put in liquidation on 1 January 2007.

The corporate name of OMNICOM Praha, spol. s r.o., changed to Telefónica O2 Services, spol. s r.o, by way of a court decision which came into legal force on 1 November 2006.

The corporate name of CZECH TELECOM Slovakia s.r.o. was changed to Telefónica O2 Slovakia s.r.o. with effect from 8 July 2006.

Information on all pecuniary and in-kind income accepted in the accounting periods by executive managers and Supervisory Board members from Telefónica O2

(in CZK thousands)	Pecuniary income	Of which royalties	In-kind income
Board of Directors total	85,208	–	5,899
– of which on the ground of being a member of the Board of Directors	1,842	–	3,904
Supervisory Board total	11,145	–	8,069
– of which on the ground of being a member of the Supervisory Board	7,382	–	7,841
Management [1]	13,212	–	470

[1] The Management category includes income of managers whose positions meet the definition of Section 27(5) of the Labour Code. Income of those members of the Board of Directors who, at the same time, qualify as Management is included in the Board of Directors total category.

Information on all pecuniary and in-kind income accepted in the accounting periods by managers and Supervisory Board members from entities controlled by Telefónica O2:

In 2006, managers and Supervisory Board members received no pecuniary and in-kind income from entities controlled by Telefónica O2.

Information on the number of shares issued by Telefónica O2 and held by statutory bodies or their members, other executive managers of the issuer and by Supervisory Board members, including persons related to these persons, information on option and similar agreements, information on individual transactions concluded by the said persons in the accounting period

	Number of shares
Board of Directors [1]	–
Supervisory Board	250
Management [2]	440

[1] This category includes also shares held by members of the Board of Directors who are at the same time managers of the company (these shares are not included in the Management category).
[2] The Management category includes income of managers whose positions meet the definition of Section 27(5) of the Labour Code.

Principles of remuneration of executive managers of the Company and of the Supervisory Board

1. Board of Directors and the Chief Executive Officer

a) Remuneration

Members of the Board of Directors are remunerated in accordance with the Rules for Remuneration of Members of the Telefónica O2 Board of Directors (Rules) which were approved by the Ordinary General Meeting of 27 April 2006. As per the Rules, the remuneration consists of two components:

- a flat remuneration for discharge of office of a member of the Board of Directors,
- an extraordinary bonus for performance of office of a member of the Board of Directors.

The actual amounts of the flat remuneration and of the extraordinary bonus are determined by the Supervisory Board acting on recommendation of the Nomination and Remuneration Committee. The flat remuneration and the extraordinary bonus for 2006 could total a maximum (for the whole Board of Directors) of CZK 3 million, an amount approved by the Ordinary General Meeting held on 27 April 2006. The same aggregate amount is applicable also to 2007 unless the General Meeting decides otherwise. As per the Rules, the extraordinary bonus is given for performance of special assignments.

The Chief Executive Officer is entitled to remuneration for discharge of the office; the bonus comprises the following components:

- basic gross salary
- performance-related bonus
- compensation of the balance between the health insurance benefits and 100% of the average daily wage

The performance-related bonus is granted to the Chief Executive Officer conditional on delivering on targets set for the CEO for the calendar year in question. The performance-bonus may, in aggregate for the calendar year, reach 60% of the basic gross salary per annum if the targets are achieved to a standard level.

Other non-pecuniary benefits are connected with relocation of the executive from Spain to the Czech Republic (accommodation in Prague, flights for visiting the family, contributions towards school fees at the international school, international insurance).

In the event of temporary work incapacity as a result of an illness or injury, the company will pay to the Chief Executive Officer, for each working day of the work incapacity, the balance between the health insurance benefits and 100% of the average daily wage.

b) Compensation for commitment to the non-competition covenant
A member of the Board of Directors may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the telecommunications industry). The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the General Meeting.

Compensation for commitment to the non-competition covenant is based on the following principles:

- The non-competition covenant is accepted for a period of six months as of the termination of office;
- The company is obliged to provide to the member of the Board of Directors in question, for committing to the non-competition covenant, compensation corresponding to a half of the proportional share (i) of the total annual amount of remuneration to members of the Board of Directors approved by the General Meeting, and (ii) the number of members of the Board of Directors as per the company's Articles of Association. All nine members of the Board of Directors accepted the non-competition covenant. After termination of their employment, the Chief Executive Officer is bound by the non-competition covenant covering the whole Telefónica Group.

c) In-kind benefits
Damage liability insurance
The company, as the policy holder, contracted an insurance policy covering against damage caused in relation to the performance of designated functions; the insured persons (i.e. persons whose functions are covered by the policy) can be also members of the Board of Directors. The total insurance premium paid by the company is evenly divided amongst the insured persons and the amount calculated per insured person constitutes their income.

Endowment insurance
No endowment insurance has been contracted for members of the Board of Directors in relation to their discharge of office.

Car
In relation to the discharge of their office, members of the Board of Directors are not provided with cars for private use. As per the Rules approved by the General Meeting, the Chief Executive Officer is provided with a car both for work and private use.

2. Supervisory Board
a) Remuneration
Members of the Supervisory Board are remunerated in accordance with the Rules for Remuneration of Members of the ČESKÝ TELECOM Supervisory Board (Rules) which were amended by the Extraordinary General Meeting of 3 February 2005. As per the Rules, the remuneration consists of three components:

- a flat remuneration for discharge of office of a member of the Supervisory Board,
- remuneration for work in committees established by the Supervisory Board,
- an extraordinary bonus for performance of office of a member of the Supervisory Board.

The actual amounts of the flat remuneration, remuneration for work in the Supervisory Board Committees and of the extraordinary bonus are determined by the Supervisory Board acting on recommendation of the Nomination and Remuneration Committee. The flat remuneration and the extraordinary bonus for 2006 could total a maximum (for the whole Supervisory Board) of CZK 8.5 million, an amount approved by the Ordinary General Meeting held on 27 April 2006. The same aggregate amount is applicable also to 2007 unless the General Meeting decides otherwise.

As per the Rules, the extraordinary bonus is given for performance of special assignments.

b) Compensation for commitment to the non-competition covenant
A member of the Supervisory Board may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the telecommunications industry). The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the General Meeting.

Compensation for commitment to the non-competition covenant is based on the following principles:

- The non-competition covenant is accepted for a period of six months as of the termination of office;
- The Company is obliged to provide to the member of the Supervisory Board in question, for committing to the non-competition covenant, compensation corresponding to a half of the proportional share (i) of the total annual amount of remuneration to members of the Supervisory Board approved by the General Meeting, and (ii) the number of members of the Supervisory Board as per the Articles of Association. All 15 present members of the Supervisory Board accepted the non-competition covenant.

c) In-kind benefits

Damage liability insurance

The company, as the policy holder, contracted an insurance policy covering against damage caused in relation to the performance of designated functions; the insured persons (i.e. persons whose functions are covered by the policy) can also be members of the Supervisory Board. The total insurance premium paid by the company is evenly divided amongst the insured persons and the amount calculated per insured person constitutes their income.

Endowment insurance

The Company, as the policy holder, contracted endowment insurance for the benefit of some members of the Supervisory Board. According to the Rules approved by the Ordinary General Meeting of 13 June 2003, the endowment policy may be contracted to the maximum amount corresponding to a double of the annual remuneration of a Supervisory Board member. The specific terms and conditions of insurance are determined by the Supervisory Board, with the following applicable at present:

- The ceiling for determination of the insured amount is calculated as pro rata share from
  - the total annual remuneration of members of the Supervisory Board as approved by the General Meeting,
  - the total number of Supervisory Board members, and it is multiplied by 2.
- A person who has been member of the Supervisory Board for at least six months may lodge a request for endowment insurance.
- The insurance contract is concluded for a minimum period of 5 years.
- After the termination of office of a member, the insurance contract is amended – the person who has hitherto been member of the Supervisory Board will become the policy holder (and payer of the premium).

No endowment insurance contracts were concluded for members of the Supervisory Board in 2006.

Car

The Supervisory Board Chairman and Vice-Chairmen are according the Rules approved by the General Meeting entitled to a higher middle class car for work and private use. This benefit has not been claimed since mid-2005.

3. Other benefits

The company also disbursed the following benefits to members of the Board of Directors (including the Chief Executive Officer) and of the Supervisory Board:

- service telephone lines
- mobile telephones
- computing equipment
- VISA payment card (in the case of the Supervisory Board, only the Chairman and Vice-Chairmen are eligible; the benefit has not been claimed since mid-2005)
- health care

The benefits were given to the persons in questions in relation to their performance of the duties attached to their office. The principles of remuneration of members of the Board of Directors and of the Supervisory Board, including discretionary benefits, are published in the full version on the Company’s website.

Information on fees paid to auditors in the accounting period

Costs incurred by Telefónica O2 in connection with activities of Ernst & Young, the external auditor, in 2006:

Type of service	Fees (in CZK thousands)
Audit	17,200
Other audit-related advisory services	13,545
Other services	–
Total	**30,745**

Costs incurred by the Telefónica O2 Group in connection with activities of Ernst & Young, the external auditor, in 2006:

Type of service	Fees (in CZK thousands)
Audit	17,550
Other audit-related advisory services	13,545
Other services	–
Total	**31,095**

Information on persons responsible for the Annual Report and for verification of the financial statements

Jaime Smith Basterra, Chairman of the Board of Directors and Chief Executive Officer of Telefónica O2 Czech Republic, a.s.

Ramon Ros, member of the Board of Directors and Chief Financial Officer of Telefónica O2 Czech Republic, a.s.

hereby declare that the information contained in this Annual Report is accurate and that no significant facts which could influence the accurate and correct evaluation of the Company were omitted.

Jaime Smith Basterra
Chairman of the Board of Directors
and Chief Executive Officer

Ramon Ros Bigeriego
Member of the Board of Directors
and Vice-President – Finance Division

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Information for shareholders

Information for shareholders

The main shareholders of Telefónica O2 Czech Republic, a.s.

(as at 31 December 2006):

Shareholder	Address	% of share capital
1 Telefónica, S.A.	Gran Vía 28 28013 Madrid the Kingdom of Spain	69.4%
2 Investment funds and individual shareholders	–	30.6%

Entities which control or could control Telefónica O2 and their share in the voting rights in the Company

Controlling entity:	Telefónica, S.A.
Registered address:	Gran Vía 28 28013 Madrid the Kingdom of Spain
Identification No.:	A 28015865

The controlling entity disposed of shares of the controlled entity in the aggregate nominal value of 69.4% of the controlled entity's share capital. The share in the voting rights of the controlled entity pursuant to the provisions of Section 183d(1) of the Commercial Code was 69.4%.

Consolidated OIBDA amounted to CZK 27.9 billion in 2006.

Shares
(as at 31 December 2006)

The Company's share capital is CZK 32,208,990,000. The share capital of the Company is fully paid up.

The company share capital is made up of:

A.	Type:	ordinary share
	Form:	bearer share
	Kind:	booked
	Number of shares:	322,089,890 shares
	Nominal value:	CZK 100
	Total issue volume:	CZK 32,208,989,000
	ISIN:	CZ0009093209
B.	Type:	ordinary share
	Form:	registered share
	Kind:	booked
	Number of shares:	1 share
	Nominal value:	CZK 1,000
	Total issue volume:	CZK 1,000

As of the effective date of the agreement on the transfer of shares between Telefónica S.A. (Telefónica) and the National Property Fund of the Czech Republic, the registered share has lost the special rights which were attached to it pursuant to the provisions of Article IV (2) of Act No. 210/1993 Coll., amending the Act No. 92/1991 Coll., on the conditions of transfer of state property to other entities, as amended.

Public markets where the shares of Telefónica O2 are listed for trading

Market	Note
Prague Stock Exchange (Burza cenných papírů Praha, a.s.)	On the main market
RM-SYSTÉM, a.s.	
London Stock Exchange	In the form of Global Depository Receipts (GDR). The depository for the GDR is The Bank of New York, ADR Division, 101 Barclay Street, West New York, NY 10286, USA; the custodian is Komerční banka, a.s., Na Příkopě 33, čp. 906, 114 07 Prague 1.

A full wording of the Terms and Conditions of the Share Issue – the document which is the source of this summary – is available at the registered address of the Company.

In connection with the change of the corporate name from ČESKÝ TELECOM, a.s., to Telefónica O2 Czech Republic, a.s., the issue name ISIN CZ0009093209 in the share list of the Prague Stock Exchange and in the RM-Systém was changed to TELEFÓNICA O2 C.R, with effect from 3 July 2006.

A. Bonds
as at 31 December 2006

Bond programme
Maximum volume of unredeemed bonds: CZK 20,000,000,000
Programme duration: 2002–2012
Maturity of issues in the programme: maximum of 15 years

Bonds issued under the bond programme

Bond:	Dluhopis TELEF.O2CR 3,50 % / 2008
ISIN:	CZ0003501355
Total nominal value of the issue:	CZK 6,000,000,000
Nominal value of the bond:	CZK 1,000,000
Interest rate:	the bonds accrue fixed interest of 3.50% per annum from 9 July 2003 inclusive; the interest is paid once a year for the previous year on 9 July of each year
Form:	bearer bond
Kind:	booked
Date of issue:	9 July 2003
Redeemable on:	9 July 2008
Company's option for prior redemption:	–
Administrator:	Česká spořitelna, a.s.
Address:	Národní 27, 110 00 Prague 1

Public markets where the bonds of Telefónica O2 are listed for trading

Market	Note
Prague Stock Exchange (Burza cenných papírů Praha, a.s.)	On the secondary market

A full wording of the Prospectus and the Terms and Conditions of the Bond Issue – the documents which are the sources of this summary – are available at the registered address of the Company. The agreement with the administrator is available at the above address of the administrator.

In connection with the change of the corporate name from ČESKÝ TELECOM, a.s., to Telefónica O2 Czech Republic, a.s., the bond issue name ČESKÝ TELECOM 3,50/2008, ISIN CZ 0003501355 was changed to TELEF.O2CR 3,50/08, with effect from 3 July 2006.

	2006	2005
Number of shares (in millions)	322.1	322.1
Net profit/(loss) per share (in CZK) [1]	25.8	18.9
Highest share price (in CZK) [2]	547.6	526.6
Lowest share price (in CZK) [2]	417.2	377.7
Share price at the end of period (in CZK) [2]	476.0	524.5
Market capitalisation (in CZK billions) [2]	153.3	168.9

[1] Unconsolidated net profit under IFRS.
[2] Source: Prague Stock Exchange.

In 2005, Telefónica O2 Czech Republic once again ranked among the most important companies on the Czech capital markets according to market capitalisation and trading volumes. The total volume of trades in company shares on the main stock market of the Prague Stock Exchange (PSE) in 2006 was CZK 98.7 billion compared to CZK 288.3 billion in 2005. Trading in Telefónica O2 Czech Republic shares measured by the total volume of shares made up 11.6% of all trades on the PSE stock market. Telefónica O2 shares were the fourth most traded issue on the PSE in 2006, after ČEZ, Zentiva and Komerční banka. The average daily volume of trades in company shares in 2006 was CZK 393 billion.

As at 29 December 2006, the market capitalisation reached CZK 153.3 billion, ranking Telefónica O2 the third on the PSE stock market. The share price of Telefónica O2 on the last PSE trading day in 2006 (29 December) reached CZK 476. The share price reached its maximum of CZK 547.60 on 9 January 2006, and its minimum of CZK 417.2 on 13 July 2006. The average share price was CZK 485.91 in 2006 compared to CZK 454.67 in 2005.

Development of Telefónica O2 share price and PX index in 2006

Dividend

At the Ordinary General Meeting of 24 June 2004 held in Prague, the shareholders approved dividends for 2003 totalling CZK 5.476 billion, i.e. CZK 17 per share of nominal value of CZK 100 and CZK 170 per share of nominal value CZK 1,000, before tax. The record day for the payment of dividends was 9 July 2004 and the disbursement date 20 October 2004.

The company did not pay any dividend in 2005.

At the Ordinary General Meeting of 27 April 2006 held in Prague, the shareholders approved a dividend payment from the 2005 net profit and part of the retained earnings from previous years, in the total amount of CZK 14.494 billion, i.e. CZK 45 per share of nominal value of CZK 100 and CZK 450 per share of nominal value CZK 1,000, before tax. The record day for the payment of dividends was 25 September 2006 and the disbursement date 2 October 2006.

General Meeting

The Ordinary General Meeting of shareholders of Telefónica O2 will be held on 26 April 2007.

Financial calendar

Date of release of current results	
For the first quarter of 2007	26 April 2007 *
For the first half of 2007	26 July 2007 *
For three quarters of 2007	25 October 2007 *
For the year 2007	28 February 2008 at the latest

* subject to change

Institutional relations and shareholders may contact

Investor Relations

Tel.:	+420 271 462 076, +420 271 462 169
Fax:	+420 271 469 825
E-mail:	investor.relations@o2.com
URL:	http://www.cz.o2.com/home/cz/aboutUs/investorRelations/index.html
Adress:	Telefónica O2 Czech Republic, a.s., Olšanská 5/55, 130 34 Prague 3

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Glossary of terms and acronyms

Glossary of terms and acronyms

By the end of 2006, spontaneous brand recognition among the respondents increased to 76%.

Glossary of terms and acronyms

ADSL – Asymmetric Digital Subscriber Line
ARPU – an indicator – average monthly revenues from services per user, excluding roaming visitors
Colour lines – premium rate numbers
BlackBerry – a mobile office solution from Telefónica O2 designed for mobile corporate customers
CDMA (Code Division Multiple Access) – a modern digital technology for wireless data and broadband internet
CTO – Czech Telecommunications Office
e-účet – a service of ČESKÝ TELECOM, offering online access to a bill for fixed-line telecommunications services
EDGE – Enhanced Data Rates for GSM Evolution, a mobile digital technology with a faster and more reliable data transmission
Eurotel Live! – a portal of entertainment and information content services distributed via WAP, SMS, MMS or video, formerly provided by Eurotel; these and other services can be instantly ordered online via the portal. After the inception of Telefónica O2, the portal was renamed O_2 Active
Eurotel Navigace – a service formerly provided by Eurotel; it is a simple and economical navigation solution for travellers. After the inception of Telefónica O2, the service was renamed O_2 Navigace
Eurotel Web Video volání – a service formerly provided by Eurotel; it allows users make video calls without a mobile telephone and outside the UMTS network coverage
GPRS (General Packet Radio Service) – a technology for mobile data transmission
GSM (Global System for Mobile Communication) – the most widely deployed digital wireless communication standard for the digital mobile system which globally uses frequencies of 450, 900, 1,800 and 1,900 MHz, and frequencies of 900 and 1,800 MHz in the Czech Republic
HSCSD (High-Speed Circuit-Switched Data) – a technology for mobile data transmission in the GSM network
HSDPA (High Speed Downlink Packet Access) – a superstructure technology for data transmission in the UMTS network, with speeds from 8 to 10 Mb/s
IFRS – International Financial Reporting Standards
Internet Expres – a broadband internet service formerly provided by ČESKÝ TELECOM, offering connection speeds up to 4Mb/s; after the inception of Telefónica O2, the service was renamed O_2 Internet Expres
Internet Speed – a HSDPA service formerly provided by Eurotel, offering mobile downlink speeds up to 1,024 kb/s in the UMTS network
IP Connect – a service for IP protocol based data communication
IPTV – Internet Protocol Television
IP VPN – Internet Protocol Virtual Private Network, a service of intra-corporate data or voice over IP communication

ISDN (Integrated Services Digital Network) a digital network powering modern and quality services of telephony, fast internet and high-speed data transmission
MMS – a multimedia format for mobile data transmission
My Europe – a mobile tariff of Telefónica O2, with free-of-charge incoming calls for roaming users
My Europe SMS – a mobile tariff of Telefónica O2, with free-of-charge incoming calls for roaming users
NMT (Nordic Mobile Telephony) – a technology standard for mobile telephony networks using the 450 MHz frequency
O_2 BlackBerry – a tariff for users of BlackBerry, with a 4 MB data allowance
O_2 BlackBerry Roaming – a tariff for users of BlackBerry, with a 4 MB data allowance when roaming abroad and 4 MB in the Czech Republic
O_2 Fajn – a mobile pre-paid tariff of Telefónica O2, designed for frequent callers and heavy SMS users who do not wish to be bound by a contract
O_2 Internet Expres – a broadband internet service of Telefónica O2 with speeds up to 4 Mb/s
O_2 Internet Komplet – a service of Telefónica O2 combining fixed and mobile services
O_2 Internet Mobil – a CDMA mobile service of Telefónica O2
O_2 Mix – a pre-paid mobile tariff of Telefónica, designed for customers who regularly top up their credit
O_2 Navigace – a service of Telefónica O2; a simple and economical navigation solution for travellers
O_2 Pohoda Simple – a mobile tariff of Telefónica O2; one of a family of O_2 Simple price plans, this tariff is targeted primarily to students
O_2 Simple – new mobile tariffs of Telefónica O2; they let customers match their mobile communication costs to their anticipated communication needs. There are 5 options with different levels of subscription: O_2 Simple 240, O_2 Simple 600, O_2 Simple 980, O_2 Simple 1350 and O_2 Simple 1980.
O_2 TV – an IPTV service of Telefónica O2
O_2 TXT – a mobile tariff of Telefónica O2 for pre-paid service customers who prefer SMS and MMS communication
OIBDA – Operating Income before Depreciation and Amortisation
SMS – a format for short text messages used in mobile telephony
Telefon Mini – a price plan, formerly of ČESKÝ TELECOM; after the inception of Telefónica O2 it was renamed O_2 Mini
Telefon Nonstop – a price plan, formerly of ČESKÝ TELECOM, offering free-of-charge calls to all fixed networks around-the-clock; after the inception of Telefónica O2 it was renamed O_2 Nonstop
Telefon Standard – a price plan, formerly of ČESKÝ TELECOM; after the inception of Telefónica O2 it was renamed O_2 Standard
Telefon Volno Plus – a price plan, formerly of ČESKÝ TELECOM, offering free calls off-peak, on weekends and holidays, and 60 free minutes of peak-time calls to fixed networks in the Czech Republic; after the inception of Telefónica O2 it was renamed O_2 Volno Plus
UMTS (Universal Mobile Telecommunications System) – a standard for the so-called 3rd generation mobile networks
VoIP – Voice over Internet Protocol
VPN – Virtual Private Network
VPN Expres – a data service formerly provided by ČESKÝ TELECOM, enabling IP VPN creation; it is based on the ADSL access technology with aggregation and the MPLS backbone network
WAP (Wireless Application Protocol) – a protocol for displaying selected web pages on a mobile telephone display
WiFi – a local wireless network for accessing the internet

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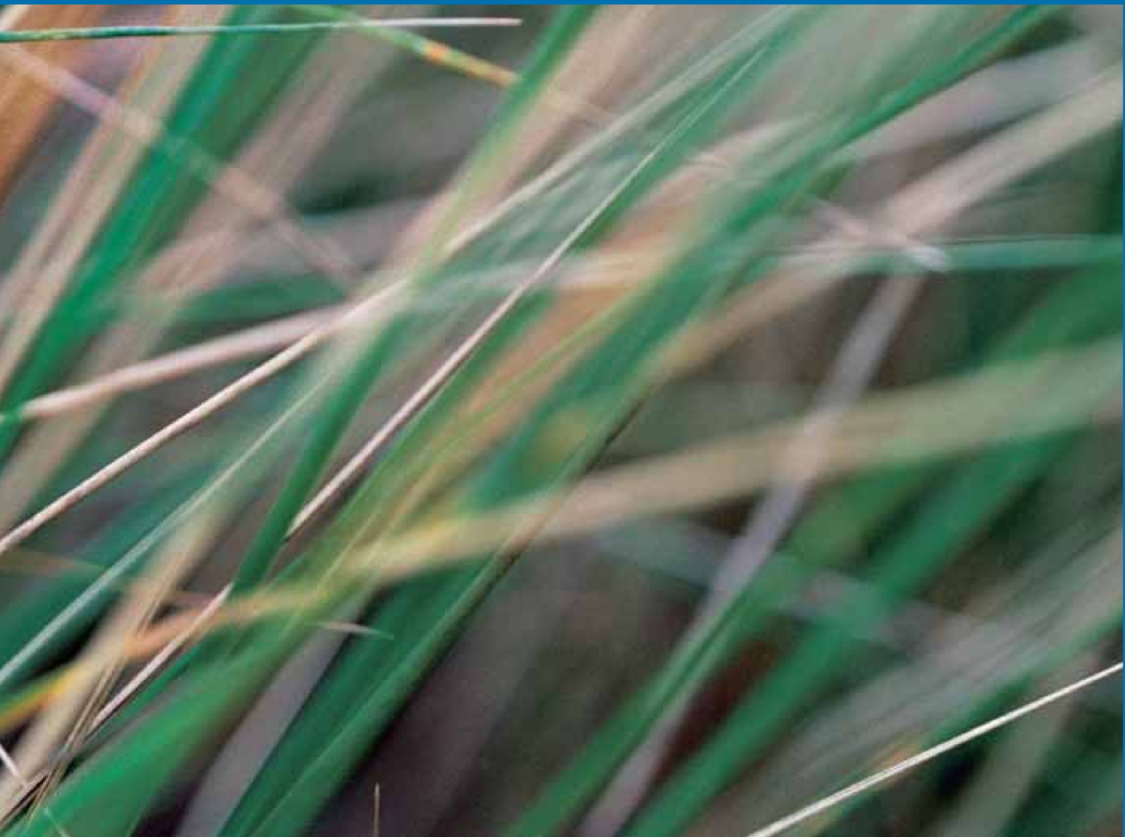

Appendix

Revenues from internet and data services recorded a 24.5% year-on-year increase.

Appendix

Report of the Board of Directors of Telefónica O2 Czech Republic, a.s.
On relationships between the controlling and the controlled entity and on relationships between the controlled entity and other entities controlled by the same controlling entity for 2006 (pursuant to provisions of Section 66a of Act No. 513/1991 Coll., the Commercial Code, as amended)

Part A
Applicable period

The report pursuant to Section 66a of Act No. 513/1991 Coll., the Commercial Code, as amended (Commercial Code) on relationships between the controlling and the controlled entity and on relationships between the controlled entity and other entities – interconnected entities controlled by the same controlling entity (Report) is prepared for the last accounting period, i.e. for the period started on 1 January 2006 and ended on 31 December 2006.

Part B
Entities forming the holding

Section I. – Identification details of the controlled entity – Telefónica O2 Czech Republic, a.s.

The company is registered in the Commercial Register of the Municipal Court in Prague, Section B, Enclosure 2322.

Registration date:	1 January 1994
Corporate name:	Telefónica O2 Czech Republic, a.s.
Registered address:	Olšanská 55/5, 130 34 Prague 3
Identification number:	60 19 33 36
Legal form:	Joint-stock company

The following changes occurred in the identification details and legal fundamentals in the accounting period 2005:

1. Under the agreement for the take-over of equity, concluded with Eurotel Praha, spol. s r.o., the equity of the dissolved company, Eurotel Praha, spol. s r.o., with the registered address in Prague 4, Vyskočilova č.p.1442/1b, PSČ 140 21, company identification number: 152 68 306, registered in the Commercial Register of the Municipal Court in Prague, Section C, Enclosure 1504, was transferred to Telefónica O2 Czech Republic, a.s. on 1 July 2006. Telefónica O2 Czech Republic, a.s., is the legal successor of the dissolved company Eurotel Praha, spol. s r.o.

2. On 1 July 2006, the corporate name of ČESKÝ TELECOM, a.s., was changed to Telefónica O2 Czech Republic, a.s.

Section II. – Identification details of the controlling entity

Controlling entity:	Telefónica, S.A.
Registered address:	Gran Vía 28, 28013 Madrid, the Kingdom of Spain
Identification number:	A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 69.41% of the share capital of the controlled entity.
The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 69.41%.

Telefónica O2 Czech Republic, a.s.
- 69.41% Telefónica, S.A.
- Other investors 30.59%

Section III. Interconnected entities
Entities controlled by the Telefónica, S.A.

(a) The list of entities controlled by Telefónica, S.A. forms the Schedule No. 1 the Report. The list was compiled from inputs from Telefónica, S.A., and verified using information from the Commercial Register and other available sources.
(b) The list of entities further controlled by Telefónica, S.A., forms the Schedule No. 2 of the Report. The list was compiled from inputs from Telefónica, S.A., and verified using information from the Commercial Register and other available sources.

Part C
Contracts and agreements between the controlled entity and the controlling entity, and contracts and agreements between the controlled entity and other interconnected entities including details of performance provided thereunder

In the applicable period, contracts for the provision of services were concluded with the controlling entity and with interconnected entities; the contents of the contracts are regarded as trade secret by the parties.

The contracts were concluded with Telefónica S.A., the controlling entity, and with Telefónica O2 Services, spol. s r.o., Telefónica Finanzas, S.A., Czech Telecom Austria GMBH, Czech Telecom Germany GMBH, Telefónica International Wholesale Services, Telefónica Investigación Y Desarrollo and CenTrade, a.s., all of which are interconnected entities.

Details of contracts concluded are regarded as trade secret by the controlled entity, according to the Commercial Code and other internal governance documents. The controlled entity has not suffered any damage in connection with contracts and agreements concluded in 2006 between the controlled entity and other interconnected entities, under which performance and counter-performance was given, or in connection with provision of performance and counter-performance in 2006 under contracts and agreements concluded prior to 1 January 2006. Performance provided in 2006 under the above contracts did not entail any advantages or disadvantages for the controlled entity.

Part D
Other legal acts between holding entities in the accounting period 2006
In accounting period 2006, no legal acts were made by the controlled entity in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage to the controlled entity.

Part E
Measures between holding entities in the accounting period 2006
In accounting period 2006, no measures were taken by the controlled entity in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage to the controlled entity.

Part F
Conclusion
(a) The Report was prepared by the Board of Directors of the controlled entity, Telefónica O2 Czech Republic, a.s., and approved at the meeting of the Board of Directors held on 19th March 2007.
(b) The Report was prepared using data and information obtained from the controlling entity and other interconnected entities, other available documents, and using results of examinations of relationships between the controlled entity on the one hand and the controlling entity and other interconnected entities on the other hand. The Board of Directors of the controlled entity, Telefónica O2 Czech Republic, a.s., declares that it proceeded with due professional diligence of a manager when collecting the data and information.
(c) With regard to the fact that the controlled entity, Telefónica O2 Czech Republic, a.s., is obliged by law to make an Annual Report pursuant to Act No. 563/1991 Coll., on accounting, as amended, this Report will be attached to the 2006 Annual Report. Shareholders will have the opportunity to read the Report at the same time and under the same conditions as the financial statements.

In Prague, on 19th March 2007

Telefónica O2 Czech Reublic, a.s. – controlled entity
Board of Directors

Jaime Smith Basterra
Chairman of the Board of Directors

Juraj Šedivý
First Vice-Chairman of the Board of Directors

Schedule No. 1

List of joint-stock companies directly controlled by Telefónica, S.A., with a share interest of 40–100% held by the Telefónica Group in the period from 1 January 2006 to 31 December 2006

Corporate name	Registered address	% Held by Telefónica, S.A.
TELEFÓNICA PUBLICIDAD E INFORMACIÓN, S.A.	**AVDA. DE MANOTERAS,12-28050 MADRID, SPAIN**	**59.90**
ALIANCA ATLANTICA HOLDING, B.V.	**STRAWINSKYLAAN 1725, 1077 XX AMSTERDAM, NETHERLANDS**	**50.00**
TELEFÓNICA FACTORING ESTABLECIMIENTO FINANCIERO DE CREDITO, S.A.	**PEDRO TEIXEIRA, 8-28020 MADRID, SPAIN**	**50.00**
TERRA NETWORKS, S.A.	**NICARAGUE, 54 – 08029 BARCELONA, SPAIN**	**75.87**
TELEFÓNICA MÓVILES, S.A.	**GOYA, 24-MADRID, SPAIN**	**92.46**
TELEFÓNICA INTERNATIONAL, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**99.88**
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES AMERICA, S.A.	**LUIS A. DE HARRERA, 1248 PISO 4-MONTEVIDEO, URUGUAY**	**100.00**
TELEFONICA GESTION DE SERVICIOS COMPARTIDOS (ARGENTINA), S.A.	**TUCUMAN 1, PISO 18 CIUDAD DE BUENOS AIRES, ARGENTINA**	**99.99**
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS (PERU), S.A.C.	**SHELL, 310-MIRAFLORES LIMA, PERU**	**99.99**
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS MEXICO, S.A.	**BLVD. DÍAZ ORDAZ PTE N 123 2, COL. SANTAMARIA-6465 MONTERREY, MEXICO**	**99.99**
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA B2B LICENCING, INC.	**1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA**	**100.00**
TELEFÓNICA INTERNACIONAL USA INC.	**1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA**	**100.00**
TELEFÓNICA EUROPE, B.V1.	**STRAWINSKYLAAN 1259, TOWER D, 12TH FLOOR 1077XX-AMSTERDAM, NETHERLANDS**	**100.00**
TELEFÓNICA EMISIONES, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA PARTICIPACIONES, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
COMMUNICAPITAL GESTIÓN, S.A.U.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
VENTURINI ESPAÑA, S.A.	**VIA AUGUSTA,117-08006 BARCELONA, SPAIN**	**100.00**
FISATEL MEXICO, S.A.	**LOMAS DE CHAPULTEPEC-11000 MEXICO CITY, MEXICO**	**100.00**
TELEFÓNICA FINANZAS PERÚ, S.A.C.	**CUIDAD DE LIMA, PERU**	**100.00**
TELEFÓNICA FINANZAS, S.A.	**GRAN VÍA, 30-4 PLTA.-28013 MADRID, SPAIN**	**100.00**
CASIOPEA REASEGURADORA, S.A.	**6D, ROUTE DE TREVES, L-2633 SENNINGERBERG, LUXEMBOURG**	**100.00**
COMPANIA ESPAÑOLA DE TECHNOLOGIA, S.A.	**VILLANUEVA, 2 DUPLICADO PLANTA 1 OFICINA 23-28001 MADRID, SPAIN**	**100.00**
COMMUNICAPITAL INVERSIONES, S.A.U.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA INVESTIGACIÓN Y DESARROLLO, S.A.	**EMILIO VARGAS, 6-28043 MADRID, SPAIN**	**100.00**
ATENTO N.V.	**LOCATELLIKADE, 1-1076 AZ AMSTERDAM, NETHERLANDS**	**91.35**
ATESECO COMUNICACIÓN, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA CAPITAL, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA INGENIERÍA DE SEGURIDAD, S.A.	**CONDESA DE VENADITO, 1-28027 MADRID, SPAIN**	**100.00**
TELEFÓNICA DE ESPAÑA, S.A.U.	**GRAN VÍA, 28 -28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA DATACORP, S.A.U.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
ENDEMOL HOLDING, N.V.	**BERGWEG 70, 1217 SC HILVERSUM, NETHERLANDS**	**99.70**
TELEFÓNICA DE CONTENIDOS, S.A.U.	**PASEO DE LA CASTELLANA. 141-28046 MADRID, SPAIN**	**100.00**
TELEFÓNICA O2 CZECH REPUBLIC, A.S.	**OLŠANSKÁ 55/5, 130 34 PRAHA 3, CZECH REPUBLIC**	**69.41**
TELEFÓNICA O2 EUROPE PLC	**WELLINGTON STREET SLOUGH, BERKSHIRE, SL1 1YP, UNITED KINGDOM**	**100.00**

Schedule no. 2

Interconnected entities and entities controlled by them, with a share interest of more than 40% held by the Telefónica Group in the period from 1 January 2006 to 31 December 2006

Corporate name	Registered address	% held by Telefónica Group
TELEFÓNICA PUBLICIDAD E INFORMACIÓN, S.A.	AVDA. DE MANOTERAS, 12-28050 MADRID	59.90
TELEFÓNICA PUBLICIDAD E INFORMACIÓN EDITA, S.A.U.		+40
TELEFÓNICA PUBLICIDAD E INFORMACIÓN DIRECT, S.L.		+40
EDINET EUROPA, S.A.U.		+40
TELEFÓNICA PUBLICIDAD E INFORMACIÓN INTERNATIONAL, S.A.U.		+40
DIRECTORIES HOLDING, B.V.		+40
PUBLIGUÍAS HOLDING, S.A.		+40
URGE CHILE, S.A.		+40
IPRESORA Y COMERCIAL PUBLIGUÍAS, S.A.		+40
TELEFÓNICA PUBLICIDAD E INFORMACIÓN PERÚ, S.A.C.		+40
TELEFÓNICA PUBLICIDADE E INFORMACAO, LTDA.		+40
11888 SERVICIO CONSULTA TELEFÓNICA, S.A.		+40
ALIANCA ATLANTICA HOLDING, B.V.	**STRAWINSKYLAAN 1725, 1077 XX AMSTERDAM, NETHERLANDS**	**50.00**
TELEFÓNICA FACTORING ESTABLECIMIENTO FINANCIERO DE CRÉDITO, S.A.	**PEDRO TEIXEIRA, 8-28020 MADRID, SPAIN**	**50.00**
TELEFÓNICA FACTORING DO BRASIL, LTD.	**AVDA. PAULISTA, 1106, BRASIL**	
TERRA NETWORKS, S.A.	**NICARAGUE, 54 – 08029 BARCELONA, SPAIN**	**75.87**
TERRA BUSINESS TRAVEL, S.A.		+40
TERRA LYCOS HOLDING.B.V.		+40
TERRA LYCOS INTANGIBLES, S.A.		+40
TERRA NETWORKS USA, INC.		+40
CENTRO DE INVESTIGACIÓN Y EXPERIMENTACIÓN DE LA REALIDAD VIRTUAL, S.L.		+40
CORPORATION REAL TIME TEAM, S.L.		+40
UNO-BANK, S.A.		+40
TERRA NETWORKS ASOCIADAS, S.L.		+40
MAPTEL NETWORKS, S.A.U.		+40
IFIGENIA PLUS, S.L.		+40
EDUCATERRA, S.L.		+40
ONE TRAVEL COM, INC.		+40
AZELER ATOMOCIÓN, S.A.		+40
RED UNIVERSAL DE MARKETING Y BOINGS ONLINE, S.A.		+40
INICIATIVAS RESIDENCIELES EN INTERNET, S.A.		+40
TERRA NETWORKS ESPAÑA. S.A.		+40
TERRA NETWORKS LATEM E.T.V.E, S.L.		+40
TERRA NETWORKS VENEZUELA, S.A.		+40
TERRA NETWORKS PERÚ, S.A.		+40
TERRA NETWORKS MEXICO HOLDING, S.A.		+40
TERRA NETWORKS MEXICO, S.A.		+40
TELEFÓNICA INTERACTIVA BRASIL, LTDA.		+40
TERRA NETWORKS BRASIL, S.A.		+40
TERRA NETWORKS CHILE, S.A.		+40
TERRA NETWORKS CHILE HOLDING LIMITADA		+40

TERRA NETWORKS GUATEMALA, S.A.		+40
TERRA NETWORKS EL SALVADOR, S.A.		+40
TERRA NETWORKS HONDURAS, S.A.		+40
TERRA NETWORKS COSTA RICA, S.A.		+40
TERRA NETWORKS NICARAGUA, S.A.		+40
TERRA NETWORKS PANAMÁ, S.A.		+40
TERRA NETWORKS CARIBE, S.A.		+40
TERRA NETWORKS ARGENTINA., S.A.		+40
TERRA NETWORKS MAROC, S.A.R.L.		+40
TERRA NETWORKS COLOMBIA HOLDING, S.A.		+40
TERRA NETWORKS COLOMBIA, S.A.		+40
TERRA NETWORKS SERVICOS DE ACCESO A INTERNET E TRADING, LTD.		+40
TELEFÓNICA MÓVILES, S.A.	**GOYA, 24-MADRID, SPAIN**	**71.03**
BRASILCEL, N.V.		+40
VIVO BRASIL COMUNIC.– HOLDING COMPANY		+40
TAGILIO PARTICIPACOES, S.A.		+40
SUDESTESEL PARTICIPACOES, S.A.		+40
AVISTA PART. S.L.		+40
TELE SUDESTE CELULAR PARTICIPACOES, S.A.		+40
TELERJ CELULAR, S.A.		+40
TELEST CELULAR, S.A.		+40
PORTELCOM FIXA, S.A.		+40
SAO PAULO TELEFÓNICA BRASIL SUL CELULAR PARTICIPACOES, S.A.		+40
PTELECOM BRASIL, S.A.		+40
PORTELCOM PARTICIPACOES, S.A.		+40
TELEFÓNICA MOVILES EL SALVADOR HOLDING, S.A.		+40
TELEFÓNICA MOVILES EL SALVADOR, S.A.		+40
TELEFÓNICA MULTISERVICIOS, S.A.		+40
TELEFÓNICA MOVILES CENTROAMERICA, S.A.		+40
TELEFÓNICA EL SALVADOR, S.A.		+40
TCG HOLDINGS, S.A.		+40
TELEFÓNICA MÓVILES GUATEMALA, S.A.		+40
TELESCUCHA, S.A.		+40
INFRAESTRUCTURA INTERNATIONAL, S.A.		+40
TELEFÓNICA MOVILES ESPAÑA, S.A.U.		+40
SPIRAL INVESTMENT, B.V.		+40
3G MOBILE AG		+40
SOLIVELLA INVESTMENT, B.V.		+40
IPSE 2000.S.P.A.		+40
GROUP 3 G UMTS HOLDING, GMBH		+40
QUAM, GMBH		+40
OPCOM MOBILE SERVICES, GMBH		+40
TELEFÓNICA MÓVILES INTERACCIONA, S.A.		+40
TERRA MOBILE BRASIL, LTD.		+40
GROUPO 3G, S.R.L.		+40
OMICRON CETI, S.L.		+40

TELEFÓNICA MÓVILES PUERTO RICO, INC.	+40
TELEFÓNICA MÓVILES USA, INC.	+40
TELCA GESTIÓN GUATEMALA, S.A.	+40
MOBIPAY INTERNATIONAL, S.A.	+40
TELEFÓNICA MÓVILES PERÚ HOLDING, S.A.A.	+40
TELEFÓNICA MÓVILES, S.A.C.	+40
TELEFÓNICA MÓVILES ARGENTINA, S.A.	+40
TELEFÓNICA COMUNICACIONES PERSONALES, S.A.	+40
RADIO SERVICIOS, S.A.	+40
TELEFÓNICA DE CENTROAMÉRICA	+40
TELEFÓNICA MÓVILES HOLDING URUGUAY, S.A.	+40
TELEFÓNICA MÓVILES URUGUAY, S.A.	+40
WIRELESS NETWORK VENTURES – HOLDING COMPANY	+40
PAGING DE CENTROAMÉRICA	+40
TELEFÓNICA SOPORTE TECNOLOGIA, S.A.	+40
TELEFÓNICA MÓVILES MEXICO, S.A.	+40
TELEFÓNICA FINANZAS MÉXICO, S.A.	+40
BAJA CELULAR MEXICANA, S.A.	+40
MOVITEL DE NOROESTE, S.A.	+40
MOVISERVICIOS, S.A.	+40
CORPORATIVO INTEGRAL COMUNICACIÓN, S.A.	+40
TELEFONÍA CELULAR DEL NORTE, S.A.	+40
GRUPO CORPORATIVO DEL NORTE, S.A.	+40
CELULAR DEL TELEFONÍA, S.A.	+40
ENLACES DEL NORTE, S.A.	+40
GRUPO DE TELECOMUNICACIONES MEXICANAS, S.A.	+40
PEGASO TELECOMUNICACIONES, S.A.	+40
PEGASO COMUNICACIONES Y SISTEMAS, S.A.	+40
PEGASO PCS, S.A.	+40
PEGASO RECURCOS HUMANOS, S.A.	+40
PEGASO FINANZAS, S.A.	+40
PEGASO FINCO I, S.A.	+40
ACTIVOS PARA TELECOMUNICACIÓN, S.A.	+40
TELECOMUNICACIONES PUNTO A PUNTO MÉXICO, S.A.	+40
TELEFÓNICA TELECOMUNICACIONES MÉXICO – HOLDING COMPANY	+40
TELEFÓNICA MÓVILES SOLUCIONES Y APLICIONES, S.A.	+40
INVERSIONES TELEFÓNICA MÓVILES HOLDING LIMITADA – HOLDING COMPANY	+40
TEM INVERSIONES CHILE LIMITADA – HOLDING COMPANY	+40
TELEFÓNICA MÓVIL DE CHILE, S.A.	+40
TELEFÓNICA MÓVILES SOLUCIONES, S.A.	+40
TELEFÓNICA MÓVILES ESERVICES LATIN AMERICA, INC.	+40
ECUADOR CELLULAR HOLDINGS, B.V.	+40
BS ECUADOR HOLDINGS, LTD.	+40
OTECEL, S.A.	+40
CELLULAR HOLDINGS (CENTRAL AMERICA) INC.	+40
GUATEMALA CELLULAR HOLDINGS, B.V.	+40

TMG (BVI) HOLDINGS, LTD.	+40
CENTRAM COMMUNICATIONS, LP – HOLDING COMPANY	+40
TEM GUATEMALA LTD. – HOLDING COMPANY	+40
TELEFÓNICA MÓVILES GUATEMALA Y CÍA, S.C.A.	+40
CENTRAL AMERICA SERVIES HOLDING, LTD.	+40
MULTI HOLDING CORPORATION – HOLDING COMPANY	+40
PANAMÁ CELLULARD HOLDINGS, B.V – HOLDING COMPANY	+40
BELLSOUTH PANAMÁ, LTD.	+40
PANAMÁ CELLULAR HOLDINGS, LLC – HOLDING COMPANY	+40
BSC DE PANAMA HOLDINGS, S.R.L.	+40
BSC CAYMAN – GENERAL PARTNERSHIP	+40
TELEFÓNICA MÓVILES PANAMÁ, S.A.	+40
PANAMÁ CELLULAR INVESTMENTS, LLC.	+40
LATIN AMERICAN CELLULAR HOLDINGS, B.V.	+40
ABLITUR, S.A.	+40
REDAMIL, S.A.	+40
ABIATAR, S.A.	+40
COMUNICACIONES MÓVILES DE PERÚ, S.A.	+40
BELLSOUTH NICARAGUA, S.A.	+40
PISANI RESOURCES Y CÍA, LTD.	+40
DORIC HOLDING Y CÍA, LTD.	+40
KALAMAI HOLDINGS, LTD. – HOLDING COMPANY	+40
KALAMAI HOLD. Y CÍA, LTD – HOLDING COMPANY	+40
TELEFONÍA CELULAR DE NICARAGUA, S.A.	+40
TELECOMUNICACIONES BBS, S.R.L.	+40
COMTEL COMUNICACIONES TELEFÓNICAS, S.A.	+40
TELCEL, C.A.	+40
SISTEMAS TIMETRAK, C.A.	+40
SERVICIOS TELCEL, C.S.	+40
TELCEL INTERNATIONAL, LTD.	+40
CORPORACIÓN 271191, C.A.	+40
PROMOCIONES 4222, C.A.	+40
ST. MÉRIDA, C.A.	+40
TELECOMUNICATION SERVICES AND PUBLIC ATENTION	+40
S.T. MARACAIBO, C.A.	+40
S.T. PUNTO FIJO, C.A.	+40
S.T. VALERA, C.A.	+40
S.T. VALENCIA, C.A.	+40
SYRED, T.E.I., C.A.	+40
SERVICIOS TELCEL ACARIGUA, C.A.	+40
SERVICIOS TELCEL BARQUISIMENTO, C.A.	+40
SERVICIOS TELCEL CHARALLAVE	+40
S.T. CUMANA, C.A.	+40
S.T. GUARENAS, C.A.	+40
S.T. LOS TEQUES, C.A.	+40
S.T. MARACAY, C.A.	+40

S.T. MARGARITA, C.A.		+40
S.T. MATURÍN, C.A.		+40
S.T. PUERTO ORDAZ, C.A.		+40
OLYMPIC, LTD.		+40
TELEFÓNICA MÓVILES COLOMBIA, S.A.		+40
BAUTZEN, INC.		+40
COMOVILES, S.A.		+40
COMUNICACIONES TRUNKING, S.A.		+40
PARACOMUNICAR, S.A.		+40
KOBROCOM ELEKTRÓNICA, LTD.		+40
TELEFÓNICA INTERNATIONAL, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**99.88**
SAO PAULO TELECOMUNICACOES HOLDING, LTDA. – HOLDING COMPANY		+40
TELECOMUNICACOES DE SAO PAULO, S.A.		+40
TELEFÓNICA FINANCE LIMITED		+40
TELEFÓNICA DEL PERÚ HOLDING, B.V.		+40
TELEFÓNICA DEL PERÚ, S.A.A.		+40
TELEFÓNICA INTERNATIONAL HOLDING, B.V.		+40
TELEFÓNICA CHILE HOLDING, B.V.		+40
TELFÓNICA INTERNATIONAL DE CHILE, S.A.		+40
COMPAÑÍA DE TELECOMUNICACIONES DE CHILE, S.A.		+40
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS CHILE, S.A.		+40
COMPANÍA INTERNATIONAL DE TELECOMUNICACIONES, S.A.		+40
TELEFÓNICA HOLDING DE ARGENTINA, S.A.		+40
TELEFÓNICA DE ARGENTINA, S.A.		+40
TELEFÓNICA VENEZUELA HOLDING, B.V.		+40
TELEFÓNICA LARGA DISTANCIA DE PUERTO RICO, INC.		+40
INFONET SERVICES CORPORATION		+40
COMUNICATION TECHNOLOGY, INC.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES AMERICA, S.A.	**LUIS A. DE HARRERA, 1248 PISO 4-MONTEVIDEO, URUGUAY**	**100.00**
EMERGIA ARGENTINA, S.A.		+40
EMERGIA PARTICIPACOES, LTD.		+40
EMERGIA BRASIL, LTD.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES CHILE, S.A.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES PERÚ, S.A.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES USA, S.A.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES GUATEMALA, S.A.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES PUERTO RICO, S.A.		+40
TELEFONICA GESTIÓN DE SERVICIOS COMPARTIDOS (ARGENTINA), S.A.	**TUCUMAN 1, PISO 18 CIUDAD DE BUENOS AIRES, ARGENTINA**	**99.99**
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS (PERU), S.A.C.	**SHELL, 310-MIRAFLORES LIMA, PERU**	**99.99**
TELEFÓNICA CENTRO DE COBROS PERÚ, S.A.C.		+40
TELEFÓNICA GESTAO DE SERVICOS COMPARTILHADOS DO BRASIL, LTDA.	**RUA DO LIVREMENTO, 66 BALCO IBIRAPUERA-SAO PAULO, BRASIL**	**99.99**
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS MEXICO, S.A.	**BLVD. DÍAZ ORDAZ PTE N 123 2, COL. SANTAMARIA-6465 MONTERREY, MEXICO**	**99.99**
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS EL SALVADOR, S.A.		+40
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS GUATEMALA, S.A.		+40
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
SOCIEDAD DE COBROS DE BRASIL		+40

TELEFÓNICA PROCESOS Y TECHNOLOGÍA DE LA INFORMACIÓN, S.A.		+40
ZELERIS ESPAÑA, S.A.		+40
TELEFÓNICA B2B LICENCING (USA), INC.	**1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA**	**100.00**
TELEFÓNICA INTERNACIONAL USA INC.	**1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA**	**100.00**
TELEFÓNICA EUROPE, B.V.	**STRAWINSKYLAAN 1259, TOWER D, 12TH FLOOR 1077XX-AMSTERDAM, NETHERLANDS**	**100.00**
TELEFÓNICA EMISIONES, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA PARTICIPACIONES, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
COMMUNICAPITAL GESTIÓN, S.A.U.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
VENTURINI ESPAÑA, S.A.	**VÍA AUGUSTA, 117-08006 BARCELONA, SPAIN**	**100.00**
VENTURINI, S.A.		+40
FISATEL MEXICO, S.A.	**LOMAS DE CHAPULTEPEC-11000 MEXICO CITY, MEXICO**	**100.00**
TELEFÓNICA FINANZAS PERÚ, S.A.C.	**CUIDAD DE LIMA, PERU**	**100.00**
TELEFÓNICA FINANZAS, S.A.	**GRAN VÍA, 30-4 PLTA.-28013 MADRID, SPAIN**	**100.00**
CASIOPEA REASEGURADORA, S.A.	**6D, ROUTE DE TREVES, L-2633 SENNINGERBERG, LUXEMBOURG**	**100.00**
PLÉIADE PENINSULAR, CORREDURÍA DE SEGUROS Y REASEGUROS DELGRUPO TELEFÓNICA, S.A.		+40
PLÉYADE PERÚ CORREDORES DE SEGUROS, S.A.C		+40
PLÉYADE ARGENTINA, S.A.		+40
TGP BRASIL CORRETORA DE SEGUROS E RESSEGUROS, LTDA.		+40
PLÉYEDE MÉXICO, AGENTE DE SEGUROS DE FINANZAS, S.A.		+40
ALTAIR ASSURANCES, S.A.		+40
SEGUROS DE VIDA PENSIONES ANTARES, S.A.		+40
COMPANIA ESPAÑOLA DE TECNOLOGIA, S.A.	**VILLANUEVA, 2 DUPLICADO PLANTA 1 OFICINA 23-28001 MADRID, SPAIN**	**100.00**
CLEON, S.A.		+40
COMMUNICAPITAL INVERSIONES, S.A.U.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA INVESTIGACIÓN Y DESARROLLO, S.A.	**EMILIO VARGAS, 6-28043 MADRID, SPAIN**	**100.00**
TELEFÓNICA INVESTIGACIÓN Y DESARROLLO DE MEXICO, S.A.		+40
TELEFÓNICA PESQUISA E DESENVOLVIMENTO		+40
ATENTO N.V.	**LOCATELLIKADE, 1-1076 AZ AMSTERDAM, NETHERLANDS**	**91.35**
PROCESOS OPERATIVOS, S.A.		+40
ATENTO TELESERVICIOS ESPAÑA, S.A.		+40
TEMPOTEL, EMPRESA DE TRABAJO TEMPORAL, S.A.		+40
ATENTO SERVICIOS TÉCNICOS Y CONSULTÓRIA, S.L.		+40
SERVICIOS INTEGRALES DE ASISTENCIA Y ATENCIÓN, S.L.		+40
ATENTO BRASIL, S.A.		+40
ATENTO PUERTO RICO, INC.		+40
ATENTO COLOMBIA, S.A.		+40
ATENTO MAROC, S.A.		+40
ATENTO VENEZUELA, S.A.		+40
ATENTO CENTROAMÉRICA, S.A.		+40
ATENTO DE GUATEMALA , S.A.		+40
ATENTO EL SALVADOR, S.A.		+40
ATENTO HOLDING CHILE, S.A.-HOLDING COMPANY		+40
ATENTO ARGENTINA, S.A.		+40
ATENTO CHILE, S.A.		+40
NEXCOM CHILE		+40

ATENTO EDUCACIÓN, LTDA.		+40
ATENTO RESURCOS, LTDA.		+40
ATENTO PERÚ, S.A.C.		+40
ATENTO ITALIA, S.R.L.		+40
ATENTO MEXICANA, S.A.		+40
ATENTO ATENCIÓN Y SERVICIOS, S.A.		+40
ATENTO SERVICIOS, S.A.		+40
ATESECO COMUNICACIÓN, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA CAPITAL, S.A.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
FONDITEL PENSIONES ENTIDAD GESTORA DE FONDOS DE PENSIONES, S.A.		+40
FONDITEL VALORES, AGENCIA DE VALORES, S.A.		+40
FONDITEL GESTIÓN, SOCIEDAD GESTORA DE INSTITUCIONES DE INVERSIÓN COLECTIVA, S.A.		+40
TELEFÓNICA INGENIERÍA DE SEGURIDAD, S.A.	**CONDESA DE VENADITO, 1-28027 MADRID, SPAIN**	**100.00**
TELEFÓNICA ENGENHARIA DE SEGURANCA (BRAZIL)		+40
TELEFÓNICA INGENIERÍA DE SEGURIDAD MÉXICO, S.A.		+40
LOTCA SERVICIOS INTEGRALES, S.L.	**GRAN VÍA, 28-28013, MADRID, SPAIN**	**100.00**
TEATEL, S.L.	**BEATRÍZ DE BOBADILLA, 3-28040 MADRID, SPAIN**	**100.00**
TELEFÓNICA DE ESPAÑA, S.A.U.	**GRAN VÍA, 28-28013 MADRID, SPAIN**	**100.00**
TELEFÓNICA S. DE INFORMÁTICA Y COMUNICACIONES DE ESPAÑA, S.A.U.		+40
TELEFÓNICA MOBILE SOLUTIONS PERÚ, S.A.C.		+40
TELEFÓNICA MOBILE SOLUTIONS BRASIL, LTDA.		+40
TELEFÓNICA SYSTEMAS INGENIÉRIA DE PRODUCTOS GUATEMALA, S.A.		+40
TELEFÓNICA SISTEMAS EL SALVADOR, S.A.		+40
TELEFÓNICA SOLUCIONES DE OUTSOURCING, S.A.		+40
SOLUCIONES TECNOLOGICAS PARA LA ALIMENTACION, S.L.		+40
TELEFÓNICA SOLUCIONES SECTORIALES, S.A.		+40
INTERDOMAIN, S.A.		+40
SODETEL, COMMERCIAL DE SERVICIOS DE TELECOMUNICACIONES, S.A.		+40
PORTEL SERVICIOS TELEMÁTICOS, S.A.		+40
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