ANNUAL REPORT 2007

A Telefónica company

“Don’t look only at the ground – raise your eyes to the sky. This way you can do more than just dream. You will stop noticing the limits of everyday life, and you will advance your thoughts and goals. Just as we do.”

Content

Independent 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 ("the Group") as at 31 December 2007, presented in the annual report of Telefónica O2 Czech Republic, a.s. ("the Company") on pages 112–161, on which we have issued an auditors' report dated 20 February 2008, presented in the annual report on page 114. We have also audited the separate financial statements of the Company as at 31 December 2007, which are presented in the annual report of the Company on pages 164–214 on which we have issued an auditors' report dated 20 February 2008, presented in the annual report of the Company on page 167 (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 6–108 and 218–234 is consistent with that contained in the audited financial statements as at 31 December 2007. 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 2007, presented in the annual report of the Company on pages 242–247. 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 2007 is materially misstated.

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

Brian Welsh
Partner

Magdalena Souček
Auditor, Licence No. 1291

11 March 2008
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	2007	2006
Revenues	63,196	61,268
OIBDA – Operating income before finance costs, tax, depreciation and amortization[1]	28,033	27,906
Operating income	13,598	11,160
Income before taxes	13,510	10,940
Net income	10,386	8,020
Total assets	113,552	117,665
Property, plant and equipment	71,809	78,755
Total equity	82,792	88,481
Financial debts	9,269	9,363
Capital expenditure	7,807	6,500
Operations		
Fixed telephony accesses (x 1,000)	2,069	2,402
ADSL connections (x 1,000)	570	470
Pay TV – O_2 TV (x 1,000)	73	16
Mobile customers in Czech Republic (x 1,000)	5,126	4,864
– of which: contract	2,244	1,875
pre-paid	2,882	2,989
Mobile data customers[2] in Czech Republic (x 1,000)	192	168
Registered mobile customers in Slovakia (x 1,000)	565	–
Group headcount	9,221	9,416

Ratios (in %)	2007	2006
OIBDA/Business Revenues (OIBDA margin)	44.8	45.8
Net income/Revenues	16.4	13.1
Capital expenditure/Revenues	12.4	10.6
ROA (Net income/Total assets)	9.1	6.8
ROE (Net income/Equity)	12.5	9.1
Gross gearing (Financial debts/Total equity)	11.2	10.6
Macroeconomic indicators[3]		
Population (in millions)	10.3	10.3
GDP growth (in %)[4]	6.5	6.1
Inflation (in %)	2.8	2.5
Unemployment (in %)	6.6	8.1
CZK/USD exchange rate – average over the period	20.3	22.6
CZK/USD exchange rate – end of period	18.1	20.9
CZK/EUR exchange rate – average over the period	27.8	28.3
CZK/EUR exchange rate – end of period	26.6	27.5

[1] Including impairment charge; in 2006 the Group posted an impairment charge of CZK 253 million, compared to CZK 5 million in 2007.
[2] CDMA and GPRS.
[3] Sources: Czech Statistical Office, Czech National Bank, Ministry of Labour and Social Affairs.
[4] At constant 1995 prices; the 2007 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 and its results in 2007. I am glad that our results of the last year delivered on most our projections from the beginning of the year and represent a solid jumping block for the achievement of our targets in 2008.

As in the previous years, we focused all activities on delivering maximum satisfaction of customer needs, as well as on responding accordingly to the current trends on the Czech telecommunications market, such as the still continuing trend of expanding portfolios of high-speed internet services, digital television over a fixed line (IPTV) and the trend of converged services. We concentrated on defending our revenues from voice and data services in the mobile and fixed segments.

Another priority was the development of IT services and integrated customer solutions for – primarily – our corporate customers, including the government segment. Here we have clearly shown that we are not only a provider of traditional telecommunications services, but also that we are committed to grow our IT and ICT market share. IT and ICT services in 2007 were the fastest growing segment of our operations and it contributed significantly to the achievement of steadfast results in the fixed line business. We further strengthened our market position in 2007 by acquiring a 100% stake in DELTAX Systems, which ranks in the top ten ICT providers in the Czech Republic. In the mobile segment, we concentrated

on maintaining the Average Revenue Per User (ARPU) by means of continuing the migration of customers from the pre-paid to the post-paid service. The mobile ARPU increased also due to the growing revenues from mobile data and mobile internet services.

In 2007 we successfully entered the mobile market in Slovakia; we acquired a licence for the operation of Slovakia's third mobile network in 2006. Since then we have managed to build up a solid customer base. We rolled out the first part of our own mobile GSM network and a distribution network is now in place.

In the financial area, we continued to place emphasis on growing our revenues whilst maintaining the current OIBDA levels, efficient investment in pro-growth areas and on robust free cash flow generation. I am delighted to say that we met or even exceeded all key financial targets for the year that we communicated at the beginning of 2007.

And now I want to briefly recapitulate the developments and our accomplishments in the past year, as well as our expectations for 2008.

As in the year before, from April 2007 we gradually increased the O_2 Internet ADSL connection speed four times. The speeds in our wholesale offers to alternative operators increased accordingly. Since 1 July, we have increased the data limits by up to three times. The increase was gradual, automatic and at no cost to the customer.

These activities have again helped us to maintain our leadership in ADSL internet on the Czech telecommunications market.

We also continued in introducing new functions to O_2 TV. In February we gave our customers the option to install the service using a self-installation kit. This method of installation has proven popular already for O_2 Internet ADSL and O_2 TV was no exception. We expanded our programming offer by adding bundles of channels for children, of documentaries, feature films and sports. Our partnership with leading Hollywood distributors means that we substantially bolstered our catalogue of films in the Video Library, which the customers can download on demand. 3D films were another addition to the array of choices. In July we became the first company in the Czech Republic to broadcast Czech Television (ČT1) nationally in High Definition (HD) quality. Thanks to our partnership with Extraliga, the highest national league in ice-hockey, we now broadcast live matches from nine stadiums from all of the Czech Republic via O_2 TV, on the internet or to a mobile telephone.

Both O_2 TV and O_2 Internet ADSL became the backbone of our service bundles combining a choice of services, both fixed line and mobile, in one subscription. First we launched O_2 Duo, which offers unlimited fixed line calls and O_2 TV or O_2 Internet ADSL, which was followed by O_2 Trio combining all the three components. Our family of converged services was expanded with the new O_2 Duo Mobil, a service combining mobile voice and O_2 Internet ADSL high-speed internet.

We also continued to develop our range of mobile data services, already the broadest on the market. We created a wholly new portfolio of mobile data services designed for non-stop connectivity in O_2 networks, regardless of the technology used.

As part of our ICT offering, we introduced the first from our range of the so-called managed services. Managed services cover the whole ICT spectrum – from computer networks, voice services and data security to hosting. Customers of managed services can flexibly adapt to the market situation without any technology limitations.
In the government segment, we were awarded a contract for KIVS, a communications solution for government agencies. In partnership with the Fire Brigade we successfully completed the project for new emergency 112 (TCTV 112) system and the eCall 112 pilot project, which set out to test the reception and visualisation of eCall data in the TCTV 112 testing interface.

Our attractive and in many ways unique portfolio of easy-to-understand and user-comfortable products and services reached out to many customers in Slovakia – at the end of the year we recorded 565 thousand customers. We also concentrated on the roll out of our proprietary network. Due to ongoing migration of traffic from the national roaming to the proprietary network as it was being built. At the end of the year more than 60% of voice traffic could already be carried by our network. We successfully completed phase one of the project to develop our distribution network and we were the first mobile operator in Slovakia to offer online shopping.

The financial results of 2007 confirmed our expectations from the beginning of the year, especially our projections for revenue growth, maintaining a strong OIBDA level and efficient capital expenditure. The consolidated revenues reached CZK 63.2 billion in 2007, which represents a 3.1% growth year on year. The mobile segment of Telefónica O2 Czech Republic was the key driver of this growth with business revenues growing 4.4%, whereas revenues in the fixed line segment in 2007 were flat compared to 2006.

The revenue share of the Slovak operation in total Group revenues in 2007 was marginal. Despite the 4.8% increase in operating cost, the consolidated OIBDA grew 0.5% to CZK 28 billion, producing an OIBDA margin of 44.8%, compared to 45.8% in 2006. Despite the decline in the consolidated OIBDA margin in 2007, which was caused largely by the dilution of the Slovak operation, its level is still high. As a result of the ongoing fall in the depreciation, amortisation and financial costs, and due to the effect of the deferred tax, the Group consolidated net profit in 2007 increased 29.5% year on year and reached CZK 10.4 billion. In 2007, our investment focused on pro-growth areas, such as the development of ADSL, IPTV and mobile data networks. The 20.1% increase in capital expenditure which totalled CZK 7.8 billion was largely caused by the launch of the Slovak operation. Investments in Slovakia were directed mainly to the construction of the proprietary network and to system development. Again, we proved our capacity to generate strong cash flows, which reached CZK 18.3 billion, i.e. almost the same level as in 2006.

In 2008, we want to consolidate our activities from the previous years. As in 2007, one of our main priorities is to slow down the decline in fixed accesses. Our improved ADSL and IPTV offerings aim to add more value to the fixed line. We see a strong growth potential in the area of IT and integrated customer solutions primarily for our corporate and government customers. In the mobile segment, we will continue in the migration of customers from our pre-paid to our post-paid service with a view to achieving better voice traffic and ARPU levels. Increasing mobile data revenues (other than SMS) and the revenues from high-speed internet access are also among our current priorities. We plan to support our Slovak operation, especially in the area of system, process and HR development. On the commercial front, our goal continues to be the improvement of customer base by means of increasing the share of post-paid customers and new business acquisition through offering new innovative services in all customer segments.

The strategic goal in the Czech Republic is to further our market position in high-speed internet services and in pay TV. The Group's financial management will continue to focus on growing revenues while maintaining the levels of operating profit and OIBDA, and on efficient capital expenditure and a strong free cash flow generation.

Salvador Anglada Gonzalez
Chairman of the Board of Directors

Calendar of key events in 2007

January

The Supervisory Board of Telefónica O2 appointed (co-opted) Andrew Harley as member of the Supervisory Board.

Telefónica O2 was the first in the Czech Republic to sign a digital content distribution agreement with a major Hollywood studio, Sony Pictures Television International, whose back catalogue of films would be broadcast by O_2 TV, Telefónica O2's IPTV service.

Telefónica O2 grants special discounts on fixed line and mobile services in the O_2 network to people with a disability or a low income.

February

Telefónica O2 published its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2006. Consolidated revenues reached CZK 61.3 billion. Consolidated net profit grew to CZK 8 billion.

The number of O_2 TV (IPTV) users reached the 20 thousand mark.

After almost seven years, Telefónica O2 terminated the O_2 Asistent 1188 service (formerly Eurotel Asistent) and launched a modern directory and assistance service – 1188.

March

The first converged service, O_2 Internet Komplet Business, was launched; it combines high-speed fixed line internet access and the service of a mobile data network in one economical tariff.

Another converged service, O_2 Trio, brought along three products in one – high-speed O_2 Internet ADSL, multimedia television O_2 TV and unlimited calling to fixed line networks in the Czech Republic, all included in one monthly subscription.

April

An Ordinary General Meeting of shareholders of Telefónica O2 Czech Republic was held. The shareholders approved a proposal of the Board of Directors for the payment of a dividend of CZK 50 per share before tax from the 2006 profit and retained earnings.

Telefónica O2 published its unaudited consolidated financial results prepared under International Financial Reporting Standards for the first quarter of 2007.

Starting from April, Telefónica O2 began to increase the ADSL connection speed to its existing customers by up to four times, while preserving the price. In one month, 70% of customers had their access speed increased.

The new O_2 Duo Mobil service offered customers a combination of internet access in the form of O_2 Internet ADSL and a mobile voice service for one monthly fee and no need to pay the fixed line rental.

O_2 TV brought 3D films to the television screen.

May

Telefónica O2 is the only company in the Czech Republic that obtained a certificate confirming the fact that the Internal Audit & Risk Management Department meets the International rules od the professional performance of the internal audit. The certificate ranks Telefónica O2 in the family of major global corporations that meet the certification criteria.

O_2 TV recorded its 30 thousandth customer.

The number of CDMA-EVDO customers of Telefónica O2 exceeded the 100 thousand mark.

AXA presented Telefónica O2 with the prestigious Employer of Choice Award 2007.

June

Jaime Smith Basterra, Chief Executive Officer of Telefónica O2 Czech Republic, was appointed Chief Executive Officer of O_2 Germany. Salvador Anglada Gonzalez was appointed his successor.

Data limits (FUP) were increased threefold for new and existing O_2 Internet ADSL customers.

July

Telefónica O2 published its unaudited consolidated financial results prepared under International Financial Reporting Standards for the first half of 2007.

The Supervisory Board of Telefónica O2 Czech Republic appointed (co-opted) Pilar López as member of the Supervisory Board. Pilar López is Chief Financial Officer of Telefónica O2 Europe.

Telefónica O2 won the majority part of the government contract for the supply of a communications solution.

Telefónica O2 became the first company in the Czech Republic to broadcast the programmes of Czech Television in High Definition (HD) quality.

The number O_2 TV reached the 40 thousand mark.

August

Telefónica O2 published its television broadcasting statistics. In the first six months of 2007, 426 television programmes in total duration of 837 hours were broadcast, which represents more airtime than the figure for the whole of 2006.

Companies in the Telefónica O2 Group were subject to audit and their quality management systems were certified according to ISO 9001 and their environmental management systems according to ISO 14001. The Company also certified its occupational health and safety system according to OHSAS 18001 and its information security system according to ISO 27001.

September

Telefónica O2 acquired a 100% shareholding in DELTAX Systems, one of the leading Czech providers of ICT solutions.

Telefónica O2 launched a unique initiative focused on supporting new projects in the field of information and communication technology (ICT) funded from European Union funds.

The number of O_2 TV customers grew to 50 thousand.

October

Telefónica O2 published its unaudited consolidated financial results prepared under International Financial Reporting Standards for the first three quarters of 2007.

The Supervisory Board of Telefónica O2 appointed (co-opted) Vivek Dev as member of the Supervisory Board. Vivek Dev is Director of Strategy in Telefónica O2 Europe.

Telefónica O2 launched a user-friendly service for comfortable sending of SMS and MMS from a PC into a mobile telephone.

November

The number of mobile customers exceeded the 5 million mark.

The number of mobile data customers in the CDMA network of Telefónica O2 reached the110 thousand mark.

O_2 TV digital television records its 60 thousandth customer.

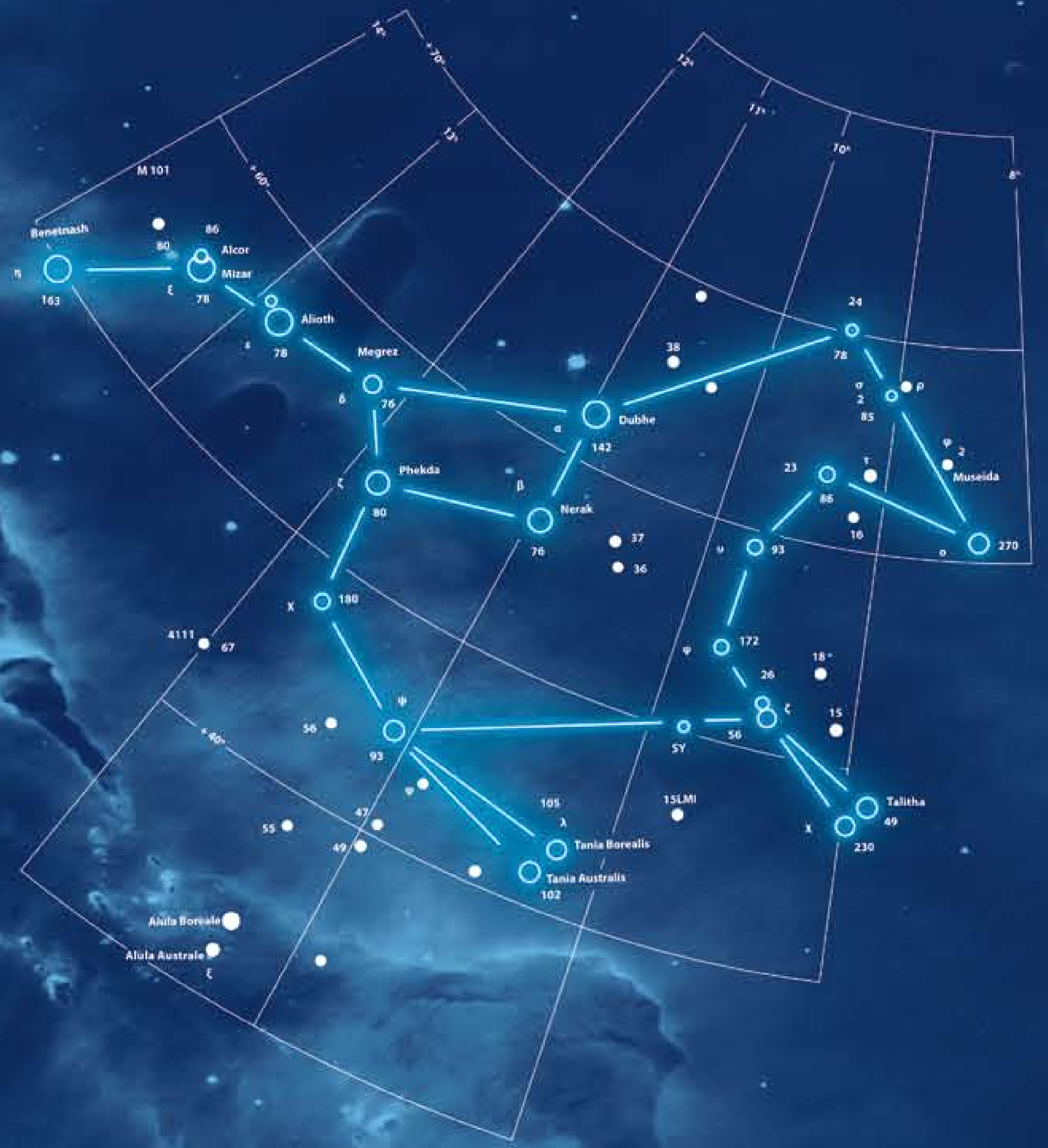
December

The emergency eCall 112 project, which Telefónica O2 implemented in partnership with the Czech Ministry of Transport and the Fire and Rescue Corps 2, was successfully completed.

The number of O_2 TV customers climbed to 70 thousand.

The number of customers using one of the service bundles reached 100 thousand.

01 ABOUT TELEFÓNICA



The Great Bear is, without doubt, one of the best-known constellations of the northern sky. The seven brightest stars in its middle form the Big Dipper. If we extend the rear line of the Big Dipper five times, we will find Polaris, the North Star, through which the axis of the Earth's rotation leads, indicating the North Pole. This quality makes Polaris unique among stars – you would be hard pressed to find a star that played such an important role in the discovery of the world and in the development of humankind.

About Telefónica

36 thousand employees trained on Business Principles, approved in 2006; in 2008 over 1,000 suppliers will be assessed under the corporate guidelines for extending these principles to the supply chain.

Nearly 90 million euros on social and cultural projects, with more than 39.8 million people benefiting from initiatives in 2007.

Some 19 thousand employees are Telefónica Volunteers.

More than 50 thousand children saved from child labour and put in school in Latin America thanks to the Proniño program.

A Customer Satisfaction Index of 6.84 (out of 10) at the end of 2007.

Employment satisfaction at 65%.

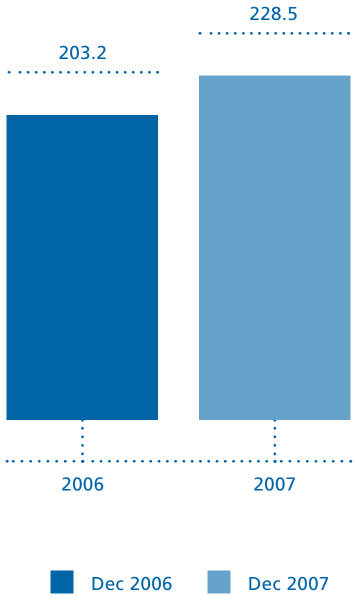
More than 50% of mobile companies environmentally certified according to ISO 14001.

Telefónica in numbers

- More than 228 million customer accesses
- 169 million wireless telephony accesses
- 42 million fixed telephony accesses
- More than 10 million broadband accesses
- 1.7 million pay-TV accesses
- Present in 24 countries
- Over 56.4 billion euros in revenues
- More than 63% of revenues from outside Spain
- Net profit of over 8.9 billion euros
- 42% shareholder return in 2007
- Market cap of 106.1 billion euros
- Annual capex of 8.2 billion euros
- Over 4.35 billion euros invested in R&D
- Over 248 thousand professionals

Total Accesses

(MILLIONS)



Geography

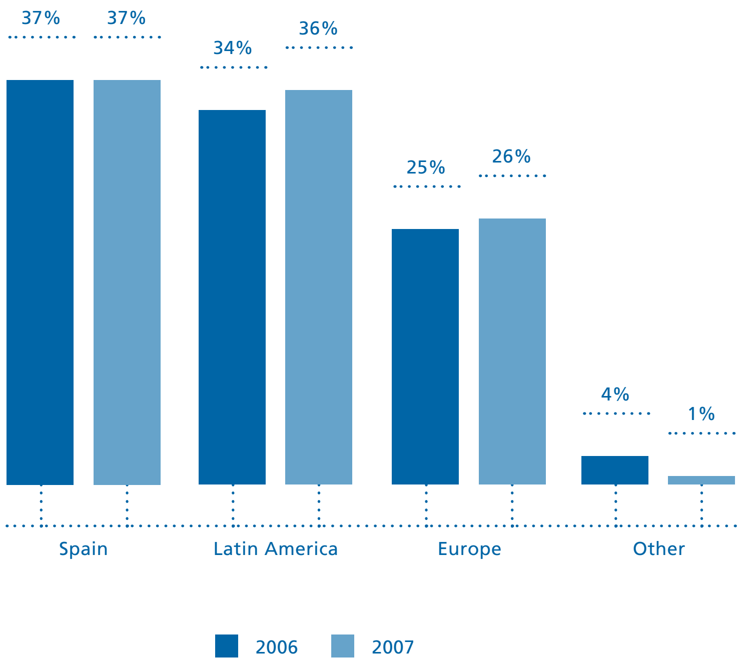
Services offered in twenty countries, with an indirect presence in another four. By region, Telefónica has the most balanced geographical profile of any telecommunications operator, with foreign operations contributing 63% of Group revenues. In 2007, Telefónica rolled out its regional organisational model, structured into three large geographic regions: Spain, Latin America and Europe.

Customers

Over 228 million customer accesses in 2007. Telefónica is the world's biggest integrated operator by customer accesses. Telefónica has closed financial year 2007 with over 228 million customer accesses, 12.5% more than in 2006, thanks to the Group's intense sales efforts. The main increases in our customer bases were in broadband, fixed and mobile telephony, and pay-TV services. By region, Latin America grew the fastest, at 16.9%.

Revenues breakdown by business unit

(% OF TOTAL)



Company Value

Market capitalization of 106,067 million euros. Returns to Telefónica shareholders in 2007 totalled 42%. In 2007, Telefónica Group strengthened its position as the fastest growing and profitable European integrated operator; it was also the fourth ranked global telecom operators by market cap.

Earnings per share jumped 43.5% in 2007 to 1.872 euros, notching up 14 straight quarters of growth. Telefónica's shares rallied 37.8%, above the 14.6% gain by the European comparable index (DJ Stoxx Telecommunications), the 7.3% rise by the Ibex-35 and the 6.8% increase by the Eurostoxx-50.

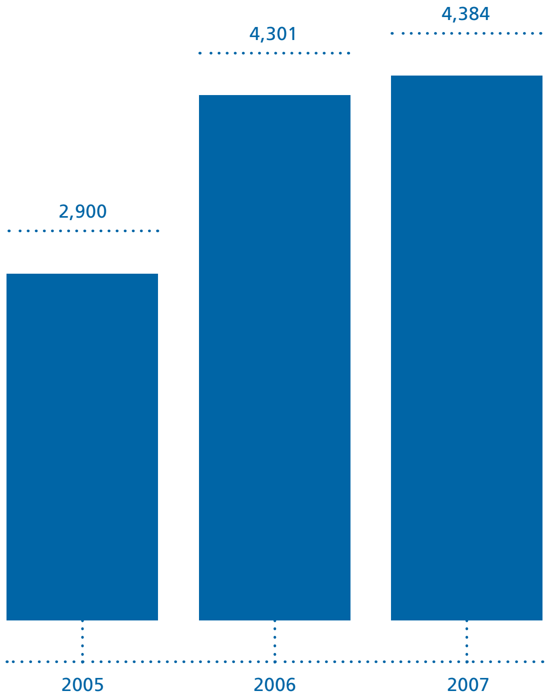
Financial results

Improvement in the financial parameters. Telefónica posted record net profit of 8,906 million euros in 2007. The Company met its guidance again in 2007 and obtained the most net profit of any integrated operator in the world. Revenue rose 6.7% in 2007 to 56,441 million euros.

OIBDA totalled 22,823 million euros, leaving an OIBDA margin of 40.4%. Capex stood at 8,027 million euros. Meanwhile, operating cash flow soared 33% in 2007 to 14,797 million euros, while debt was cut by 6,861 million euros.

Technological innovation

(MILLIONS OF EURO)



Employees

The Group employees over a half a million people directly and indirectly. Telefónica directly employs over 248,000 professionals. By region, Latin America accounts for 66% of total headcount. Spain, at 22%, is the second most important region, while Europe accounts for 12%.

Atento, with a staff of over 123,000, is the largest employer among the Telefónica Group companies.

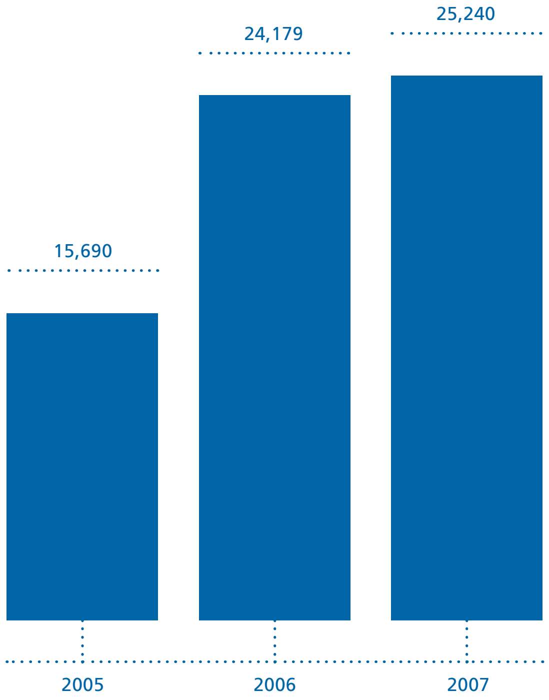
Innovation

594 million euros invested in R&D. Telefónica spent more than 4,350 million euros in 2007 on technological innovation. Last year, Telefónica ranked fourth among telecoms operators in R&D spend based on OECD criteria and spent the most of any Spanish company. The Company established an open innovation network, with inputs from each of the Group companies and a corporate innovation program spearheaded by Telefónica I+D. In addition, it participated in 190 projects sponsored by Spanish and European public funds and collaborated with 920 institutions.

Last year the Company launched over 600 products and services worldwide.

Purchase volume

(MILLIONS OF EURO)



Infrastructure

Network transformation continued with fibre optic and 3G and 3.5G technologies. Telefónica offers wireless services via 80,499 base stations.

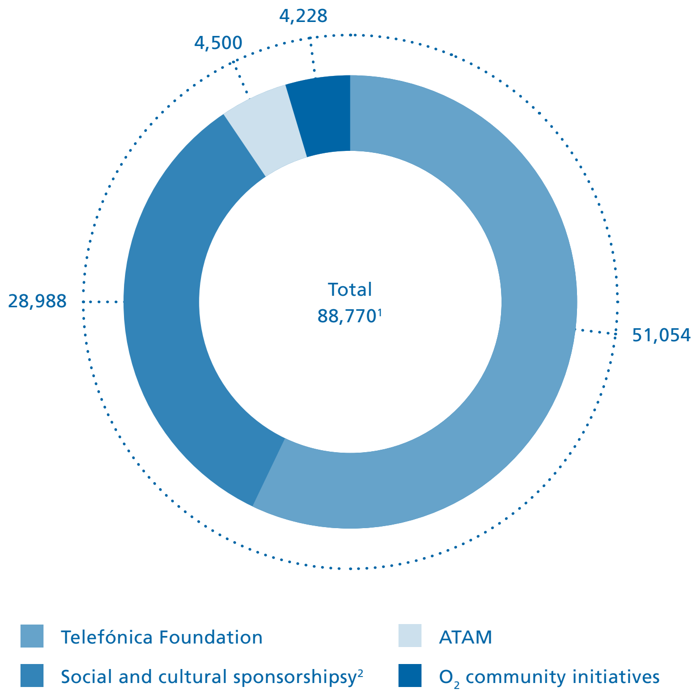
Telefónica began the roll out of fibre to the home (FTTH) technology, the first to do so in Spain. In terms of wireless accesses, work continued on making 3G and 3.5G technology more broadly available across all operators to increase wireless data connection capacity. In 2007, the Group had 80,499 base stations. In 2007, Telefónica continued the process of extending its fixed to-mobile architectures to boost convergent services. The work in this field was concentrated in Spain, Argentina, Brazil, Chile, Colombia, Peru, UK, Germany and Czech Republic.

Suppliers

Spain and Brazil, the most important markets in terms of by purchasing volumes. Telefónica awarded more than 25 billion euros to its suppliers. In 2007 more than 28,000 suppliers were awarded business. Most of its procurement came under the category of Services and Works which, along with Market Products (including mobile handsets) and Network Infrastructure made up over 80% of total purchasing. The rest was split between IT systems, Advertising and Marketing and Content. Telefónica E-sourced 84% of its Spanish and Latin American operators' purchases, with than 33,000 transactions, including over 4,100 e-auctions.

Social and cultural action

(THOUSANDS OF EURO)



[1] Based on LBG methodology.
[2] All projects that have a positive impact on society, culture and art are considered social and cultural sponsorships in accordance with LBG.

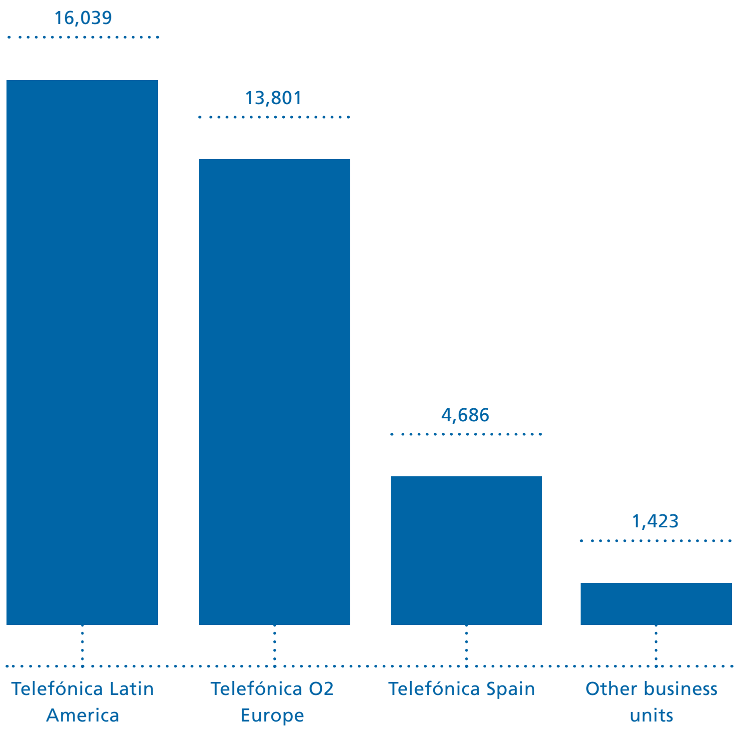
Business Principles

More than 80% of employees will receive training in 2008. Over 36 thousand Telefónica Group employees received training on Business Principles. In 2006 Telefónica approved its Business Principles. Throughout 2007, following approval by the Board of Directors, 81% of Group companies and subsidiaries ratified the Business Principles. Based on its Vision and Business Principles, the Company is building a new corporate culture In 2007, the Company approved the Corporate Guidelines for Extending these principles to the Supply Chain and Responsible Supplier Contracting Guidelines. An internal communications program was rolled out to support the implementation of these principles.

Social and cultural action

Telefónica spent almost 90 million euros on social and cultural initiatives in 2007. In order to measure and evaluate its social action, last year Telefónica adopted the LBG model, an internationally known method to improve the management, evaluation and measurement of the company's community contributions. Telefónica Foundation channelled 51.1 million euros into more than 700 projects, benefiting 39.8 million people. The most important programs are: Proniño (the company's initiative to eradicate child labour in Latin America), EducaRed (a program designed to enhance education standards through the application of new technologies), Telefónica Volunteers, Forum (concerned with knowledge creation under the umbrella of the information society), and Art & technology. Telefónica Foundation also earmarked 13 million euros to integrate the disabled within society through the ATAM program.

Employees with training on bussines principles



Note: It does not include Atento, as the Company has different training schemes for the business principles targeting teleoperators.

Corporate responsibility

Telefónica is included in the main indices: DJSI and FTSE4good. Telefónica published fourteen corporate responsibility reports at seventeen of its operations.

In order to extend its Business Principles to the supply chain, Telefónica designed a self-assessment questionnaire for suppliers to evaluate their CR performance. Over 1 thousand suppliers will be evaluated in 2008. In 2007 the Company set up the Corporate Environmental Unit, as well as by Regional Committees to ensure implementation of the 2008-2012 Environmental Action Plan. In addition, Telefónica made 15,167 measurements of radio wave emissions and invested 5.2 million euros in 2007 to minimise the visual impact of its infrastructure. Telefónica launched a strategy to fight climate change, comprising internal initiatives and others related to the customer services on offer.

Digital inclusion

Telefónica invests in infrastructure and services designed for people on low incomes or with disabilities. Last year in Latin America, the company's net contribution to providing Universal Telecommunications Service coverage was 161 million euros. At year-end 2007, over 81% of our 102 million mobile accesses in Latin America were using pre-pay services. In addition, the Company had over 6 million pre-pay fixed and controlled lines, accounting for 25.9% of fixed telephony accesses in Latin America. Telefónica upgraded its Accessible Telefónica Standards, which set minimum accessibility criteria in thirteen areas, and began to implement the policy internally and its application in areas of accessibility: web, handsets, Telefónica stores and customer service.

Spain

SPAIN	Economic Impact	Revenue/GDP	Magnitudes
Revenue	20,806	2%	Employees 53,300
Expenses	7,413 / 3,711 / 2,635 / 2,381		Suppliers 4,065 (87.7%)
			Accesses 46,374

CHILE	Economic Impact	Revenue/GDP	Magnitudes
Revenue	1,825	1.6%	Employees 14,613
Expenses	988 / 231 / 248 / 418		Suppliers 1,728 (90.7%)
			Accesses 9,377

COLOMBIA			
Revenue	1,585	1.3%	Employees 6,369
Expenses	836 / 128 / 302 / 360		Suppliers 1,430 (89.4%)
			Accesses 10,974

Latin America

ARGENTINA	Economic Impact	Revenue/GDP	Magnitudes
Revenue	2,368	1.3%	Employees 21,493
Expenses	905 / 413 / 470 / 289		Suppliers 1,451 (95%)
			Accesses 19,471

BRASIL			
Revenue	8,139	0.9%	Employees 75,839
Expenses	4,117 / 936 / 3,519 / 1,087		Suppliers 3,231 (99.2%)
			Accesses 49,000

CENTRAL AMERICA			
Revenue	587	1.2%	Employees 5,786
Expenses	300 / 54 / 78 / 133		Suppliers 2,005 (68.3%)
			Accesses 5,425

ECUADOR			
Revenue	281	0.9%	Employees 773
Expenses	173 / 24 / 48 / 60		Suppliers 390 (80%)
			Accesses 2,582

MEXICO			
Revenue	1,571	0.2%	Employees 16,589
Expenses	1,002 / 167 / 120 / 230		Suppliers 1,111 (93.4%)
			Accesses 12,538

PERU			
Revenue	1,506	2%	Employees 14,554
Expenses	834 / 309 / 378 / 281		Suppliers 2,143 (89.8%)
			Accesses 12,174

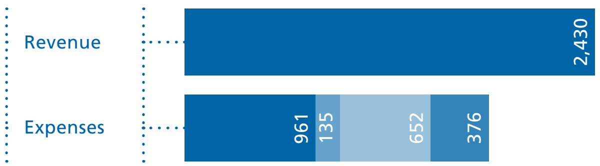
URUGUAY

Economic Impact

Revenue/GDP: 0.7%

Magnitudes:
Employees 250
Suppliers 445 (72.8%)
Accesses 1,148

VENEZUELA



Revenue/GDP: 1.5%

Magnitudes:
Employees 6,873
Suppliers 1,130 (89%)
Accesses 10,430

IRELAND

Economic Impact

Revenue/GDP: 0.5%

Magnitudes:
Employees 1,617
Suppliers 824 (92.5%)
Connections 1,646

CZECH REPUBLIC (INCL. SLOVAKIA)

Revenue/GDP: 1.8%

Magnitudes:
Employees 9,049
Suppliers 481 (87.2%)
Connections 8,517

Europe

GERMANY

Economic Impact

Revenue/GDP: 0.1%

Magnitudes:
Employees 5,101
Suppliers 2,179 (94%)
Connections 13,142

UK

Revenue/GDP: 0.4%

Magnitudes:
Employees 13,221
Suppliers 7,240 (98.6%)
Connections 18,453

Purchases | Salaries | Taxes | Investments

Note:

Revenues, personnel expenses, payment of tax in the country, purchases and investment (capex) in millions of euros.

Revenues correspond to all Telefónica business units in the country.

Employees: direct employees of the Telefónica Group in the country (headcount at 31 December 2007).

Suppliers: suppliers awarded businesses in the country in 2007.

% in parentheses represents the % awarded to local suppliers (% awarded to suppliers domiciled in the country/total awards based on volume).

Accesses: number of fixed + mobile + ADSL + TV connections (thousand).

Revenue TEF/GDP: ratio between Telefónica revenue (contribution by the country to consolidated revenue of the Telefónica Group) and forecast GDP for the country (source: IMF).

02 BOARD OF DIRECTORS’ REPORT ON BUSINESS ACTIVITY

Arcturus is the brightest star in the Boötes constellation and in the northern sky; it is 100 times brighter than the Sun. Being an estimated 4,500,000,000 years old, Arcturus is a peer of the Earth. It is a red giant, a star in the final stages of its life cycle. Its core has gone cold, but thermonuclear storms will continue to rage within its surface layers for several million years more.

Board of Directors' Report on Business Activity

Telefónica O2 Czech Republic Group

Overview of the Group and the main changes in 2007

Telefónica O2 Czech Republic Group (Telefónica O2 Group) comprises Telefónica O2 Czech Republic, a.s. (Telefónica O2, Company) and other subsidiary companies. The Group's services were provided mostly on the territory of the Czech Republic. Through a wholly-owned subsidiary Telefónica O2 Slovakia, the Group has expanded its business to Slovakia from 2 February 2007. In line with its strategy focusing on the high growth potential areas of business and on achieving leadership in the segment of integrated ICT solutions, in 2007 Telefónica O2 acquired a 100% interest in DELTAX Systems a.s. (DELTAX Systems). Deltax Systems is one of the top ten leading providers of ICT solutions in the Czech Republic. The company provides the following services: consulting in the area of IT/ICT, application development, outsourcing and system integration, and counts leading Czech corporations and government agencies among its clients. DELTAX Systems co-operated with Telefónica O2 on several projects. The acquisition was an organic step in the ongoing partnership of the two companies. A complete overview of the Group as at 31 March 2008 is given on page 68.

Telefónica O2 is the only integrated telecommunications operator in the Czech Republic to offer a comprehensive range of both fixed and mobile voice, data and internet services. In September 2006 it also started to offer an IPTV service

(O_2 TV) and in 2007 it significantly expanded its IT and ICT operations (comprehensive customer communications solutions). It also offers its network infrastructure for lease by other operators of public and private networks and services.

The retail business in the Czech Republic focused on two main customer segments – business and consumers. The business segment included corporate, business and government sub-segments. Telefónica O2 also provides wholesale services to other public telecommunications network providers and to providers of public telecommunications services both in the Czech Republic and abroad.

As at 31 December 2007, total fixed accesses operated by the Company in the Czech Republic reached 2.069 million and the total number of mobile customers was 5.126 million. As at the same date, the Company also registered 570,000 ADSL connections; the number of O_2 TV customers reached 73,000. As at the end of 2007, Telefónica O2 Slovakia had more than 560,000 mobile customers.

Telefónica O2 Slovakia

In August 2006,Telefónica O2 Slovakia won a tender for the third mobile network licence in Slovakia; 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, to be used for the provision of telecommunications services in Slovakia. Telefónica O2 Slovakia lauched the commercial operation symbolically on 2 February 2007 (02. 02. 2007).

Telefónica O2 Slovakia provides mobile telecommunications services in the GSM network, which it began to roll out in 2007. In geographic locations where it does not have its own coverage, Telefónica O2 Slovakia uses the network of T-Mobile Slovensko based on a national roaming agreement.

The priority of Telefónica O2 Slovakia in 2007 was to build up a base of active customers by offering innovative services.

At the end of 2007, the market share in active customers attributed to Telefónica O2 Slovakia exceeded 5% of the market with penetration of more than 104%, surpassing its own target set at the beginning of 2007. The first 100,000 active customers were acquired already in the first ten days after the commercial launch. This is an unparalleled feat that not even operators in countries with more population than Slovakia could not match.

In the first half 2007, Telefónica O2 Slovakia began to market a pre-paid card with activated data services and a single rate on calls in peak/off-peak times, any day of the week and to all networks in Slovakia (and with a discounted rate on on-net calls as a part of the promotional package). The company approached its customers a new philosophy – with open pricing, transparent products and simple price lists.

Another new development was the launch of O_2 Voľnosť post-paid tariffs. They are innovative product on the Slovak mobile market, giving the customer all the benefits of the post-paid service, without the requirement to sign a written contract. Customers could also get subsidised telephones without commitment for a specific period of time. They could also set their calling limit themselves, which gave them control over their costs. Unused minutes could be carried over to the next billing cycle free-of-charge.

In the second half of 2007, Telefónica O2 Slovakia let its customers register any telephone number with the given pre-fix, free-of-charge; it marked the launch of the new O_2 Pre mňa post-paid tariffs. The tariffs have a function which automatically adjusts the charge based on the number of minutes used, to make it most economical for the customer. The new tariffs were supported with a promotion offering calls to all networks in Slovakia for Sk 1 only. It was historically the first such promotion in Slovakia when the duration of the offer is longer than the commitment. At the end of 2007, the number of registered customers in Slovakia reached 565,000, with the majority subscribing to the pre-paid service. Although many customers have the SIM card as their second or third one, the market share of active customers in Slovakia exceeded 5%.

In 2007 Telefónica O2 Slovakia continued to roll out its own network. The terms and conditions of the licence obliged the company to build 400 base stations by 7 September 2007. The company went beyond the duty – more than 500 base stations were in operation by the deadline. This has given the company almost three times the coverage (34% coverage of the population) than what was required by the licence (12% coverage of the population). By the end of the year, approximately 550 base stations were in operations and more than 60% of the company's voice traffic was carried in its own network. The completion of own network within two years and relying on the national roaming only in places where there is no own network continues to be the company's strategy. The gradual increase in the proportion of voice traffic carried by the company's own network will lead to lower interconnection costs and to improved traffic profitability.

Telefónica O2 Slovakia also concentrated on the gradual expansion of its distribution network. Brand stores were opened in all regional capitals. The network of brand stores was complemented by franchises and a wide range of dealerships. As at the end of 2007, the distribution network comprised 14 brand stores, 16 franchises and more than 3,500 other points of sale. The company successfully implemented also door-to--door selling. It was also the first mobile operator in Slovakia to have let customers shop online in the e-shop (O2shop) on its website. In the middle of 2007, the company completed its own call centre in Banská Bystrica. The call centre is available 24 hours a day, 365 days a year.

The main commercial goal for Telefónica O2 Slovakia in 2008 continues to be the initiative to improve the customer base by means of increasing the share of post-paid customers in the total base, and new business acquisition by means of offering innovative services for all customer segments.

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 and is based on the COSO (Committee of Sponsoring Organizations of the Tradeaway Commission) model, which represents and integrated framework of internal controlling mechanisms and risk management methods. The system is 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.

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 2007, 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 divides risks into the following categories:

Financial risks

Risks stemming from the fluctuations in the exchange rates of currencies or in the interest rates. Credit risk (risk of exposure to defaulting business partners or customers) is also included in this category.

Commercial risks

Competition and market risks, reputation risk are all included in this category.

Human resources risk

Risks including, but not limited to personnel development and recruitment.

Legal and regulation risks

Activities in the fixed line and mobile segment are subject to regulatory supervision and intervention, both on the national and on the European level. This category includes also risks of ongoing litigation and potential litigation outcomes.

Operating risks

Risks that may impact on process efficiency, service provisioning, customer satisfaction and on the Company's good image.

Security risks

The category includes risks affiliated with a potential damage to the technology, abuse of the Company's services and networks, and risks associated with data leaks.

The telecommunications market in the Czech Republic

The developments on the Czech telecommunications market in 2007 confirmed the trends of the past several years. The market grew approximately 4% year on year, which is a rate similar to that of 2006. The total market increase measured in revenues lagged behind the GDP rate of growth by approximately 2%. Fixed line market revenues were stable in the year-on-year comparison, and the mobile market revenues grew 7% year on year.

Fixed line penetration reached a level of approximately 24%, copying the trend of previous years. SIM card penetration, on the other hand, grew to almost 126%, which is one of the highest figures in Europe.

The trend of fixed-to-mobile substitution continued. The share of mobile traffic in the total traffic grew from approximately 69% in 2006 to almost 76%. The demand for data, internet and value added services also continued to grow.

Trends on the fixed line market

Similarly to 2006, revenues on the fixed line market in 2007 reached approximately CZK 52 billion. The declining voice revenues were offset particularly by the fast growth of internet and pay television.

Competitive pressures in the voice segment also increased. Cable operators applied a pricing policy based on low rates and acquisitive promotions. Net calling (VoIP) was also on the rise, namely due to the low prices and the increasing number of operators that offer the service; another factor in the play is the increasing number of internet users. The trend of fixed-to-mobile substitution continued. According to estimates, 76% voice minutes were originated in mobile networks. The number of fixed accesses fell again in 2007.

In 2007, the trend of offering service bundles combining voice, high-speed internet access and IPTV services became strong. In March, Telefónica O2 launched its O_2 Trio bundle, which included high-speed internet access, O_2 TV multimedia television and unlimited calling to fixed line networks in the Czech Republic. A month later, the Company launched O_2 Duo Mobile, which combined a mobile voice service and internet access.

Internet speeds increased in the internet segment in 2007. The majority of internet providers increased the access speeds and preserved the prices. T-Mobile entered the ADSL market; in addition to mobile internet T-Mobile now offers fixed line internet access. WiFi-based access technologies continued to enjoy a strong position in the Czech Republic. With more than 600,000 users (based on research by RT Audit), WiFi in the Czech Republic held a unique position compared to the rest of Europe.

IPTV also enjoyed a growth. The number of Telefónica O2 customers of O_2 TV reached 73,000 at the end of 2007. In July 2007, the Company became the first in the Czech Republic to offer national High Definition (HD) broadcasting of Czech Television. Transition to HD broadcasting is set to become one of the major trends in pay TV. In August, VOLNÝ launched its IPTV service branded as VOLNÝ TV. By November, already 500,000 homes were potential customers of the service. At the end of the year, UPC announced price increases, and the introduction of new channels in its programming, for its pay TV services.

The fixed line market saw ongoing ownership changes and consolidation which began already in 2006. The acquisition of Karneval by Liberty Global Inc., the owner of UPC, was concluded in January 2007. Liberty Global hence became the largest cable operator in the Czech Republic. The market offers of both companies gradually consolidated, too, and the UPC service was available to 1.2 million Czech residents. In March, Dial Telecom acquired 100% of shares of net4net. The merger produced a national telecommunications operator with a telecommunications product portfolio focused particularly on wholesale and corporate services. In April, Czech On Line, a subsidiary of Telekom Austria Group offering its services under the VOLNÝ brand, commenced a process that led to a merger with the Czech branch of eTel. In August, ČD Telematika acquired more than 400 corporate accounts from Tiscali ČR. At the beginning of December, NetCentrum, the second largest internet company in the Czech Republic and the operator of Centrum.cz portal, announced that it had been taken over by private equity investor Warburg Pincus. At the same time, Telefónica O2 received permission from the Office for the Protection of Competition to go ahead with the acquisition of a 100% stake in Deltax Systems, a provider of IT services. The acquisition sought to strengthen the position of Telefónica O2 in the information systems, software development and systems integration markets. At the end of 2007, GTS Central European Holding (GTS CE), comprising also the Czech No. 2, GTS Novera, was sold to a consortium of three U.S. financial investors. The new owner of GTS CE is a consortium of financial investors: Columbia Capital, M/C Venture Partners and Innova Capital. The transaction should be completed in the first quarter of 2008.

Trends on the mobile market

The mobile market in the Czech Republic, as measured by total revenues, reached CZK 85 billion according to the Company's estimates, growing approximately 7% year on year. The SIM card penetration in the Czech Republic, being among the highest in Europe, reached 126% at the end of 2007; compared to the same period in 2006 it grew by 7 percentage points. The total net adds of customers were 729,000 in 2007, compared to 874,000 in 2006. The highest net adds of customers, of 262,000, was attributed to Telefónica O2, followed by Vodafone (245,000) and T-Mobile (222,000). The number of mobile customers grew almost 5.9% year on year and reached 13,055,000, compared to 7.6% in 2006.

Tension in the already fiercely competitive environment on the highly penetrated market grew after the entry of U:Fon, the fourth mobile operator, in May 2007. The network is operated by MobilKom owned by the Czech-Slovak financial group Penta. The network uses CDMA 2000 technology. In addition to high-speed internet and calls, U:fon offers a national short-wave radio service using Push-to-Talk technology. According to MobilKom, at the end of 2007 it had 32,740 customers.

The total number of Telefónica O2 mobile customers grew 5.4% to 5,126,000 in 2007, which accounts for a 39% share of the market. Telefónica O2 holds the highest market share in post-paid customers. As a result of the ongoing migration from the pre-paid to the post-paid service, the number of customers using one of the post-paid tariffs grew almost 20% to 2,244,000. The migration of customers from pre-paid mobile services to post-paid mobile services has been – and still is – one of the major trends in the Czech mobile market; all operators increased their post-paid customer base in 2007.

The trend was bolstered by the operators' promotions aimed at stimulating pre-paid to post-paid migration. Free airtime was offered to migrating customers and new tariffs were introduced. Already in September 2006, Telefónica O2 added three new post-paid tariffs and T-Mobile followed suit in January 2007 with the new credit-based tariffs, which offer free airtime for calls to all networks regardless of the time of day and SMS and MMS for a flat monthly fee.

The focus of mobile operators on data and internet services was also intense. Telefónica O2, which concentrated on promoting high-speed mobile internet access using CDMA and HSPDA technologies, launched a new portfolio of technologically-independent data tariffs in September 2007, and migrated to the so-called EVDO Rev. A (improved CDMA) in November 2007. Already in mid-2007, the number of CDMA customers of Telefónica O2 exceeded the 100,000 mark. At the end of 2007, the number was 114,000. T-Mobile offering mobile internet using UMTS TDD technology and branded as Internet 4G promoted mobile internet heavily throughout the year, particularly by giving discounts and offering their 4G tariffs bundled with a notebook. Vodafone, on the other hand, announced yet another postponement of the launch of its UMTS service in December. The service, which originally should have been launched in January 2008 and cover 90% of the Prague area, is now scheduled for a launch in early 2009.

In addition to the ongoing pre-paid to post-paid migration and the strong trend in mobile data, operators in 2007 focused on the corporate segment. In October, Telefónica O2 began to market its new business tariffs tailored especially to businesses. New ICT services for business customers from all segments were launched by the Company throughout the year. Vodafone introduced OneNet, its first proposition to business customers; OneNet is a comprehensive telecommunications solution combining fixed line, mobile and data services.

Regulation

Several changes occurred to the legal environment of the electronic communications market in the Czech Republic in 2007. The most material changes were the following:

- publication of the final European Commission paper for the review of the so-called new regulatory framework in electronic communications,
- approval by the European Parliament and Council of the proposal to regulate roaming on mobile public networks in the Community and of the amendment to Directive No. 2002/21/EC,
- approval of a directive amending the Council Directive 89/552/EEC on the coordination of certain provisions in member states concerning the pursuit of television broadcasting activities (the so-called Audiovisual Media Services Directive),
- amendment to the Electronic Communications Act (concerning radio and television broadcasting, in particular the ongoing digitalisation, and also the provision of the so-called special price plans as part of the Universal Service),
- amendment of the government order concerning the amount and method of calculation of fees for the usage of radio frequencies and numbers,
- publication of a general provision (amendment of a general provision setting the technical and organisational conditions for the implementation of Number Portability and the billing principles between businesses in connection with Number Portability; general authorisations for the use of radio frequencies; parts of the plan for the use of the radio frequency spectrum).

Relevant markets analysis and product regulation

Also in 2007, Telefónica O2 continued to honour its duties arising from the relevant markets analysis performed by the Czech Telecommunications Office (CTO) in 2006. The Company prepared and published a new bitstream reference offer reflecting the regulatory provisions in the wholesale broadband access market. New types of regulated services stemming from the regulatory provision on market no. 13 were launched. Telefónica O2 also published a reference offer concerning the final sections of leased lines, thus complying with another duty imposed by the CTO.

The second round of the relevant markets analysis began in the middle of 2007. The CTO commenced the analysis of the wholesale bitstream market; the conclusion should be published in the first half of 2008.

In late 2007, the European Commission published its relevant markets guidelines, which leave out retail markets in particular. The original number of markets was reduced from eighteen to seven.

International roaming regulation

After almost twelve months of debate, the European Commission and other European institutions agreed on the language of a regulation concerning the provision of international roaming services. The most important part of the regulation deals with the regulation of retail roaming prices in the European Union. The prices were set as a ceiling, at EUR 0.49 per minute and EUR 0.24 per minute for outgoing and incoming calls, respectively. The maximum average price of wholesale roaming was set at EUR 0.30 per minute. The regulation came into force at the beginning of July 2007.

Imposition of duties related to the provision of the Universal Service

Telefónica O2 provided the following services during 2007 as part of meeting its duties imposed by the CTO in relation to the Universal Service provision:

- regular publication of directories of subscriber telephone numbers in the area of the public telephone service, and access of end users to those directories;
- directory services;
- the public payphone service;
- 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;
- 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;
- 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.

Universal service

Telefónica O2 and the CTO were in negotiation throughout 2007 concerning the compensation for the services provided as part the Universal Service in 2006. The method of calculation and documentation of costs incurred in connection with the Universal Service provision changed in 2006. The legitimate loss method was used for the first half of the year, and the net cost method was used for the remaining part of the year.

The compensation for services provided as part of the Universal Service in 2007 will be negotiated in 2008.

In respect of the first half of the year in question, Telefónica O2 claimed compensation for the documented loss it had incurred as a result of the provision of loss-making services, which form a part of the Universal Service, in 2006, under the hitherto applicable telecommunications law, the Telecommunications Act. The legitimate loss for 2006 was 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.

Regulation 235/2001 Coll. of the Ministry of Transport and Communications provides for the calculation of the legitimate loss; it does not however cover the whole range of services provided as part of the Universal Service. The CTO has not conclusively ruled in 2007 on the amount of loss incurred in relation to the Universal Service provision in 2006, which Telefónica O2 claimed in 2007 under the Telecommunications Act and for which Telefónica O2 should be compensated for by other holders of telecommunications licences. Given the market share that Telefónica O2 holds, the contribution from other licensed operators towards the loss incurred in connection with the Universal Service provision will represent only about 40% (the CTO has not set the amount of respective contributions for 2006).

For the remaining part of 2006, the net costs related to the provision of the Universal Service were calculated according to Act No. 127/2006 Coll., on electronic communications and on amendment of some other related laws (Electronic Communications Act), as amended. The method for calculation of net costs is laid down in the Ministry of Informatics Regulation 388/2006 Coll., on the net costs of the Universal Service in electronic communications. The CTO has not ruled on the amount due to the Company from the Universal Service Account in 2007.

Networks and technology

As the number of its customers was increasing, the Company focused its network and technology investments on achieving broader coverage and higher network capacity in particular.

Due to the more than 20% increase in the volume of voice traffic and in order to offer sufficient connectivity in newly developed areas (residential, commercial and industrial) and along transport routes, 179 base stations were added to the GSM network in 2007. The total number of base stations at the end of 2007 reached 4,164.

The CDMA network also increased the coverage. 47 new base stations were put into operation, which increased the coverage of the population to 88.3% as at the end of 2007, compared to 83.7% previously. In November 2007, the so-called CDMA Revision A, an improved version of the CDMA network, was launched. It gives a higher uplink (from the user) data throughput; the maximum speed is now 1.8 Mb/s, compared to 156kb/s offered previously by Release 0. The maximum downlink (to the user) speed was 3.1 Mb/s. At the end of 2007, Revision A was available to users in regions Ostrava, Karviná and Olomouc.

Investments in the UMTS network were aimed namely at increasing the quality and coverage in the existing locations in Prague, Brno and their urban agglomerations. Efforts were directed at improving the quality of co-operation with second generation networks (transmission of connected calls between the networks). Coverage of the population increased to 16.2% and the number of base stations grew by 128 to 919.

Investments in fixed line technology included namely investments in Fixed Access, data networks technology and in the fixed line voice technology. Fixed Access investments were driven by the customer demand for service carried by the traditional metallic cables in particular. Enabled by agreements with residential developers, 523 purely optical connections were installed in 2007. Investments in data technology focused namely on meeting the demand for the latest data services from customers, mostly from the corporate segment. Investments in the fixed line voice technology were mostly of a maintenance nature, since the traffic in the voice network has stabilised and there was no need to increase the capacity.

Investments in ADSL and IPTV sought mainly to increase the capacity in connection with the growing customer demand and the increasing number of new installations. The total installed capacity of ports in all locations reached 764,123; that is a growth of 20% year on year. The share of access points installed in IP DSLAMs, which support the O_2 TV service, reached 42.3% in 2007, compared to 25.8% at the end of 2006. As at the end of 2007, the capacity of 566,423 ports was occupied (up 16.5% from the year before). The coverage increased only slightly. Access points were created in 60 new locations. The total number of locations reached 2,234.

In 2007, Telefónica O2 upgraded its IPTV platform, making it possible to offer new functionality to O_2 TV customers, such as the new Electronic Program Guide (EPG), faster channel switching and High Definition (HDTV) quality.

Voice services

Also in 2007, the trend of fixed to mobile substitution continued. In this environment, the Company's key priority was to maintain the volume of traffic regardless of the type of network where it was generated. Marketing campaigns aimed at mobile traffic stimulation succeeded in their goal and the growth in mobile traffic adequately compensated for the decline in the fixed line voice traffic. The overall voice traffic generated by Telefónica O2 customers in 2007 grew 4% compared to 2006.

In addition to offers aimed at the customers of post-paid services, Telefónica O2 had a special offer to the customers of pre-paid services. From 15 February until 30 April, pre-paid customers could buy the O_2 pre-paid card and call all mobile numbers in the O_2 network free of charge on weekends and also off-peak during the week; the offer was good for up to three months after the service activation. Customers who topped up their credit with a minimum of CZK 300 were also eligible for unlimited calls for a period of four weeks. Customers who migrated from the pre-paid to the post-paid service and activated any of the post-paid O_2 mobile tariffs with a commitment from 6 to 24 months could, depending on the tariff and commitment of their choice, make unlimited calls 24 hours a day, seven days a week to all mobile numbers in the O_2 network and to all fixed line numbers in the Czech Republic for up to two years. Depending on the type of contract, customers – small business owners and self-employed persons – got unlimited calls for up to 36 months.

Self-employed persons and business owners could also benefit from O_2 Moje firma, a new service offering special rates on calls within one company. Companies could make unlimited calls between 2 to 5 O_2 mobile numbers for one fixed monthly fee. The user paid a one-off fee of CZK 20 exclusive of VAT for every SIM card added to the group. The activation was conditional on all the numbers in the group being registered to one company. The fixed monthly fee for O_2 Moje firma was CZK 200 exclusive of VAT per one SIM card.

On 1 October 2007, Telefónica O2 launched a new family of post-paid tariffs for business customers – O_2 Business. In addition to five new standard tariffs (O_2 Business 30, 120, 300, 600, 1 200), the new tariff structure also included O_2 Business Nonstop, a tariff with unlimited calls to all fixed line networks in the Czech Republic and to O_2 mobile numbers. Users of the tariff paid only for calls to other operators' networks.

The Company also introduced a new roaming offer to its mobile customers. From 15 February, both existing and new mobile post-paid customers who activated the O_2 Cestování tariff could call from fifteen most popular international destinations for prices which were 20% cheaper than the standard listed prices. Calls in neighbouring countries or from them to the Czech Republic was charged at CZK 20 per minute exclusive of VAT, and calls in other European countries or from them was charged at the rate of CZK 28 per minute exclusive of VAT. This time-unlimited offer extended to all outgoing calls from the partner networks to the Czech Republic, to any foreign network and to local calls. No set-up or other charges were applicable. Customers who activated the service from 15 February to 31 May 2007 did not pay an activation fee. Otherwise, the activation fee was CZK 10 exclusive of VAT per month.

On 20 June, the roaming offer was further supported with a special roaming tariff O_2 Smart Roaming, which made it possible to call from 14 popular holiday destinations (the so-called O_2 Smart zone) up to 82% cheaper compared to the regular listed roaming prices. In O_2 Smart zone, outgoing calls to the Czech Republic and in-zone calls were charged at the rate of CZK 9.90 per minute exclusive of VAT. Calls from other European Union countries were cost CZK 25 per minute exclusive of VAT. O_2 Smart Roaming covers the following countries: Croatia, Slovakia, France, Italy, Spain, Cyprus, Malta, Bulgaria, Greece, Egypt, Tunisia Turkey, Malaysia and Thailand. Customers who activated O_2 Smart Roaming received 30 free incoming call minutes in the O_2 Smart zone free. After the free limit was used up, the incoming calls were charged at the rate of CZK 5 per minute exclusive of VAT. No activation, subscription or set-up fees were applicable and the offer was good for peak and off-peak times and for all networks in the destination country.

As required by the European Commission regulation concerning the regulation of retail prices of roaming in foreign networks, Telefónica O2 introduced O_2 Eurotarif designed for travellers to EU countries. By 30 September, the tariff was automatically activated for all customers with voice roaming, except for those who opted for O_2 Smart Roaming, My Europe or one of the other special roaming tariffs. O_2 Eurotarif offered CZK 13.95 exclusive of VAT (CZK 16.60 inclusive of VAT) per minute of an outgoing call from or in an EU country, and CZK 6.85 exclusive of VAT (CZK 8.15 inclusive of VAT) per minute of an incoming call. The prices of SMS, MMS and data services continued to be governed by the roaming price list, which differentiates between geographical zones.

The Company stimulated voice traffic by adding O_2 Volám and O_2 Nonstop, two tariffs offering free calls to all fixed line networks in the Czech Republic to its service bundles combining fixed voice, high-speed internet and IPTV (O_2 Duo and O_2 Trio).

Internet, data and value added services

As in 2006, its activities focused on the improvement in quality of the data services, with a view to adding more value to the fixed line and stimulating further growth of high-speed internet. In the area of ADSL high-speed internet, connection speeds and data limits were increased. The IPTV product, O_2 TV, also underwent innovation. The two innovated products became the cornerstones of convergent offers launched by the company in March and April 2007.

Effective from 1 April 2007, Telefónica O2 increased the ADSL connection speed for all wholesale customers up to 8 MB/s. The new basic speed increased from 512 kb/s to 2,048 kb/s, followed by a similar campaign on the retail side; the connection speeds were gradually increased by up to four times, while the prices were preserved. The speed of the basic service increased from 512 kb/s to 2 048 kb/s. Higher-end services also increased the speed: from 2,048 kb/s to 4,096 kb/s, from 3,072 kb/s to 6,144 kb/s and from 4,096 kb/s to 8 192 kb/s. ADSL high-speed internet is currently available to 97% of all fixed lines and Telefónica O2 is continuously working on expanding the coverage.

On 1 July, Telefónica O2 increased the data limits for both new and existing customers of O_2 Internet ADSL, by up to three times. In the case of O_2 Internet ADSL 2048, the limit went up from 3 GB to 10 GB, for O_2 Internet ADSL 4096 from 12 GB to 20 GB, for O_2 Internet ADSL 6144 from 20 GB to 30 GB and for O_2 Internet ADSL 8192 the limit went up from 30 GB to 40 GB. The wholesale limits increased accordingly.

The launch of O_2 Internet ADSL Start for CZK 150 per month exclusive of VAT on 1 July was aimed at stimulating the number of ADSL internet customers. The low monthly subscription included two hours per month of internet access without any data limits. A minute of connection above the free limit was charged at the rate of CZK 1 per minute inclusive of VAT.

In the second half of 2007, Telefónica O2 concentrated on promoting O_2 Internet ADSL. Several campaigns and limited promotions offering special activation and usage prices were launched.

In order to make O_2 TV, launched by Telefónica O2 in September 2006, more attractive, several innovations were introduced in 2007. From 15 January, the service came with the option of a self-installation kit. The kit let the customer install the service without professional help, aided only by written instructions. The self-installation option for O_2 TV copies the successful self-installation kit for O_2 Internet ADSL, which is opted for by 99% of all customers.

The catalogue of films in the Video Library, one of the complementary services of O_2 TV, was also expanded. An agreement with Hollywood studios – Sony Pictures Hollywood International, The Walt Disney Company and Warner Brothers – gave Telefónica O2 access to a back catalogue of more than 2,000 films. Approximately 60 new releases will be added every year.

The Video Library also began to offer 3D films in April. The films require that customers wear special 3D viewing glasses which Telefónica O2 distributed for free. The 3D programming include mainly documentaries and travel films. Additional programme bundles were introduced to the existing programming offer. One of them was O_2 TV DĚTI Plus offering four channels of content for children of all ages; another was O_2 TV DOKUMENTY Plus with four channels of documentary programmes – Viasat History, Viasat Explorer, National Geographic Wild and Travel Channel. In September, two more bundles were added – O_2 TV Sport and O_2 TV Sport plus for the sports fan, and O_2 TV Filmy plus for the film enthusiast.

In October 2007, Telefónica O2 started the broadcasting of its own O_2 TV info-channel, which runs announcements of the current highlights of the TV channels, trailers of feature films from the Video Library and of new releases in the various categories, films from the TV Archive and special promotions.

After a successful pilot in the closing stages of last year's O_2 Extraliga ice hockey league, Telefónica O2 launched the broadcasting of live matches from nine stadiums in the Czech Republic in September 2007. Ice hockey fans could see most of the matches live in digital audio and video quality via O_2 TV, but also on the internet or on the mobile. The broadcasts only confirmed the success in the Company's efforts to improve its content services offering.

In June 2007, all O_2 TV programmes were re-grouped into blocks by genre and the blocks were arranged in the order of popularity. The new, more logical arrangement makes it easier to navigate and creates space for new programmes. From July Telefónica O2, as the only company in the Czech Republic, began a national broadcasting of Czech Television (ČT1) in High Definition (HD) quality. The whole programming scheme is broadcast in HD quality; a part of the content is converted to the higher quality format and a part is made directly in HD using modern HD recording technology.

At the end of 2007, O_2 TV was available on more than 70% of the Czech territory. The success of O_2 TV manifests itself in the fact that at the end of 2007 the service was subscribed by 73,000 customers. The success was aided by the growing customer demand for convergent services (O_2 Duo and O_2 Trio). At the end of 2007, approximately 60% of O_2 TV customers subscribed to one of the service bundles.

Telefónica O2 continued in the promotion of its mobile data services. In that, it could rely on the broadest portfolio of mobile data services on the market, which includes also CDMA technology with the coverage of approximately 80% of the Czech population. It gives the Company a substantial competitive edge on other mobile operators. Prague, Brno and their urban agglomerations are covered by UMTS and its higher and faster versions – HSDPA and HSCSD. GPRS and EDGE completed the offer.

In September 2007, Telefónica O2 launched a new offer of mobile data tariffs that responded to requirements of customers from all segments. The simpler and easy-to-understand offer was designed with the philosophy that the tariff should give the customer connectivity in the O_2 network at any time, regardless of the technology used.

Also residential customers and business customers of mobile data services benefited from several major innovations. One of them was the brand new tariff Internet Mobil 256; for CZK 399 exclusive of VAT per month gives the customer high-speed CDMA connectivity. Internet Mobil 1024 gave twice the speed of CDMA and WiFi connection for the same price of CZK 699 per month. Internet Mobil 1024 Plus, which still cost CZK 899, offered the broadest mobile data connectivity at the speed of up to 1Mbit/s, without any data limit. If the customer invested into a combo modem and a SIM card, they could use more of the supported technologies (HSDPA/UMTS, CDMA, GPRS/EDGE, WiFi) for their data needs. Customers who did not require such a fast connection could opt for Internet Mobil 512 Plus for CZK 699 exclusive of VAT per month, with the same spectrum of supported technologies, coverage and availability as Internet Mobil 1024 Plus.

Together with the new mobile data tariffs, Telefónica O2 introduced Combo, a new data modem with unique functionality, to its product portfolio. The modem works in all O_2 networks and abroad, wherever there is GSM/UMTS coverage. The high-speed mobile internet modem is the only device of its kind and capabilities on the Czech market; its users always benefit from the highest available speed of connection.

In addition to the changes in the area of roaming prices Telefónica O2 improved its offering of data roaming services. On 15 November, Telefónica O2 launched a new data roaming tariff aimed at all pre-paid and post-paid customers who use data services abroad. The new mobile data roaming tariff could be used in all networks in the world that are enabled for data roaming using GPRS or UMTS technology. The tariff offered lower prices and more simplicity – all countries are divided into three world zones (European Union, rest of Europe and rest of the world) and the customer's choice of network in the foreign country. On-zone traffic was charged at the rate applicable to that zone. Customers benefited from the fact that the billing did not take account of the transmission technology, only the volume of data transmitted. In the European Union, 100 KB of data cost CZK 25 exclusive of VAT. For the rest of Europe and the rest of the world it was CZK 35 and CZK 55, respectively. The tariff could be supplemented with one of the top-up data packages (2, 4, 10, 50 and 250 MB). Post-paid customers had the whole billing cycle to use the free data capacity, and post-paid customers had to use it within 30 days. The prices for the top-up packages ranged from CZK 250 exclusive of VAT for 2MB to CZK 1,990 exclusive of VAT for 250 MB.

In the area of mobile access to e-mail, Telefónica O2 expanded its BlackBerry service. It launched a brand new BlackBerry Internet Service, which brought BlackBerry also to small and medium businesses. Companies using BlackBerry Internet Service no longer need to install and operate a proprietary BlackBerry server. The mobile access to e-mail is web-based and the synchronisation is done via POP3/IMAP4/Outlook Web Access, which makes the service suitable for customers who have freemail accounts. The BlackBerry mobile equipment can be synchronised with up to ten different email accounts from different providers. On 1 December 2007, Telefónica O2 started offering unlimited BlackBerry tariffs in the Czech Republic.

Convergent services

Being the only integrated operator on the Czech telecommunications market, Telefónica O2 launched several services in 2007 that combine fixed and mobile voice, high-speed internet and television over a fixed line.

O_2 Trio, a new service introduced in March, combined O_2 Internet ADSL highs-speed internet, O_2 TV multimedia television and unlimited free calls to fixed networks in the Czech Republic, all as part of one fixed monthly fee. Customers could configure a product which suits their needs and usage patters from three components: high-speed internet with speeds ranging from 2 MB/s to 8 MB/s, O_2 Nonstop or O_2 Volám voice tariff and O_2 TV. The “trio” product was followed in May 2007 by O_2 Duo that combined unlimited free calls to fixed networks in the Czech Republic and either O_2 Internet ADSL high-speed internet or O_2 TV. On a per-service basis, the bundles are more economical than if the individual components were to be purchased separately.

After the launch of the pilot convergent service O_2 Internet Komplet in 2006, which combined ADSL high-speed fixed line internet and CDMA mobile internet, in April 2007 Telefónica O2 came with O_2 Duo Mobil. As part of one monthly subscription fee, the customer gets O_2 Internet ADSL and a mobile voice tariff. The subscription already includes the line rental fee. As with O_2 Duo and O_2 Trio, customers can have their pick from two options of O_2 Internet ADSL (2048 or 4096) and choose from the family of O_2 Simple tariffs (240, 600 or 980). Again, the O_2 Duo Mobil service is more economical than if the components were to be purchased separately.

On 1 March 2007, a version of O_2 Internet Komplet designed for business customers was launched under commercial brand O_2 Internet Komplet Business. In addition to being economical, O_2 Internet Komplet Business comes with an offer of a CDMA modem (USB or PCMCIA) for CZK 1 exclusive of VAT, an ADSL2+ modem/router with WiFi capability for CZK 495 exclusive of VAT, service activation for CZK 1 exclusive of VAT and up to three months of unlimited data using CDMA technology.

At the end of 2007, the total number of customers subscribing to convergent services climbed to nearly 100,000. The launch of the convergent services propelled the demand for O_2 TV and helped to slow down the net loss of fixed accesses to 333,000 in 2007; compared to 506,000 in 2006, that is by 34%.

ICT services

Telefónica O2 substantially bolstered its activities to include also the area of information and communication technologies (ICT). The acronym, in fact, stands for an end-to-end communication solution, including the design, hosting, outsourcing and management of an application and hardware. In 2007, the Company introduced its first in the range of the so-called managed services. Managed services cover the whole ICT spectrum – from computer networks and voice services to security and hosting. The services are of professional standard and use state-of-the art technologies; maintenance responses are under guarantee. The services let customers respond flexibly to the market situation without having to consider the limits of their technology. The services also bring the comfort of not having to worry about technology as all activities are carried out and guaranteed by Telefónica O2.

When designing a concept, Telefónica O2 laid emphasis not only on the latest technology and processes, but also the needs of the customer in question.
The scope and parameters of the service can be operatively scaled up or down based on the actual need. A high degree of flexibility enables fast response to non-standard requirements; if such requirements were to be addressed in-house, it would require a substantial one-off investment. The whole platform was designed in a way which makes the life easier for all potential customers of ICT solutions, helping them use their resources more efficiently.

The first in the range of managed services launched by Telefónica O2 was O_2 Managed Hosting. The service consists of three components: Managed Data Storage comes with a dedicated disk array for the storage of up to thousands of GB of data, which can be retrieved any time and very fast; Managed Server Hosting offers a server computing capacity in the required quality for a set period of time and system administration up to the operating system level, including planning and change request implementation; Managed Backup & Restore provides for the back-up of data onto a spare medium for the eventuality of loss of data in the primary storage, data recovery and the corresponding back-up hardware and software capacity including administration.

In 2007, Telefónica O2 also won a substantial proportion of the government tender for the so-called Government Communication Infrastructure (KIVS). KIVS is one of important elements of the future government. As part of the KIVS project, end-to-end solutions were provided to technical, networking, application, security and organisational issues related to voice and data communication for all central government agencies and selected external stakeholders. The project covers the central and local governments, public agencies, the general public, corporations and other parties.

After the framework agreement with Telefónica O2 expired, the Czech Ministry of Informatics, acting on government resolution, mandated a tender for a KIVS framework agreement which would be signed with more than supplier, as per the requirement of the new Public Procurement Act No. 137/2006 Coll.

The total value of the contract was approximately CZK 1,7 billion. Three suppliers were chosen in the tender. Telefónica O2 successfully claimed 55 out of a total 58 catalogue items for the delivery of telecommunications services, 49 out of a total 52 catalogue items for data transmission and all six catalogue items for the delivery of voice services. The success meant that the Company delivered on one of its strategic goals and decided to support the e-Government programme, which is key for the government infrastructure development.

Another project in 2007 was the creation of a modern system of emergency call centres 112 (TCTV 112), accommodating European Union requirements, for the Czech Ministry of Interior and the Fire and Rescue Brigade. The solution comprised the delivery of voice and data services, call centre technology, information systems and call processing applications, a complete system testing, pilot operation and system commissioning.

Telefónica O2 successfully completed the eCall 112 pilot project, which was implemented in partnership with the Czech Ministry of Transport and the Fire and Rescue Brigade. The pilot set out to test the possibilities for eCall data reception and visualisation in the TCTV 112 test interface. The preparation for the implementation included modifications of the emergency centres for the reception of data from on-board devices, which are activated by sensors mounted in a vehicle; the sensors either manually or automatically trigger dialling of the 112 emergency number. The accident site is then visualised on the operator’s monitor using GPS. The pilot project was a precursor of a later implementation of the public eCall 112 project in the TCTV 112 live environment. Before the service is launched, a European standard must be adopted, committing all Member States which signed the eCall Memorandum. The process is projected to conclude in 2008. The pan-European on-board emergency system will ensure that the rescue teams will immediately know if a road accident had happened, regardless of where it may be, and respond faster. It may have a positive impact on the number of deaths, reduce losses and improve the quality of road traffic.

Domestic and international wholesale services

In 2007, the Czech telecommunications market continued in its consolidation. The fiercely competitive environment drove the prices of data services down. As in the previous years, the wholesale market was dominated by optical networks operators and FWA access providers. In 2007, they were joined at an increasing rate by operators using the unbundled local loop. Telefónica O2 responded by improving the quality of service, shortening delivery times and by innovating and expanding its product portfolio.

In 2007, Telefónica O2 overhauled its Carrier Broadband (ADSL wholesale offering) product. It increased access speeds two fold and raised the data limits, while preserving the wholesale prices. In the area of high-speed internet, the Company launched a new product, Carrier IP Stream, which gives wholesale customers greater flexibility in defining their own retail services. Telefónica O2 also published its last mile access reference offer for leased lines.

As at 31 December 2007, Telefónica O2 registered 26 networks of other public electronic communications service providers interconnected with its fixed line network. As at the same date, the Company had five agreements for the so-called Shared Metallic Path Facility (SMPF) and co-location framework agreements. 173 local co-locations in total were opened to other operators for the provisioning SMPF services.

No significant changes occurred in the area of interconnection of the mobile electronic communications networks of Telefónica O2 with the networks of other domestic operators. The Company laid emphasis on the quality of service required by the applicable laws and regulations and technical standards. As at 31 December 2007, the Company's mobile network was interconnected with 11 providers of public electronic communications network services.

Also in 2007, Telefónica O2 succeeded in maintaining its strong position in the market of international voice services. The Company was a sought-after provider of international voice transit. In spite of the competition which drove the prices down, Telefónica O2 maintained an extensive portfolio of partners, especially a network of direct connections to mobile operators; it helped the Company in offering the highest possible quality of direct termination services at competitive rates, which led to a growth in the volume of international transit traffic and of traffic terminated in the Czech Republic.

Comments on the financial results

Consolidated financial results

Revenues, operating costs and OIBDA

The consolidated revenues reached CZK 63.2 billion in 2007, up 3.1% year on year. The domestic mobile business of Telefónica O2 was the key driver of this growth. Business revenues in the domestic fixed line segment were almost flat in 2007 compared to 2006. The contribution of the Slovak operation to the consolidated revenues in 2007 was marginal. The total consolidated operating costs reached CZK 35.7 billion in 2007, up 4.7% year on year. The consolidated OIBDA amounted to CZK 28 billion in 2007, up 0.5% year on year. The OIBDA margin (OIBDA over Business Revenues) reached 44.8% in 2007, compared to 45.8% in 2006. Despite the decrease in the Group's OIBDA margin in 2007, caused primarily by the dilution of the Slovak operation (approximately 2 p.p. in 2007), it still remains high.

Depreciation and Amortization

The consolidated depreciation and amortization reached CZK 14.4 billion in 2007, declining 13.8% year on year.

Operating Income, Income before tax and Net income

The consolidated operating income and consolidated income before tax went up by 21.8% year on year and 23.5% year on year, to reach CZK 13.6 billion and CZK 13.5 billion, respectively, in 2007; the trend was driven by a decrease in the consolidated depreciation and amortization and by the low financial expenses. The consolidated net income in 2007 was CZK 10.4 billion, up 29.5% year on year. A decrease in the deferred tax expense resulting from lower income tax rates in the period 2008-2010 positively affected the income tax expense in 4Q 2007.

CAPEX

Total consolidated CAPEX accounted for CZK 7.8 billion in 2007, up 20.1% year on year, which was a result driven mainly by the CAPEX demands in connection with the launch of operation in Slovakia. The CAPEX in the Czech Republic was largely related to increasing the capacity and coverage of the GSM network, ADSL and IPTV expansion driven by the increasing customer numbers, improvements in the fixed access network and by upgrades of the Company's information systems. The CAPEX in Slovakia was expended on the GSM network rollout and systems deployment (billing, collection, call centre, etc.). Despite the 20.1% growth in CAPEX in 2007 compared to 2006, the actual CAPEX of CZK 7.8 billion was well below the original target from the beginning of the year, which stood at around CZK 9 billion. This attests to the Group's focus on efficient CAPEX expenditure and on its direction to pro-growth areas.

Free Cash Flows

In 2007, the Group confirmed its ability to generate strong free cash flow. The total volume of the free cash flows generated was CZK 18.3 billion in 2007, down 0.7% year on year. Operating cash flows went down 2.3% year on year to CZK 23.9 billion due to negative impact of lower depreciation and amortization non-cash adjustment and due to a higher amount of tax paid; that, in turn, was partly offset by working capital improvement, while net cash used in investing activities decreased 5.7% year on year to CZK 5.7 billion.

Cash and Debt levels

The Group's consolidated financial debt (long-term and short-term) as at 31 December 2007 amounted to CZK 9.3 billion, down 1% compared to the end of December 2006. Cash and cash equivalents and short term financial investments reached CZK 9.6 billion at the end of 2007, resulting in a net leverage of minus 0.4% and gross leverage of 11.2%, compared to 2.1% and 10.6%, respectively, as at 31 December 2006.

Overview of results in the Czech Republic

The Company's strategy in the last quarter of 2007 continued to focus in particular on new and enhanced products and services in the growth areas. In the fixed line segment, these include broadband, IPTV and data services, IT and end-to-end business solutions. In the mobile segment, Telefónica O2 continued to focus on improving of the attractiveness of voice service bundles with a view to stimulating voice traffic. The Company also focused on the marketing of its family of mobile data services, which offer 100% availability in the O_2 network, regardless of the technology used, as part of one monthly subscription. The Company also continued to stimulate the pre-paid to post-paid migration with the aim to develop the ARPU potential of these customers.

Overview of the mobile segment[1]

Total business revenues in the mobile segment increased 4.4% year on year in 2007 to CZK 32.6 billion.

Revenues from voice services (monthly subscription fees, usage and interconnection) increased 4.9% year on year to CZK 24.3 billion.

The total number of registered mobile customers increased 5.4% year on year to 5,126 thousand at the end of December 2007. The total number of customers

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

under contract reached 2,244 thousand, up 369 thousand year on year, which makes for an increase of 19.7%. The result is attributed to the active pre-paid to post-paid migration. Contract customers accounted for 43.8% of the total customer base at the end of 2007, up from 38.5% at the end of 2006.

The number of registered prepaid customers fell by 108 thousand year on year (a year-on-year decline of 3.6%) to 2,882 thousand at the end of 2007. According to the methodology which defines a prepaid customer as one that generated revenue in the last 3 months, the number of active mobile prepaid customers as at 31 December 2007 was 2,536 thousand, down 3.9% year on year.

The blended monthly average churn rate reached 1.5% in 2007, the same as in 2006.

Revenues from monthly subscription fees increased 10.9% year on year and reached CZK 7.1 billion in 2007, mainly as a result of the 19.7% year on year growth in the contract customer base.

Usage revenues increased 3.5% year on year and reached CZK 11.9 billion in 2007, namely as a result of the 21.7% growth in the outgoing traffic volumes. The average monthly Minutes of Use (MOU) per customer improved to 117 minutes in 2007; compared to 102 minutes in 2006 it represents a growth by 14.7% year on year. The trend was driven chiefly by the growing number of contract customers generating higher average traffic per customer and the success of tariffs designed to stimulate mobile traffic.

The interconnection revenues amounted to CZK 5.3 billion in 2007, up 0.6% year on year.

In 2007, the blended monthly ARPU[1] reached CZK 524, up from CZK 511 in 2006 (+2.5% year on year). The post-paid monthly ARPU reached CZK 907 in 2007, which is 8.3% less than in 2006 (2006: CZK 989). The main reason behind the lower post-paid ARPU is the dilution caused by the customer migration from the prepaid to the post-paid segment. The prepaid monthly ARPU increased 3.3% year on year to CZK 247 in 2007.

The total revenues from value added services (including SMS, MMS and content) increased 3.6% year on year to CZK 4.6 billion, owing to the growing volume of SMS and MMS messages. In 2007, Telefónica O2 customers sent and received in total 3,082 million SMS, up 7.8% year on year.

The revenues from internet and data recorded a 15.6% increase year on year and reached CZK 2 billion. The total number of data customers (GPRS and CDMA) increased 14.3% to 192 thousand as at 31 December 2007. The average data ARPU improved by 2.8% year on year and was CZK 111 in 2007. The average monthly data ARPU per customer (excluding SMS) represented 43% of the total data ARPU in 2007, compared to 41% in 2006. The increase is attributed to the growth in the number

[1] Including inter-segment revenues.

of CDMA and GPRS customers and to the increase in the number of MMS sent. The data ARPU as % of blended ARPU remained stable in 2007 compared to 2006 at about 21%.

Equipment sales (including connection fees) fell in 2007 1.9% year on year down to CZK 1.5 billion. Other business revenues decreased by 48.2% year on year to CZK 157 million.

Overview of the fixed line segment[1]
The total business revenues in the fixed line segment went down 0.2% to CZK 29.6 billion in 2007; the decline in traditional voice revenues was almost completely offset by a healthy growth in the revenues from broadband internet, value added and IT services. Revenues from broadband, data and other value added telecommunication services accounted for 28.6% of business revenues in 2007 compared to 25.9% in 2006.

The revenues from traditional access decreased 8.4% year on year to CZK 9.6 billion in 2007. The total number of fixed accesses at the end of 2007 stood at 2,069 thousand, which is 13.9% less year on year. It is the result of primarily the strong and ongoing fixed to mobile substitution. The decline in the number of fixed accesses nonetheless slowed down in 2007. The net losses decreased to 66 thousand in 4Q 2007 from 114 thousand in 1Q 2007, 81 thousand in Q2 2007, 72 thousand in Q3 2007 and 135 thousand in 4Q 2006. This is a result of the improving gross adds and the lower number of cancelled lines. The Company has been trying to add more value to the fixed line by means of offering internet access and convergent bundles. The total number of customers subscribing to one of the bundled products (O_2 Duo, O_2 Trio, O_2 Duo Mobil and O_2 Internet Komplet) reached close to 100 thousand at the end of 2007.

The revenues from the traditional voice services (usage and interconnection) declined by overall 6.0% to CZK 9.1 billion in 2007. Usage revenues fell 17.1% year on year to CZK 4.6 billion in 2007, which was caused by a lower volume of traffic generated by our fixed line customers; the total volume of traffic in 2007 was 2,702 million minutes.

Interconnection revenues went up 8.7% year on year in 2007 and reached CZK 4.6 billion. The increase is attributed to the higher volume of international transit traffic and to an increase in the number of LLU.

The revenues from internet (both dial-up and broadband) increased 16.6% year on year to CZK 3.9 billion in 2007, due to the strong 34.3% growth in the revenues from broadband services, which was more sufficient to offset the decreasing revenues from narrowband. It has proven the Company's strategy to focus on ADSL and IPTV services and on premium content.

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

Revenues from broadband internet (ADSL, IPTV and content) amounted to CZK 3.7 billion in 2007, up 34.3% year on year. Of this, CZK 3.3 billion were revenues from retail broadband (up 40.3% year on year) and CZK 391 million were revenues from wholesale ADSL services (down 1.2% year on year). The total number of ADSL accesses (retail and wholesale) reached 570 thousand as at 31 December 2007, compared to 470 thousand a year ago (up 21.3% year on year). The total number of O_2 TV customers increased to 73 thousand at the end of 2007, with 20 thousand net adds in 4Q 2007 alone, up from 16 thousand in 3Q 2007 and 12 thousand in 2Q 2007. The successful take up of bundled products is the main reason behind the improved O_2 TV net add figures in 4Q.

The revenues from data services were down 6.2% year on year to CZK 3.9 billion, mainly due to a 12% decline in the revenues from leased lines, while revenues from data network services increased 1.1% year on year as a result of the growth of IP Connect and IP VPN connections.

The revenues from IT services and business solutions reached CZK 1.7 billion in 2007, which is 2.9 times higher than in 2006. It is a result of the intensive activities in ICT and IT services for large corporate customers and for the government. Equipment sales yielded CZK 462 million, down 22.1% year on year, which is due to the lower number of units sold and special discount offers.

Consolidated operating costs

The total consolidated operating costs (including the Slovak operation) in 2007 reached CZK 35.7 billion, up 4.8% year on year.

Supplies expenses, including the cost of interconnection and roaming, the cost of goods sold and other supplies, grew 10.9% year on year to CZK 17.1 billion in 2007. Interconnection costs increased 10.0% year on year to CZK 11 billion in 2007 due to interconnection charges recorded in Slovakia, more activity in the transit business and also to the growth in mobile traffic generated by customers in the Czech Republic. The cost of goods sold went up 14.1% year on year to CZK 3.5 billion; costs in Slovakia increased, while costs in the Czech Republic grew slightly. Other supplies and the cost of sales increased 10.4% to CZK 2.6 billion in 2007, which we explain by the increase in the volume of sub-contracts in the course of ICT projects.

Personnel costs, including headcount reduction costs, accounted for CZK 7.1 billion in 2007, which is almost the same amount as in 2006The total number of Group employees as at 31 December 2007 reached 9,221, down 5.9% year on year. The number of employees of Telefónica O2 Czech Republic went down 6.2% year on year and closed at 8,695.

The total cost of external services increased 3.7% year on year and reached CZK 10.9 billion in 2007. The total cost of marketing and sales went up 14.0% year on year to CZK 3.6 billion due to marketing activities in Slovakia and to the higher sales expenses driven by a different mix of the sales channels. The marketing costs in the Czech Republic went down as a result of marketing activities related to re-branding in 2H 2006. The cost of network & IT maintenance increased 0.3% year on year to CZK 2.6 billion in 2007. Rental, buildings and vehicles costs reached CZK 1.9 billion, up 14.8% year on year, the cost of media increased 8.2% year on year to CZK 807 million in connection with the general price hikes. The cost of other external services including consultancy fees, call centre and other external services went down 15.2% year on year to CZK 2 billion in 2007 due the lower cost of consulting services and the re-branding costs incurred in 2006.

The taxes, comprising taxes other than income tax, fees and provisions, went down 44.4% year on year to CZK 600 million, chiefly as a result of the lower bad debt provisions in 2007 and the higher inventory provision charged in 4Q 2006.

Outlook for 2008

In 2008, the Company's activities will continue to address the current trends and customers' needs in the highly competitive Czech telecommunication market, specifically in the areas of broadband, data, value added and ICT services and convergent products. At the same time, the Company will maintain a focus on revenue retention in traditional voice services in the both fixed and mobile segments.

In the fixed line business the Company's effort will focus on the consolidation of actions taken in the past periods. As in 2007, a slow down of the decline in fixed accesses remains among the top priorities for 2008. The Company believes that a continuing enhancement of ADSL and IPTV value proposition will further increase the value of the fixed line and eventually reduce the churn rate. Broadband services will be the fundamental product of the bundles, with a strong focus on value proposition supported by the quality of service, coverage expansion and improved customer care. The Company will also continue the innovation of its O_2 TV service. We see a strong potential in the area of IT and integrated business solutions designed primarily for corporate and government customers – this is where the Company will continue to focus its efforts in 2008. The acquisition of a 100% stake in DELTAX Systems, one of the most prominent Czech providers of ICT services, will further strengthen the Company's position on the fast growing ICT market. The strategy in the mobile segment continues to focus on ARPU defense by means of continuing the prepaid to postpaid migration and growing non-SMS mobile data and Internet revenues through broadband based services.

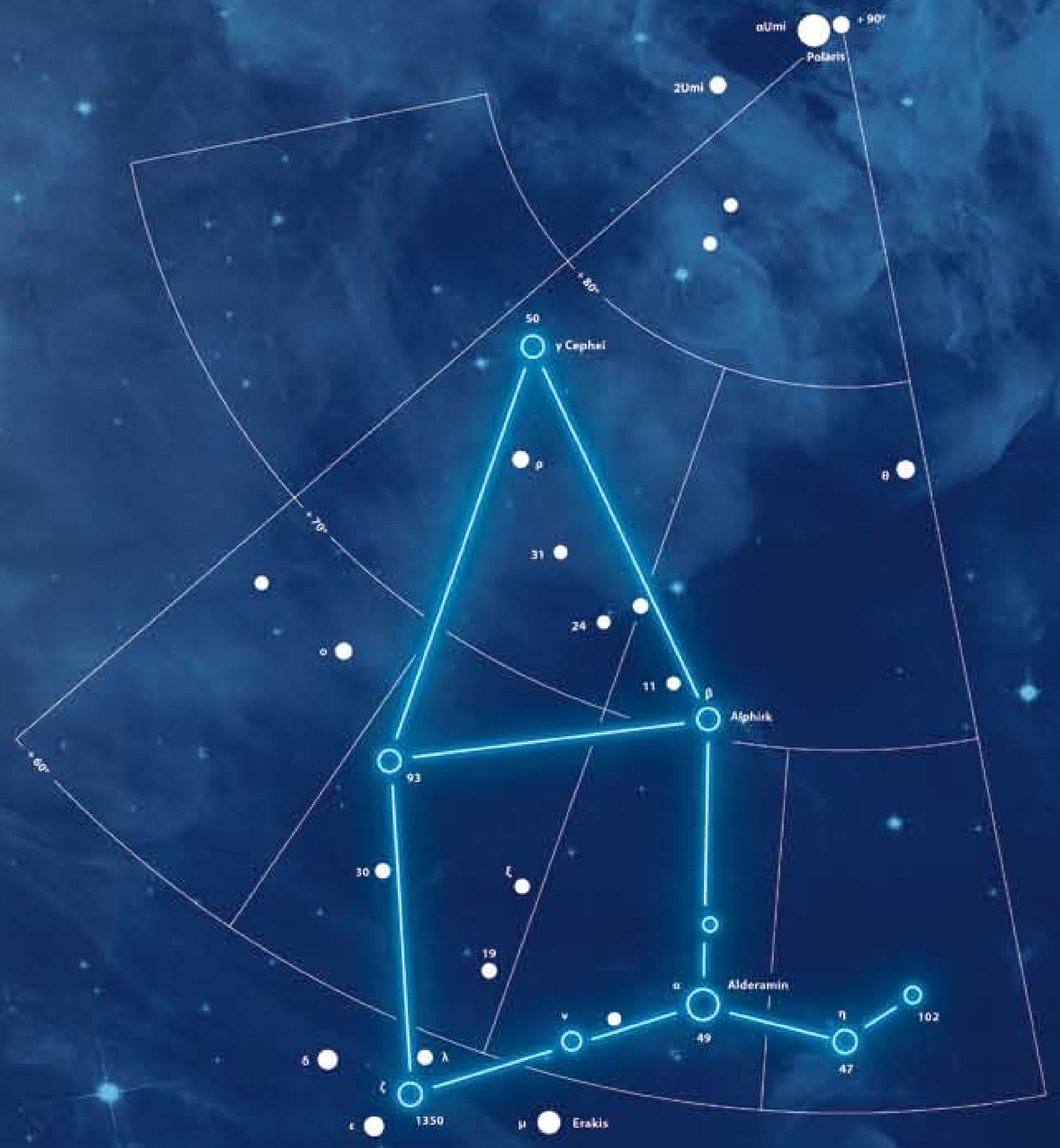
Telefónica O2 will continue to support the gradual deployment of the Slovak operation including the development of systems, processes and network rollout to achieve a quality and customer experience equal to that of O2 in the Czech Republic, while applying a cost conscious approach. Activities in Slovakia will focus primarily on the improvement of the customer mix by means of increasing the share of postpaid customers, and on acquiring new business by offering innovative services for all customer segments.

The key strategic effort of the Company in the Czech Republic is to further increase its position in the broadband market and also in the pay TV market. The main aspects of financial management of the Telefónica O2 Czech Republic Group will remain focused on profitable growth, while maintaining its operating profit and OIBDA growth, emphasis on efficient CAPEX expenditure and on strong free cash flows.

In 2008, Telefónica O2 Czech Republic expects a consolidated revenue growth[1] of 2–4% and OIBDA[2] to grow 0–2% compared to 2007. The CAPEX is expected to be around CZK 9 billion in total. In addition, the Group reiterates its medium term guidance for the period 2007–2010 communicated in February 2007.

[1] In the guidance calculation, revenues represent business revenues only.

[2] In the guidance calculation, OIBDA excludes other extraordinary revenues/expenses not foreseeable in 2008. For the purpose of comparison, the equivalent other extraordinary revenues/expenses posted in 2007 are also deducted from the reported figures (the impairment charge was the only unforeseeable expense deducted from OIBDA in 2007).



It may seem that stars have their fixed positions on the night sky, but it is far from the truth. Stars are constantly moving, although the movement is indiscernible during one human life. The position of stars – to the human eye – changes due to the rotation of the Earth's axis; we call this phenomenon precession. Precession will cause that between the years 3,000 and 5,200 A.D., the star γ Cephei of the constellation Cepheus will take Polaris' place and become the new star determining the north.

Corporate Social Responsibility

Employees

Telefónica O2 is committed to Corporate Social Responsibility and it employs systematic and measurable methods designed to tackle environmental, social and ethical issues and to manage risks. All Telefónica O2's activities in the field of Corporate Social Responsibility are described in detail on the Company's website: http://www.cz.o2.com/osobni/cz/o_nas/nas_odpovedny_pristup/index.html

Employee structure of Telefónica O2

Employees	As at 31 December 2007
Total number of employees	8,695
Women	3,062
Men	5,633
Employees with reduced work capacity or with a disability	155

The Company has always cared for feedback from employees. In February 2007, the employee satisfaction and engagement survey Reflect O_2 was conducted for the first time as a pilot; the second survey was conducted in November 2007.

Reflect O_2 2007	February	November	Variance
Return rate of questionnaires (%)	74	83	+9
Overall Reflect Index (points)	67	72	+5
Performance and development index (points)	68	73	+5
People management index (points)	67	74	+7
Business focus index (points)	65	70	+5
Atmosphere index (points)	71	74	+3
Top management index (points)	56	54	–2
Action plans	1,694		

After the survey results were published, managers on all levels discussed them with their teams and suggested measures for improvement. This exercise resulted in the so-called action plans which were used for management work during the year. The activities have led, among other things, to an increase in the overall index in the November survey.

In 2007, Telefónica O2 was awarded the AXA Employer of the Year Award by public poll. A jury of experts and university students voted the Company into the ninth place in the Employer of the Year 2007 and The Most Desired Company 2007 categories.

Telefónica O2 always offers its employees a wide range of employee benefits – financial products, O2 products and services at a discount and benefits promoting better work-life balance. Employees with reduced work capacity also get a CZK 10,000 voucher towards a convalescence holiday every year. The range of benefits is updated every year based on the employees' demand. In April 2007, for instance, the Company launched a programme which awards discounts on purchases with programme partners (e.g. spa treatments, healthcare, etc.).

A new five day training programme for middle and higher level managers, O_2 Leading to Excellence, which is focused on the development of management skills, was launched in February 2007. By the end of 2007, a total of 170 managers and executives went through the programme. The Company also has a two day course for newly appointed managers, Roles of a Manager; 36 managers have been trained to date.

The relationship with the trade union partner was productive and scrupulous. The social dialogue was conducted on an ongoing basis. A new Collective Agreement was signed on 1 January 2007, through which both parties agree to take into account the internal rules and regulations governing the rights of employees, updated after changes in the labour law.

Environment

Telefónica O2's attitude towards environmental protection is laid down in the Environmental Policy. The document covers the areas of the Company's operation and strives to mitigate, in the light of the latest scientific knowledge, all possible impacts on, damage to or degradation of the environment as a whole or any of its parts. The policy strives to ensure that the level of environmental protection is continually improved, pollution prevented and that the Company complies with various legal and environmental requirements by which it is bound. The key principles of Telefónica O2's environmental policy have not changed in the process of integration into the global Telefónica Group and they are fully in line with the Group's own standards and with the national legal requirements.

Company increased its environmental expectations from suppliers and new standards were elaborated. Selected suppliers were subject to customer audits, audits of their integrated management systems and of their environmental standards in processes dedicated to supplying under the contract with the Company.

The Company's own environmental management system was successfully certified by TÜV NORD Czech according to the ISO 14001:2004 international standard. Telefónica O2 drew on its past success of being the only telecommunications operator in the Czech Republic with the certificate.

The course of reducing the negative impacts on the environment was maintained also in 2007. The Company used 1% less energy in 2007 for its operations than in 2006, the volume of heat purchased and of natural gas fell 54% and 69% year on year, respectively. Compared to 2006, the volume of pollutants released into air from heat generators and vehicles also fell; fuel consumption also decreased by 4.3% year on year.

Health and safety

Telefónica O2 regards safety as a very important and essential part of all its processes. Emphasis is also laid on occupational health. In 2007, a new contract was signed with Santé Networks, a company providing preventative healthcare to Telefónica O2 employees. Workplaces were inspected, work activities involving employees were evaluated for risk factors and a re-cataloguing of work commenced. The results showed that no work carried out as part of the Companies operations could be classified as dangerous under the applicable labour law regulations. A new EU directive concerning protection against electromagnetic radiation was also implemented.

Based on the successful audit, Telefónica O2 occupational health and safety systems were certified according to OHSAS 18001 and its information security system was certified according to ISO 27001. Telefónica O2 was also awarded the seal of Healthy Company (1st degree).

In order to support employees in precarious security situations, Security HELP *15 was established. An employee can call the *15 toll-free number and speak with a qualified operator who will arrange for assistance from an expert from the Security department. The service is available on a 24/7 basis. Employees can also use Security HELP, an intranet application that serves as an intuitive wizard for the solution of the most common problems and incidents. Employees also have contacts for experts in various fields who can assist with consultation and guidance.

O_2 Foundation

Telefónica O2 channels its philanthropic activities through its foundation. The total volume of funds, in-kind donations and telecommunications services provided by Telefónica O2 to projects of public benefit in 2007 exceeded CZK 27 million. The Company invested more than CZK 18 million in support of non-profit projects in 2007.

In 2007, Telefónica O2 took sixth place in the TOP CORPORATE PHILANTHROPIST chart, as measured by the absolute volume of donations. Telefónica O2 is also founding member of the Donator club affiliated with the Donors’ Forum.

In 2007, O_2 Foundation became general partner of Linka bezpečí, the only national free helpline for children and young people in difficult life situations. The helpline takes and handles 300–400 calls from children on a daily basis.

2007 saw the conclusion of the three year pilot anti-bullying campaign in Czech schools. The final evaluation showed that the campaign had helped to reduce bullying in 17 participating schools by up to 20%.

Telefónica O2 is also member of the Donor SMS project aimed at developing individual donorship in the Czech Republic. In 2007, individual donors sent DMS in the total value of CZK 14,338,050 via the O_2 network.

Telefónica O2 became the first telecommunications operator to give discounts on its fixed line and mobile services to people with disability. More than 80 thousand customers with disability received discounts in the total value of CZK 181 million.

Business ethics

In autumn 2007, Telefónica O2 adopted its Business Principles which reflect Telefónica Group’s corporate values and principles and which lay down the rules of ethical conduct by which all its employees are bound. The Business Principles are also an inherent part of the Company's efforts to build its good name and the O_2 brand; they also provide a basic framework for the implementation of procedures and working methods which are instrumental in the building of relationships with customers, shareholders, employees, suppliers and with the society at large. The Company also implemented tools for redress of any potential unethical practice or incident. Employees are free to contact Human Resources, Security and Legal experts for consultation. They can also use the electronic application, hotline with a voice mail service and a special e-mail address to communicate their issues.

The Business Principles apply across the whole Telefónica Group, i.e. in all 23 countries where Telefónica has a presence, and to all its employees.

The implementation of the Business Principles was fully endorsed by the governing bodies and the executive management of the Company; its progress is monitored by the Ethics and Corporate Responsibility Committee and, through the committee, by the Supervisory Board. The full version of the Business Principles is available on: http://www.cz.o2.com/osobni/cz/o_nas/profil_spolecnosti/profil_spolecnosti-spravni_organy-eticke_zasady_podnikani.html

04 CORPORATE GOVERNANCE

Betelgeuse, the second brightest star in the constellation of Orion, seems to our eyes only a marginally brighter dot on the night sky. In reality it is a red supergiant and one of the most well-known stars. If Betelgeuse, with its circumference of almost 1,000,000,000 kilometres, were placed in the middle of the Solar System, it would reach as far as the orbit of the planet Jupiter – it would swallow not only our Earth, but also Mercury, Venus and Mars.

Corporate Governance

Corporate governance of the Telefónica O2 Czech Republic Group

Year 2007 saw the continuation of the project to implement a corporate governance model, which was introduced to Telefónica O2 Czech Republic (Telefónica O2, Company) as part of the integration process. Also in this period, the Company relied on experience and best practice of the global Telefónica Group. In 2007, activities again focused on optimisation and development of the Group, both on the level of the parent company (Telefónica O2 Czech Republic), as well as on the level of subsidiaries.

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 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.

In terms of organisation, Telefónica O2 is a part of Telefónica's European division (Telefónica O2 Europe), which holds all companies that use the O_2 commercial brand. No significant changes occurred in the ownership structure of the Company; Telefónica, S.A., holding a 69.41% stake, remains the majority owner.

Subsidiaries and associated companies

(AS AT 31 MARCH 2008)

Based on an earlier decision of the sole shareholder of CenTrade, a.s., (December 2006) on the winding-up of the company with liquidation, the process of liquidation was completed in November 2007 and the company was subsequently de-registered from the Commercial Register. In July 2007, the Board of Directors of Telefónica O2, acting as sole member, decided to liquidate SPT TELECOM (Czech Republic) Finance B.V. on the grounds of the company's redundancy; the company had been dormant for several years.

In order to support the business operations of Telefónica O2 Slovakia, s.r.o., the equity of the company was increased by decision of the sole member to SKK 1.5 billion. The corporate name of the company was also changed to a more accurate version at that time.

In December 2007, Telefónica O2 Group acquired 100% shares of DELTAX Systems a.s., which ranks among the top providers of ICT services in the Czech Republic.

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

Subsidiary and associated companies
(as at 31 March 2008)

Corporate name	Registered capital		Share of Telefónica O2 Czech Republic, a.s.
Telefónica O2 Slovakia, s.r.o.	SKK	1,500,000,000	100%
Telefónica O2 Services, spol. s r.o.	CZK	10,000,000	100%
DELTAX Systems a.s.	CZK	3,006,000	100%
GITUS a.s.*	CZK	2,100,000	
Internet Information Services s.r.o.*	CZK	100,000	
CZECH TELECOM Austria GmbH	EUR	35,000	100%
CZECH TELECOM Germany GmbH	EUR	25,000	100%
První certifikační autorita, a.s.	CZK	20,000,000	23.25%
SPT TELECOM (Czech Republic) Finance B.V. v likvidaci	EUR	18,151	100%
AUGUSTUS spol. s r.o.**	CZK	166,000	39.76%

* Companies wholly controlled through DELTAX Systems a.s.
** Telefónica O2 Czech Republic, a.s. does not control the company.

Organisation chart of Telefónica O2 Czech Republic

The optimisation of the system of organisation and governance of Telefónica O2 continued also in 2007. The following changes occurred since the 2006 Annual Report and the 2007 Half-year Report:

- The Transformation and Convergence Unit was dissolved in August 2007; its powers and agendas were transferred to other existing organisation units and also to a new unit called Branding & Customer Experience;
- Regulation and Interconnect merged with Public Affairs in January 2008 and formed Public Affairs & Regulation. The interconnect agenda was transferred to the Wholesale Unit.

Executive macrostructure of Telefónica O2 Czech Republic

(AS AT 31 MARCH 2008)

Telefónica O2 Czech Republic, a.s.
General Meeting

Telefónica O2 Czech Republic, a.s.
Supervisory Board
Supervisory Board Chairman

Telefónica O2 Czech Republic, a.s.
Board of Directors
Board of Directors Chairman

Telefónica O2 Czech Republic, a.s.
Chief Executive Officer

- **Operations Division** – Vice-President, Operations Division
- **Finance Division** – Vice-President, Finance Division
- **Business Division** – Vice-President, Business Division
- **Consumer Division** – Vice-President, Consumer Division
- **Wholesale** – Executive Director, Wholesale
- **Strategy & Product Development** – Executive Director, Strategy & Product Development
- **Human Resources & Support Services** – Executive Director, Human Resources & Support Services
- **Public Affairs & Regulation** – Executive Director, Public Affairs & Regulation
- **Internal Audit & Risk Management** – Executive Director, Internal Audit & Risk Management
- **Legal Affairs** – General Counsel & Company Secretary
- **Branding & Customer Experience** – Executive Director, Brand & Customer Experience

Governing bodies of Telefónica O2 Czech Republic

(AS AT 31 MARCH 2008)

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. The Supervisory Board meets as needed, generally once in 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 20–25 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 or the Supervisory Board. As a rule, the Board of Directors meets once every calendar month, but at least twelve 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 two and a half 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.

The Company has 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 2008)

Salvador Anglada Gonzalez (*1965)

Chairman

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 was 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). Since July 2006 he held the position of Vice-President – Consumer Division in Telefónica O2 Czech Republic. Since July 2007 he has been Chief Executive Officer of this company and member of the Board of Directors of Telefónica O2 Europe plc. In February 2008 he was elected Chairman of the Board of Directors of Telefónica O2 Czech Republic.

SALVADOR ANGLADA GONZALEZ
CHAIRMAN

Juraj Šedivý (*1962)

1st Vice-Chairman

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, USA, 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 in 1996 and 1997 as the Finance Director of Globtel, a.s., a mobile subsidiary of France Telecom in the Slovak Republic (now Orange). 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 1st Vice-Chairman of the Board of Directors of Telefónica O2 Czech Republic. In October 2006 he was appointed Chief Executive Officer of Telefónica O2 Slovakia.

Petr Slováček (*1959)

2nd Vice-Chairman

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 (the legal predecessor of ČESKÝ TELECOM) in 1989, working in switching, technical development, network management projects and OSS. In June 2003 he was elected 2nd Vice-Chairman of the Board of Directors of ČESKÝ TELECOM, now Telefónica O2 Czech Republic. He currently holds the position of Vice-President, Operations Division.


JURAJ ŠEDIVÝ
1ST VICE-CHAIRMAN
PETR SLOVÁČEK
2ND VICE-CHAIRMAN

Martin Bek (*1969)

Member

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 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 Executive Director, Human Resources and Support Services in Telefónica O2 Czech Republic.

José Fernando Astiaso Laín (*1961)

Member

He studied telecommunications engineering at the Polytechnic University of Madrid and holds a PDG degree from IESE Business School. He has more than twenty years of experience in several technology sectors; he worked for Sener as project engineer, for IBM as account manager, and for Cable & Wireless as sales manager. He has been within the Telefónica Group since 1997 in various sales and marketing management positions in SME and Corporate segments. Currently he is Vice-President, Business Division at Telefónica O2 Czech Republic. In addition to Spanish, he also speaks English, French, Greek and some Czech.

Jakub Chytil (*1961)

Member

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, 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 Republic 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 December 2003 he has been in the position of General Counsel at ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic) and since May 2006 he has also been in the position of the Company Secretary.

MARTIN BEK
MEMBER

JOSÉ FERNANDO ASTIASO LAÍN
MEMBER

JAKUB CHYTIL
MEMBER

Ramón Ros Bigeriego (*1967)

Member

Graduated in Business Administration and European Masters in Management at ESCP EAP, Paris. Also studied at Alcalá de Henares University and at Dublin City University. Before joining Telefónica, he worked in Banesto, one of the biggest financial institutions 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); in October 2005 he was elected member of the Board of Directors of ČESKÝ TELECOM, Statutory Representative and Chief Financial Officer of Eurotel, and since September 2006 he holds the position of Vice-President, Finance Division in Telefónica O2 Czech Republic.

RAMÓN ROS BIGERIEGO
MEMBER

Personnel composition of the Board of Directors of Telefónica O2 Czech Republic, a.s., as at 31 March 2008

Name	Office	Member from
Salvador Anglada Gonzalez	Chairman	23 June 2005
Juraj Šedivý	1st Vice-Chairman	13 June 2003
Petr Slováček	2nd Vice-Chairman	13 June 2003
Ramón Ros Bigeriego	Member	16 October 2005
José Fernando Astiaso Laín	Member	27 April 2006
Martin Bek	Member	27 April 2006
Jakub Chytil	Member	27 April 2006

As per the Articles of Association, the term of office of a member of the Board of Directors is five years.

No changes occurred in the personnel composition of the Board of Directors in 2007.

The following changes occurred in the personnel composition of the Board of Directors during January-March 2008:

Jaime Smith Basterra	his resignation from the office of Chairman of the Board of Directors was discussed on 8 February 2008;
Salvador Anglada Gonzalez	elected Chairman of the Board of Directors on 8 February 2008;
Jaime Smith Basterra	his membership in the Board of Directors ended on 21 February 2008, when the Supervisory Board discussed his resignation;
Antonio Botas Bañuelos	his membership in the Board of Directors ended on 21 February 2008, when the Supervisory Board discussed his resignation.

Executive management of Telefónica O2 Czech Republic

(AS AT 31 MARCH 2008)

Salvador Anglada Gonzalez (*1965)
Chief Executive Officer
(resumé in section Board of Directors of Telefónica O2 Czech Republic, page 72)

Ramón Ros Bigeriego (*1967)
Vice-President, Finance Division
(resumé in section Board of Directors of Telefónica O2 Czech Republic, page 78)

Petr Slováček (*1959)
Vice-President, Operations Division
(resumé in section Board of Directors of Telefónica O2 Czech Republic, page 74)

José Fernando Astiaso Laín (*1961)
Vice-President, Business Division
(resumé in section Board of Directors of Telefónica O2 Czech Republic, page 76)

Jakub Chytil (*1961)
General Counsel and Company Secretary
(resumé in section Board of Directors of Telefónica O2 Czech Republic, page76)

Martin Bek (*1969)
Executive Director, Human Resources and Support Services
(resumé in section Board of Directors of Telefónica O2 Czech Republic, page 76)

Zdeněk Radil (*1975)

Executive Director, Internal Audit and Risk Management

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 (the legal predecessor of Telefónica O2 Czech Republic) 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 holds the position of Executive Director for Internal Audit and Risk Management in Telefónica O2 Czech Republic. He is also Vice-President of the Czech Treasury Association and Secretary-General of the Czech Association of Investment Companies. He holds a full broker's licence.

ZDENĚK RADIL
EXECUTIVE DIRECTOR, INTERNAL AUDIT AND RISK MANAGEMENT

STANISLAV KŮRA
EXECUTIVE DIRECTOR, STRATEGY AND PRODUCT DEVELOPMENT

PAVEL JIROUŠEK
EXECUTIVE DIRECTOR, WHOLESALE

ESTER JÁNOŠIOVÁ
EXECUTIVE DIRECTOR, BRAND AND CUSTOMER EXPERIENCE

Ester Jánošiová (*1965)

Executive Director, Brand and Customer Experience

Graduated in Foreign Trade from the University of Economics and holds a postgraduate Master of Arts in International Affairs (M.A.I.A.) from the Johns Hopkins University. After graduation she worked at the Economic Institute of the Academy of Sciences. From 1992 she worked in managerial positions in companies Unilever, L´OREAL and Kraft Foods, in the Czech Republic and abroad. She joined ČESKÝ TELECOM (now Telefónica O2 Czech Republic) in 2005 as Director for Data Analyses, Market Research and Customer Experience. Since 2006 she has also been responsible for the brand. Currently she holds the position of Executive Director, Brand and Customer Experience.

Pavel Jiroušek (*1963)

Executive Director, Wholesale

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 programme). 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 its transformation into Telefónica O2 Czech Republic, he is the new company's Executive Director for Wholesale.

Stanislav Kůra (*1968)

Executive Director, Strategy and Product Development

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 spans the whole Telefónica O2 Czech Republic.

David Šita (*1969)

Executive Director, Public Affairs and Regulation

He graduated from the University of Economics, Prague, with a degree in finance and macroeconomics. 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, in operations, and managed a small brokerage firm. He joined ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Repulic) 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 Executive Director, Regulation, and later also for Interconnect. In January 2008 he was appointed Executive Director, Public Affairs and Regulation of Telefónica O2 Czech Republic.

Andrei Marc Torriani (*1967)

Vice-President, Consumer Division

Has a degree in Economics and International Business from Dickinson College in Pennsylvania, USA, and an International MBA from the American Graduate School of International Management (Thunderbird). Previously served as Chief Marketing Officer of Telefónica O2 Czech Republic's Consumer division. Prior to the integration of our company, he was Chief Commercial Officer of Eurotel, where he led Eurotel's sales, marketing, roaming and customer care activities. In the past he worked in senior executive roles in Europe, Middle East and USA. Presently he is Vice-President, Consumer Division in Telefónica O2 Czech Republic.

ANDREI MARC TORRIANI
VICE-PRESIDENT, CONSUMER DIVISION

Report by the Supervisory Board

In keeping with the Company's Articles of Association, the Supervisory Board of Telefónica O2 Czech Republic in 2007 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 21 February 2008, the Supervisory Board examined the audited annual financial statements for 2007 (unconsolidated and consolidated) prepared under the International Financial Reporting Standards, and recommended them to the Ordinary General Meeting for approval.

Signed in Prague on 21 February 2008

Jaime Smith

Jaime Smith Basterra
Chairman of the Supervisory Board


JAIME SMITH BASTERRA
CHAIRMAN

Supervisory Board of Telefónica O2 Czech Republic

(AS AT 31 MARCH 2008)

Jaime Smith Basterra (*1965)

Chairman

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 held the position of Chief Financial Officer of Telefónica de España. In June 2005, he was made Chief Executive Officer and Chairman of the Board of Directors of ČESKÝ TELECOM (now Telefónica O2 Czech Republic). In June 2007, he was promoted to Chief Executive Officer of O_2 Germany GmbH. He also serves as member of the Board of Directors of Telefónica O2 Europe plc, and Chairman of the Supervisory Board of Telefónica O2 Czech Republic.

Julio Esteban Linares López (*1945)

1st Vice-Chairman

Graduated in telecommunications engineering and after joining Telefónica's R&D Centre in May 1970, he 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). 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 CEO 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. 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 June 2005 he was appointed Chairman of the Supervisory Board of ČESKÝ TELECOM (now Telefónica O2 Czech Republic), and is currently the 1st Vice-Chairman. 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. In December 2007 he was appointed Chief Operating Officer of Telefónica, S.A. He is also a member of the Board of Directors in Telefónica de España, Telefónica O2 Europe plc, Telefónica Latinoamérica, 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.

Lubomír Vinduška (*1956)

2nd Vice-Chairman

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. He has been with Telefónica O2 Czech Republic and its legal predecessors since 1979. 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.

Petr Zatloukal (*1970)

Member

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. Since August 2007 he has been Deputy Director for Business Development at Česká pošta, s.p.

Alfonso Alonso Durán (*1957)

Member

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. In 2005, he became General Manager for Strategy, Budget and Control. Now he holds the position of Director of Operations in the corporation and in charge of Purchases, Technology, Information systems and Commercial Development in the scope of the operative integration of the business units of Telefónica.


ALFONSO ALONSO DURÁN
MEMBER

Miloslav Krch (*1958)

Member

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

Dušan Stareček (*1956)

Member

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 (the 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 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, Chairman of KOV MORAVA and member of EWC (European Works Council) at Telefónica O2 Europe.

Vlastimil Barbořák (*1953)

Member

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 in the area of Corporate Governance in 2004. In 2007 he successfully completed a course in financial management for members of corporate bodies. In 2008, under the National Certification Programme for Corporate Culture Management and Ethics Studies, he was certified for performance of Ethics & Compliance Officer.


MILOSLAV KRCH
MEMBER
DUŠAN STAREČEK
MEMBER
VLASTIMIL BARBOŘÁK
MEMBER

Luis Lada Díaz (*1949)

Member

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 systems 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 elected 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 Telefónica Research & Development (TID, S.A.) and the Telefónica Latinoamerica Advisory Board; and Member of the Boards of Directors of INDRA Sistemas S.A. and Ydilo Advanced Voice Solutions, S.A.

Guillermo José Fernández Vidal (*1946)

Member

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, S.A.

LUIS LADA DÍAZ
MEMBER

GUILLERMO JOSÉ FERNÁNDEZ VIDAL
MEMBER


VIVEK DEV
MEMBER
MARIA PILAR LÓPEZ ÁLVAREZ
MEMBER

Vivek Dev (*1958)

Member

He joined the company in 1994 as Chief Financial Officer (CFO) for BT Mobile. In 1996, he became CFO of BT Europe, before taking on the role of CFO for BT Wireless. He was appointed Chief Operating Officer of O2 UK in August 2001. Prior to joining BT, he held various senior finance roles in GrandMet (Diageo). He qualified at KPMG and then moved to Price Waterhouse, San Francisco. He joined the Board of Directors of Telefónica O2 Europe plc on 1st March 2007 and is also a member of the Supervisory Board of Telefónica O2 Czech Republic. He was also appointed Board Member of the GSM Association on 10th February 2008 to represent the Telefónica Group. At present he is Chief Operating Officer of Telefónica O2 Europe plc.

Maria Pilar López Álvarez (*1970)

Member

A graduate of Business Studies, she joined Telefónica after working for several years at JP Morgan in London and New York where she worked her way up to Vice President. Pilar joined the Telefónica Group 1999 in Telefónica de España’s Strategic Planning Department. In May 2000 she was appointed Director of Management Control at Telefónica, S.A. Two years later she joined Telefónica Móviles S.A. to head up its Management Control function. In October 2006 she was promoted to Director of Strategy and Business Development at Telefónica de España. On 1st March 2007, she was appointed Chief Financial Officer of Telefónica O2 Europe plc.

Andrew Harley (*1960)

Member

Is Group HR Director for Telefónica O2 Europe plc and member of the Board of Directors since 1 January 2007. He joined O_2 from British Telecommunications plc (BT), where he had worked since 1980. Before being appointed as Senior Vice President, HR, BT Wireless in February 2001, Mr Harley was Senior Vice President, Human Resources, BTopenworld, BT's fixed internet service provider, and before that he was Human Resources Director for BT Cellnet. Mr Harley was also Human Resources Director for Telenordia in Sweden.

Pavel Herštík (*1951)

Member

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 2005, 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 and Support Services Unit of Telefónica O2 Czech Republic. In 2005 he completed a course in international accounting standards. In 2007 he was certified under the National

Certification Programme for Corporate Ethics and Culture. He is Chairman of the Trade Union Steering Committee of Telefónica O2 Czech Republic.

Ángel Vilá Boix (*1964)

Member

Graduated in Industrial Engineering from the Universitat Politécnica de Catalunya (1988) and holds a MBA from Columbia University (New York, 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, being promoted in 1998 to CFO at Telefónica Internacional and, subsequently, to Managing Director of Corporate Development at Group level. He is member of the Supervisory Board of Telefónica O2 Czech Republic, and Vice Chairman of Telco SpA and Olimpia SpA. He previously served on the Boards of Banco Bilbao Vizcaya Argentaria (BBVA), CTC Chile, Cablevisión Argentina, Terra Lycos, Indra SSI, Telefónica Sistemas, Telefónica Data, Estratel (currently Atento) and Catalana d'Iniciatives.

PAVEL HERŠTÍK
MEMBER

ÁNGEL VILÁ BOIX
MEMBER

Personnel composition of the Supervisory Board of Telefónica O2 Czech Republic, a.s., as at 31 March 2008

Name	Office	Member from
Jaime Smith Basterra	Chairman	21 February 2008
Julio Esteban Linares López	1st Vice-Chairman	23 June 2005
Lubomír Vinduška	2nd Vice-Chairman	28 June 2003
Luis Lada Díaz	Member	23 June 2005
Maria Pilar López Álvarez	Member	26 July 2007
Vivek Dev	Member	25 October 2007
Ángel Vilá Boix	Member	23 June 2005
Alfonso Alonso Durán	Member	23 June 2005
Andrew Harley	Member	15 January 2007
Guillermo José Fernández Vidal	Member	23 June 2005
Vlastimil Barbořák	Member	28 June 2003
Pavel Herštík	Member	28 June 2003
Miloslav Krch	Member	28 June 2003
Dušan Stareček	Member	28 June 2003
Petr Zatloukal	Member	23 June 2005

As per the Articles of Association, the term of office of a member of the Supervisory Board is five years.

The following changes occurred in the personnel composition of the Supervisory Board during 2007:

Andrew Harley	appointed (co-opted) member of the Supervisory Board on 15 January 2007; his membership was confirmed by the General Meeting on 26 April 2007;
Catherine Jane Keers	her membership in the Supervisory Board ended on 26 July 2007, when her resignation was discussed by the Supervisory Board;
Maria Pilar López Álvarez	appointed (co-opted) member of the Supervisory Board on 26 July 2007;
Sohail Qadri	his membership in the Supervisory Board ended on 25 October 2007, when his resignation was discussed by the Supervisory Board;
Vivek Dev	appointed (co-opted) member of the Supervisory Board on 25 October 2007.

The following changes occurred in the personnel composition of the Supervisory Board during January-March 2008:

Peter Anthony Erskine	his membership in the Supervisory Board ended on 21 February 2008, when the Supervisory Board discussed his resignation;
Jaime Smith Basterra	appointed (co-opted) member of the Supervisory Board on 21 February 2008 and elected its Chairman on the same day.

Telefónica O2'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 since 2001. In 2007 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 (the Code), which the Company helped to design (the Code is available in Czech and in English on the website of the Czech Ministry of Finance – www.mfcr.cz), 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).

Corporate governance

No principal changes occurred in the corporate governance model of Telefónica O2 in 2007. The model, as per the Articles of Association, 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 (using the mechanism of "prior standpoints" of the Supervisory Board to selected issues) and monitor other important aspects of the Company's operation. The powers of the Supervisory Board and their discharge make a full and active use of advisory and initiative roles of the Supervisory Board's committees. 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, which the Company finds efficient and acceptable given the strong role of the Supervisory Board.

Organisation of corporate governance

The model of corporate governance applied by the Telefónica O2 ensured that throughout 2007 the Company had adequate management and the management's actions were monitored by the Board of Directors and the Supervisory Board.

An **Ordinary General Meeting** of the Company was held on 26 April 2007. The agenda comprised only points related to the standard business of a joint-stock company. Full details of the conclusions of the General Meeting are given in the 2007 Half-year

Report and on the Company's website. Information regarding the dividend, record date and the dividend disbursement date is in Section 08.

The **Board of Directors** of the Company held twenty eight meetings in 2007, thus complying with the duty to hold a minimum of twelve meetings each year. The corporate governance practice in Telefónica O2 shows that the Board of Directors meets usually twice a month; the increased number of meetings is linked namely to the preparation for Supervisory Board meetings, the General Meeting and with the approval of the financial results (based on the audited financial statements of the Company). The departure of Jaime Smith Basterra and Antonio Botas Bañuelos for executive positions in O2 Germany GmbH in the second half of 2007 meant that they resigned in February 2008 on membership in the Telefónica O2 Board of Directors. Salvador Anglada Gonzalez, Chief Executive Officer, was elected Chairman of the Board of Directors at the same time. The separation of the office of Chairman of the Board of Directors from the office of Chief Executive Officer in the second half of 2007 was only temporary, pending the finalisation of personnel changes in the Board of Directors. An amendment to the Articles of Association, which will be presented by the Board of Directors to the Ordinary General Meeting of Telefónica O2 convened for 21 April 2008, contains, among other points, a proposal to reduce the number of members of the Board of Directors from nine to seven.

The **Supervisory Board** held six meetings in 2007; the number of meetings complied with the Articles of Association. Several personnel changes occurred in the Supervisory Board in 2007 and in the first quarter of 2008; they were a product of organisational realignment in connection with the Company's integration in the Telefónica O2 Europe Group. Full details of all personnel changes in the Supervisory Board in 2007 and the first quarter of 2008, together with the current line-up as at 31 March 2008, are given on page 100 of the Annual Report. The résumés of the members of the Supervisory Board are given on pages 88–99. Throughout 2007 and in the first quarter of 2008, the Supervisory Board included one member who qualifies as independent under the Code – Petr Zatloukal.

New members of the Board of Directors, Supervisory Board and its committees have, already at the beginning of their office, all information about the corporate governance rules and principles applied in Telefónica O2 and in its Group, namely financial, commercial and other important information necessary for exercising their functions.

The information is disseminated via the Corporate Governance Portal of the Telefónica O2 Group (CG Portal).

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. No changes were made to the governance documents (including those concerning Internal Audit and Risk Management) in 2007.

The hitherto existing position of Company Secretary is combined with that of General Counsel in the new corporate governance model of Telefónica O2. Company Vice-Secretary provides for the activities of the Telefónica O2 governing bodies.

Internal Audit and Risk Management functions were merged into one organisation unit in 2006. Its functions are exercised and organised in a way which ensures that all professional standards are met. All methods and instruments proven and used by the global Telefónica Group are also used.

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 2007, Internal Audit carried out twenty one audits (excluding regular SOX 404 audits) and a number of other inspections, as mandated by 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 work of Internal Audit is monitored on a regular basis by the Audit and Control Committee. 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 March 2008 in order to accommodate recommendations of an international quality assurance audit of our Internal Audit and Risk Management Unit. The audit was carried out in February 2007 by the Spanish branch of the international Institute of Internal Auditors (IIA). The audit set out to test the compliance with international practice of professional auditing (Quality Assurance and Improvement Program). The audit concluded that our Internal Audit and Risk Management Unit complied with all standards and principles of professional auditing. A successful completion of the IIA Quality Assurance and Improvement Program is the highest mark of recognition. The Company received a certificate that comes with the right to use the IIA seal of quality. Telefónica O2 is currently the only company in the Czech Republic whose internal audit was certified. Telefónica O2 now ranks among eleven members of the global Telefónica Group that hold the certificate.

The Company has a well-developed **risk management** function. The risk management system covers all areas of the Company's operation, as well as the subsidiary Telefónica O2 Slovakia, and provides for identification, assessment, mitigation of risks and follow-up. In line with the Company's Articles of Association, a report on the main risks is regularly made to the Board of Directors, Audit and Control Committee and to the Supervisory Board. More about risk management in Section 02 of the Annual Report.

In 2007, the Corporate Governance Portal, which supports efficient and effective corporate governance processes in the Telefónica O2 Group, added more content and functionality. The portal also helps in meeting the requirements of the Code and the best practice for the delivery of timely and accurate information on terms of equal access without any limitation, with regard to time or location, to the governing bodies and their members. More about the Corporate Governance Portal in the 2006 Annual Report. The portal offers all information related to corporate governance in two languages, Czech and English, which employees, executive managers and members of the corporate governing bodies of the Telefónica O2 Group need for their work and the exercise of their powers. The portal provides a secure direct and remote access to both the current and archive documents for the meetings of the governing bodies, including the conclusions of Internal Audit and Risk Management activities. It also brings employees up-to-date and complete information about Telefónica O2 and its subsidiaries.

Shareholder relations

Telefónica O2 declares that in 2007 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). To this end, the Company used namely its website (section About us), where shareholders can find information in both Czech and English, concerning the financial results, shareholder structure and the General Meeting, and an overview of upcoming events. The Company publishes regular press releases with the quarterly financial results and announces all significant events and developments.

When organising General Meetings, the Company proceeds in a way that guarantees the compliance with all the statutory conditions and with the Articles of Association, whilst observing to the maximum extent possible the requirements of the Code which concern the rights of shareholders and their fair treatment. The Company publishes the date of the General Meeting several months prior on its website. The venue of the General Meeting has been the same for several years now; it was selected on the merit of its accessibility for all shareholders. The Rules of Procedure of the General Meeting, despite the fact that they have not deviated from the standard language, are 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. The draft Rules are available to shareholders on the Company´s website and in Telefónica O2 headquarters, usually already on the day of the publication of the date of the General Meeting. Each point on the agenda is voted on separately, after the discussion on that point is concluded. In addition to members of the Board of Directors and of the Supervisory Board, chairpersons of committees established under the Articles of Association are also available to take questions from shareholders. A public notary is present for the whole duration of the General Meeting.

All motions (questions, requests for explanation, counterproposals and proposals) made by shareholders during the Ordinary General Meeting of 26 April 2007 (ten in total) were adequately addressed by the members of the Board of Directors. All questions from shareholders and the corresponding answers are noted in the Minutes of the General Meeting. Shareholders did not put any questions to the chairpersons of the Supervisory Board committees and to Supervisory Board members.

Transparency and open information policy

In line with the applicable laws, 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. The Company also publishes various information beyond the scope of the disclosure duties on its website, and intends to continue its open policy toward shareholders.

In addition to the traditional information channels (Commercial Bulletin, print media), 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.

Section 07 Information on the registered security issuer of the Annual Report contains information on the remuneration and other emoluments paid to members of the Company's governing bodies. All related documents (rules for the disbursement of remuneration to members of the Board of Directors and of the Supervisory Board and disbursement of discretionary benefits) can be found on the Company's website. The Annual Report contains information on the benefits and other emoluments granted to members of the Company's governing bodies and on the shares held by these persons.

Telefónica O2 pays constant attention to issues of conflict of interest. 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 by a dedicated committee established by the Supervisory Board – the Ethics and Corporate Social Responsibility Committee.

No conflicts of interest were detected in the case of members of the Board of Directors, Supervisory Board or the executive management of the Company; nor were any members convicted of fraud-related crimes; party to bankruptcy proceedings, receiverships and liquidations of undertakings; charged or sanctioned by statutory or regulatory bodies.

The Company is scrupulous about prevention of insider trading; in this respect, it is compliant with the applicable community and Czech laws, as well as with rules adopted by the UK Financial Services Authority. The Company has adopted a strict internal rule, which sets the limits for the disposal of shares issued by the Company or by undertakings that it controls. Telefónica O2 keeps a regularly updated list of persons (members of governing bodies, employees, external persons) who would qualify as insiders in possession of such information.

The Company has implemented the requirements of the Sarbanes-Oxley (SOX) Act; it is bound by this law primarily because the parent company, Telefónica S.A., is listed on the US financial markets. In 2007, internal controlling mechanisms in the area of financial reporting in the scope of regulation laid down in SOX section 404 were audited, together with the Company's controlling mechanisms in respect of its information technologies that may have an impact on financial statements. The audit concluded that the audited controlling mechanisms are up to the standard required by SOX. The management (Chief Executive Officer and Vice-President, Finance Division) attest to the accuracy of information contained in the financial statements and to the existence and application of effective controls, as well as to other facts required by SOX section 302 in respect of the quarterly, semi-annual and an annual results of the Company.

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 Supervisory Board.

The Audit and Control Committee (ACC) has five members. Only one change in the personnel composition of the committee occurred in 2007 – Peter Anthony Erskine was replaced by the co-opted Supervisory Board member Maria Pilar López Álvarez, Chief Financial Officer, Telefónica O2 Europe. As at the end of 2007, the ACC had the following members: Alfonso Alonso Durán, Chairman; Ángel Vilá Boix, Vice-Chairman; Maria Pilar López Álvarez, Julio Esteban Linares López and Pavel Herštík, members.

As at the end of 2007, no member was a chartered accountant. The committee meets usually before each meeting of the Supervisory Board, to which it reports on its activities. The ACC is an advisory body to the Supervisory Board; it co-operates also with the Board of Directors, Internal Audit and Risk

Management and with the External Auditor. It exists primarily to monitor the integrity of financial information provided by the Company, and to monitor and test the internal controlling and risk management systems. Some of the primary tasks of the committee include the discussion of audit reports submitted by Internal Audit and participation in the planning and evaluation of Internal Audit activities. Every year the ACC takes position on the appointment of the External Auditor and makes recommendations concerning internal and external audit matters to the Supervisory Board.

The ACC also invokes the institute of closed consultation with the External Auditor and internal auditors. The committee monitors the independence of the External Auditor and 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 and Risk Management outputs, also via the Corporate Governance Information Portal. In 2007, the committee held five meetings.

The Nomination and Remuneration Committee (NRC) has five members. 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 2007, the committee held three meetings. As at the end of 2007, the NRC had the following members: Peter Anthony Erskine, Chairman; Julio Esteban Linares López, Vice-Chairman; Luis Lada Díaz, Guillermo José Fernández Vidal and Andrew Harley, members. In February 2008, Peter Anthony Erskine left the NRC after his resignation on membership in the Supervisory Board, and the co-opted member, Jaime Smith Basterra, was elected into the vacant position by the Supervisory Board.

The Ethics and Social Corporate Responsibility Committee (ESCRC) has eight members. In addition to issues related to potential conflicts of interest on the part of members of the Board of Directors, Supervisory Board and members of the governing bodies of the Company's subsidiaries, the committee monitors compliance with the business principles and corporate responsibility principles of the Company. In 2007, the committee held three meetings. The personnel composition of the committee did not incur any changes in 2007; its members were: Pavel Herštík, Chairman; Petr Zatloukal, Vice-Chairman; Peter Anthony Erskine, Vlastimil Barbořák, Dušan Stareček, Julio Esteban Linares López, Ángel Vilá Boix a Guillermo José Fernández Vidal, members. In February 2008, Peter Anthony Erskine resigned on his membership in the Supervisory Board and the co-opted member, Jaime Smith Basterra, was elected member of the committee by the Supervisory Board.

Company policy towards stakeholders

Telefónica O2 has espoused the concept of Corporate Social Responsibility (CSR) and actively develops all areas concerned by CSR. To demonstrate the significance that Telefónica O2 and the global Telefónica Group attaches to CSR, the Annual Report now contains a separate section on Corporate social responsibility.

05 CONSOLIDATED FINANCIAL STATEMENTS

Big stars end their life in a very dramatic fashion – they go out with a stellar bang, which we call the supernova explosion. The star closest to our Earth that is bound for such fate is IK Pegasi, a binary star system in the constellation of Pegasus. During a supernova explosion, energy equivalent to that our Sun emits during its billions of years of life is released. However a supernova explosion manages that during a precious few weeks or months.

Consolidated financial statements for the year ended 31 December 2007

(Prepared in accordance with International Financial Reporting Standards)

Content

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. in liquidation, SPT TELECOM (Czech Republic) Finance B.V., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH and Telefónica O2 Slovakia, s.r.o.

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 Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

The Group is 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 four suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Group amounted in average to 9,417 in 2007 (2006: 9,951).

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 20 February 2008.

Acquisition of DELTAX Systems a.s.

In September 2007, Telefónica O2 Czech Republic, a.s. announced the conclusion of an agreement for the purchase of 100% of the shares in DELTAX Systems a.s. DELTAX Systems a.s. is a system integrator company operating on the market since 1993 and, at present, its yearly turnover exceeds CZK 300 million. The main business activities include IT/ICT consulting, application development, outsourcing services and capacities in system integration. Key clients include top Czech companies and government agencies. The acquired company has a long-term track record of a successful co-operation with the Company in several projects. Acquisition of DELTAX Systems a.s. fits in the Company's current growth plan being a leader in integrated ICT solutions.

In December 2007, the transaction was approved by the Office for the Protection of Competition. The acquisition will be effective as of 1 January 2008. DELTAX Systems a.s. financial results will be fully included in the Group financial statements from the effective date. The total cost of the acquisition was agreed to be up to CZK 200 million and costs directly attributable to the acquisition were CZK 7 million.

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. and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2007 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 as adopted by the European Union. 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 and implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the 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 2007, 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 European Union.

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

20 February 2008
Prague, Czech Republic

Consolidated income statement

For the year ended 31 December 2007

In CZK million	**Notes**	**31 December 2007**	**31 December 2006**
Revenue	2	63,196	61,268
Gains from sale of non-current assets		42	98
Internal expenses capitalized in fixed assets	2	553	911
Operating expenses	3	(35,753)	(34,118)
Impairment loss	8, 9, 10	(5)	(253)
Depreciation and amortisation	8, 9	(14,435)	(16,746)
Operating profit		13,598	11,160
Interest income	4	403	149
Interest expense	4	(446)	(430)
Other finance income (net)	4	(45)	61
Profit before income tax		13,510	10,940
Taxes on income	5	(3,124)	(2,920)
Profit for the year		**10,386**	**8,020**
Attributable to:			
Equity holders of the Company	6	10,386	8,020
Minority interest		–	–
Earnings per share (CZK) – basic*	6	32	25

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

Consolidated balance sheet

As at 31 December 2007

In CZK million	Notes	31 December 2007	31 December 2006
ASSETS			
Property, plant and equipment	8	71,809	78,755
Intangible assets	9	21,805	21,628
Held-to-maturity investments	13	–	27
Investment in associate	0	11	11
Deferred tax receivable	17	–	26
Other financial assets	12	566	377
Non-current assets		**94,191**	**100,824**
Inventories	11	853	987
Receivables and prepayments	12	8,577	8,134
Available-for-sale investments/Held-to-maturity investments	13	27	56
Cash and cash equivalents	14	9,576	7,461
Current assets		**19,033**	**16,638**
Non-current assets classified as held for sale	**8**	**328**	**203**
Total assets		**113,552**	**117,665**
EQUITY AND LIABILITIES			
Ordinary shares	24	32,209	32,209
Share premium		30,816	30,816
Retained earnings, funds and reserves		19,767	25,456
		82,792	88,481
Minority interest		**–**	**–**
Total equity		**82,792**	**88,481**
Long-term financial debts	16	3,062	9,156
Deferred taxes	17	3,353	4,495
Non-current provisions for liabilities and charges	19	2,150	2,037
Non-current other liabilities	15	452	807
Non-current liabilities		**9,017**	**16,495**
Short-term financial debts	16	6,207	207
Trade and other payables	15	13,765	10,917
Income tax liability		870	730
Provisions for liabilities and charges	19	901	835
Current liabilities		**21,743**	**12,689**
Total liabilities		**30,760**	**29,184**
Total equity and liabilities		**113,552**	**117,665**

These consolidated financial statements were approved by the Board of Directors on 20 February 2008 and were signed on its behalf by:

Salvador Anglada Gonzalez
Chairman of the Board of Directors and Chief Executive Officer

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

Consolidated statement of changes in shareholders' equity

For the year ended 31 December 2007

In CZK million	Notes	Share capital	Share premium	Hedging reserve	Foreign exchange translation reserve	Funds*	Retained earnings	Minority interest	Total
At 1 January 2006		**32,209**	**30,816**	**(11)**	**–**	**5,912**	**26,049**	**–**	**94,975**
Fair value gains (net of tax) – cash flow hedges		–	–	(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
At 31 December 2006		**32,209**	**30,816**	**(18)**	**(12)**	**6,270**	**19,216**	**–**	**88,481**
At 1 January 2007		**32,209**	**30,816**	**(18)**	**(12)**	**6,270**	**19,216**	**–**	**88,481**
Fair value gains (net of tax) – cash flow hedges		–	–	(2)	–	–	–	–	(2)
Currency translation differences – amount arising in year		–	–	–	21	–	–	–	21
Changes in statutory reserves and other movements		–	–	–	–	182	(172)	–	10
Net income/(expense) recognised directly in equity		–	–	(2)	21	182	(172)	–	29
Dividends declared in 2007	7	–	–	–	–	–	(16,104)	–	(16,104)
Net profit		–	–	–	–	–	10,386	–	10,386
At 31 December 2007		**32,209**	**30,816**	**(20)**	**9**	**6,452**	**13,326**	**–**	**82,792**

* Refer Note 24 regarding amounts not available for distribution.

Consolidated movement of gains and losses recognised in equity

In CZK million	Gains/(losses) proceeding from cash flow hedges	Translation differences	Tax effect	Total
At 1 January 2006	(14)	–	3	**(11)**
Gains/(losses) arisen in the fiscal year	(19)	(12)	1	(30)
Gains/(losses) re-classified to the profit and loss account	11	–	–	11
At 31 December 2006	**(22)**	**(12)**	**4**	**(30)**
Gains/(losses) arisen in the fiscal year	(17)	21	–	4
Gains/(losses) re-classified to the profit and loss account	15	–	–	15
At 31 December 2007	**(24)**	**9**	**4**	**(11)**

Consolidated cash flow statement

For the year ended 31 December 2007

In CZK million	Notes	31 December 2007	31 December 2006
Net profit		10,386	8,020
Non-cash adjustments for:			
Income tax	5	3,124	2,920
Depreciation	8	12,563	14,038
Amortisation	9	1,872	2,708
Impairment loss	8, 9, 10	5	253
Disposals of obsolete assets		36	49
Profit on sale of property, plant and equipment		(51)	(96)
Net interest and other charges		42	243
Foreign exchange (gains)/losses (net)		(136)	(203)
Fair value changes		–	29
Increase in provisions		(641)	(11)
Operating cash flow before working capital changes		27,200	27,950
Working capital adjustments:			
Decrease/(increase) in trade and other receivables		(218)	(10)
Decrease/(increase) in inventories		(104)	(753)
(Decrease)/increase in trade and other payables		1,143	1,076
Cash flows from operating activities		28,021	28,263
Interest paid		(432)	(429)
Interest received		375	186
Income tax paid		(4,078)	(3,564)
Net cash from operating activities		**23,886**	**24,456**
Cash flows from investing activities			
Purchase of property, plant and equipment		(4,060)	(4,770)
Purchase of intangible assets		(1,594)	(1,444)
Proceeds from sales of property, plant and equipment		74	214
Proceeds from marketable securities		53	–
Cash purchase of financial investments		(176)	–
Dividends received		2	–
Grant of loan		–	(3,294)
Repayment of loan		–	3,253
Net cash used in investing activities		(5,701)	(6,041)
Cash flows from financing activities			
Dividends – paid		(16,083)	(14,494)
Net cash used in financing activities		(16,083)	(14,494)
Net increase/(decrease) in cash and cash equivalents		**2,102**	**3,921**
Cash and cash equivalents at beginning of year		7,461	3,538
Effects of exchange rate changes		13	2
Cash and cash equivalents at the year end	14	**9,576**	**7,461**

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 (ASB) 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 the year-end, 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, inventory held at net realizable value, 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 new or revised IFRS standards and interpretations

In 2007, the Group applied the below stated new or revised IFRS standards and interpretations, which are relevant to its operations. Adoption of these new or revised standards and interpretations did not have any effect on the financial performance or position of the Group, however they resulted in presenting additional disclosures:

IAS 1 Amendment – (issued 2005, effective date 1 January 2007) Presentation of financial statements, Capital disclosures

The amendment requires the Group to make new disclosures to enable users of the financial statements to evaluate the Group's objectives, policies and processes for managing capital. This new information is shown in Note 24.

IFRS 7 (issued in 2005, effective date 1 January 2007) Financial Instruments: Disclosures

The standard requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and the extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results, comparative disclosures information has been revised where needed.

IFRIC 8 (issued in 2006, effective date 1 May 2006) Scope of IFRS 2

This interpretation requires IFRS 2 to be applied to any arrangements in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. As the Group can identify specifically services received in the share based transactions granted to the employees, the interpretation had no impact on the financial position or performance of the Group.

IFRIC 9 (issued in 2006, effective date 1 June 2006) Reassessment of Embedded Derivatives

IFRIC 9 states that the date to assess the existence of an embedded derivative is the date that an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. As the Group has no embedded derivative requiring separation from the host contract, the interpretation had no impact on the financial position or performance of the Group.

IFRIC 10 Interim Financial Reporting and Impairment (issued 2006, effective date 1 November 2006)

The interpretation limits the Group in reversing the impairment loss recognised in previous interim periods in respect of goodwill or an investment. This adoption had no material effect on the financial position or presenting figures of the Group.

Standards and interpretations issued and endorsed by the European Union but not early adopted by the Group

IFRS 8 Operating Segments (issued 2006, effective date 1 January 2009)

The standard requires entities to disclose segment information based on the information reviewed by the entity's chief operating decision maker. The impact of this standard is still to be determined, i.e. whether the Group will define new segments replacing current fixed/mobile.

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.

Standards and interpretations issued but not endorsed by the European Union and neither early adopted by the Group nor effective.

IAS 1 Amendment – (issued 2007, effective date 1 January 2009) Presentation of financial statements, Comprehensive revision including requiring a statement of comprehensive income

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.

IAS 23 Borrowing costs (issued 2007, effective date 1 January 2009)

The amendment requires the Group to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Since the Group has already applied this policy as an allowed alternative treatment before, no impact is expected on the financial position of the Group.

Revised IFRS 3 Business combinations (issued January 2008, effective date 1 July 2009) – the Group has not yet considered impacts of the adoption of this revision.

Amendments to IAS 27 (issued January 2008, effective date 1 July 2009) – the Group has not yet considered impacts of the adoption of this amendment.

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 13 Customer Loyalty programmes (effective date 1 July 2008)

This interpretation addresses the accounting by entities that provide their customers with incentives to buy goods or services by providing awards as part of the sale transaction. The interpretation requires the entity that grants the awards to account for the sales transaction that gives rise to the award credits as a multiple element transaction and allocate the fair value of the consideration received or receivable between the award credits granted and the other components of the revenue transaction.

This adoption will affect current accounting policy in respect of change of the fair value awards measurement and change in the presentation in the financial statements. This will also affect certain disclosures in the notes to the consolidated financial statements and will be classified as a change of accounting policy. The impact on the financial position is being analysed by the Group. This change will impact the financial results in 2009.

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

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.

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 the corresponding accumulated amortisation (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 one 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 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).

Impairment losses are recognised in the expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised as a reduction in the expenses in the period in which the reversal occurs.

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 2007 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.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible or sold.

(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

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of specific asset or assets and the arrangement conveys a right to use the assets.

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 in the relevant country.

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 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 the 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 2007, 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 binominal 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 2007, 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 a selected price based on a 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 are 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:

a the Group is the primary obligor in the arrangement,
b the Group has general inventory risk,
c the Group has price latitude,
d the Group changes the product or performs part of the service,
e the Group has discretion in supplier selection,
f the Group is involved in the determination of product or service specifications,
g the Group has credit risk,
h the Group has the ability to set the terms of the transaction,
i 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.

(1) Fixed line business 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.

- Universal service

The Group is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications where the Group receives the contributions from the other operators in respect of the above mentioned Act and the approval and decision by Czech Telecommunication Office. The Group recognises such contributions when the consideration is received.

- 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 business 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 recognised 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, IPTV and data services

The Group earns revenue from providing Internet services, IPTV and other data 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. Detailed figures are described in Note 16.

Financial risk management

The Group's is exposed to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates as a result of ordinary business, debt taken on to finance its business and net investment in foreign operations. The Group's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Group. The Group uses either derivative financial instruments (such as forward and swap contracts) or non-derivative instruments (such as cash instruments) 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 of Directors 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, liquidity risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign currency risk

The Group is exposed to foreign currency risk arising from various currency exposures, primarily with respect to the Euro, partially to US Dollar:

a balance sheet items (such as debt, receivables, payables) denominated in foreign currency,
b probable forecasted transactions or firm commitments (such as purchases or sales) denominated in foreign currency,
c net investment in Slovak subsidiary (functional currency differs from CZK).

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 Group primarily hedges the balance sheet foreign currency exposure, mainly long term debt denominated in EUR and net payables in EUR or USD. Non-derivative instruments are currently used for hedging this kind of exposure.

Additionally, the Group uses to a certain extent derivative hedging via short term forwards to buy respective foreign currency for highly probable or committed purchase transactions, primarily up to 6 months horizon.

(ii) Interest rate risk

The Group is exposed to interest rate risk arising from:

a floating interest rate bearing cash investments and debt instruments,
b fair value of debt on fixed interest rate.

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The cash assets and short term debt are currently maintained on floating rates while long term debt instruments are on fixed rates. The Group may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable rate debts.

(iii) Liquidity risk

The Group's essential objective of liquidity risk management is to have ready access to cash resources sufficient to meet all its cash payment obligations as they fall due, allowing some flexibility. The cash resources consist of cash instruments, marketable securities and available committed credit facilities.

The Group is particularly focusing on the liquidity profile within the time horizon of the next 12 months considering projected cash flow from operations and maturity structure of both debt obligations and financial investments. The balance between funding continuity and flexibility is managed through maintaining the possible use of bank overdrafts or bilateral credit lines.

(iv) 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.

The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 12. There are no significant concentrations of credit risk within the Group.

With respect to credit risk arising from the financial assets of the Group, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Credit Risk is managed by the Credit Management Department and is based on three main activities:

a monitoring of accounts receivables (AR): regular monitoring of payment moral of existing customers and monitoring and analyzing of the receivable aging structure (internal and external indicators of any potential bad debts), b prevention: scoring of new customers – checking procedures (Black Lists, External Debtors Register, other information), set up the limits or/and collection of the deposit according to customer segments, products and set up the credit limits for indirect sales partners (dealers, distributors, retailers) for purchase of our products, "securing" of credit limits (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc.). Guarantees are either in cash (deposits) or there are special procedures to collect cash for the other securing tools (insurance etc.),

c collection: reasonable, effective and continual collection process is the additional tool of bad debts decrease and prevention as well.

New credit management activities during last two years

During the last two years, the Group introduced new credit management activities such as:

a implementation of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),

b implementation of the credit management best practice from the merge of the fixed and mobile business in all company activities,

c checking of the new activation by using of fixed and mobile Black Lists,

d implementation of tight activation rules for all distribution channels.

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:

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

b 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 4,162 million, advances paid for income taxes amount to CZK 3,292 million and the net deferred tax liability is CZK 3,353 million.

In October 2007, the Czech government enacted legislation, by which the corporate income tax rate will be reduced from 24% to 21%, 20% and 19% for the fiscal years ending in 2008, 2009 and 2010, respectively. The positive impact on deferred tax liability amounts to CZK 798 million in 2007 (see Note 5).

(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. 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, 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 no longer exist, 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 calculated, there is 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 2007 (see Note 8 and 10).

(6) Operating lease commitments – Company as lessee

The Group changed its headquarters and moved to the new premises, where the Group has entered into the commercial property leases. The Group has determined, based on an evaluation of the terms and conditions of the arrangements, that the lessor retains all the significant risks and rewards of the ownership and accounts for the contract as an operating lease. The original premises that have become temporarily idle are currently under consideration of the next usage.

U Change in accounting policy

No substantial changes in accounting policies were applied in 2007.

V Slovakia business

Telefónica O2 Slovakia, s.r.o. (Telefónica O2 Slovakia), a 100% subsidiary company of Telefónica O2 Czech Republic, a.s., was awarded the 3rd mobile license in Slovakia in September 2006.

The license allows Telefónica O2 Slovakia to use frequencies GSM 900 MHz, GSM 1800 MHz, UMTS and FS 29 GHz for the period of 20 years for providing telecommunication services in the Slovak Republic.

The new operation in Slovakia is considered as an organic expansion of the Telefónica Group business in the region and is utilizing synergies with the Company operations. The leverage of the Czech operations is expected in areas of network (development, monitoring, support), IT, procurement and back office (finance, HR, legal).

Telefónica O2 Slovakia launched its commercial service in February 2007 offering prepaid voice, SMS (Short Message Service) and GPRS (General Packet Radio Service) data in the GSM (Global System for Mobile communications) spectrum. In September 2007, Telefónica O2 Slovakia launched its postpaid services. In August 2007, Telefónica O2 Slovakia also launched its UMTS (Universal Mobile Telecommunication System) network with a limited coverage.

In 2006, Telefónica O2 Slovakia signed a national roaming agreement with T-Mobile Slovakia. It provides Telefónica O2 Slovakia with the ability to offer full network coverage to its customers immediately from commercial launch even before the construction of its own network is finished. The strategy of the Telefónica O2 Slovakia is to build own network coverage in areas where it is economically feasible.

The top priority of Telefónica O2 Slovakia is a gradual fulfillment of the license conditions, gaining a base of active customers and aiming to provide the telecommunications market with innovations and technological advances as the first company on the market.

By the end of the year 2007, Telefónica O2 Slovakia had more than 500 thousand customers.

W Real-estate portfolio optimisation

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.

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

Notes to the consolidated financial statements

1 Segment information

Business segments recognised by the Group are as follows:

- Fixed – network communications services using a fixed network provided by the Company and other consolidated subsidiaries,
- Mobile – mobile communications services provided by the Company and by Telefónica O2 Slovakia

Year ended 31 December 2007 In CZK million	Fixed	Mobile	Group
Revenues	30,500	33,934	64,434
Inter-segment sales	(455)	(783)	(1,238)
Total consolidated revenues	30,045	33,151	63,196
Gains from sale of non-current assets	42	–	42
Work performed by the Group and capitalized	448	105	553
Costs	(16,973)	(20,018)	(36,991)
Inter-segment purchases	783	455	1,238
Total consolidated costs	(16,190)	(19,563)	(35,753)
Impairment charge	(5)	–	(5)
Depreciation	(8,521)	(4,042)	(12,563)
Amortisation	(684)	(1,188)	(1,872)
Total consolidated depreciation and amortization	(9,205)	(5,230)	(14,435)
Operating profit	5,135	8,463	13,598
Interest and other financial costs (net)			(88)
Profit before tax			13,510
Tax			(3,124)
Profit after tax			10,386
Minority interest			–
Net profit			**10,386**
Assets (excluding Goodwill and non-current assets held for sale)	47,697	52,207	99,904
Goodwill on purchase of additional ownership interest in Eurotel Praha, spol. s r.o.	–	13,320	13,320
Non-current assets held for sale	328	–	328
Total assets	**48,025**	**65,527**	**113,552**
Trade and other payables	(5,577)	(8,188)	(13,765)
Other liabilities	(8,166)	(8,829)	(16,995)
Total liabilities	**(13,743)**	**(17,017)**	**(30,760)**
Capital expenditure	**4,263**	**3,544**	**7,807**

Year ended 31 December 2006 In CZK million	Fixed	Mobile	Group
Revenues	30,895	31,690	62,585
Inter-segment sales	(521)	(796)	(1,317)
Total consolidated revenues	30,374	30,894	61,268
Gains from sale of non-current assets	96	2	98
Work performed by the Group and capitalized	726	185	911
Costs	(17,926)	(17,509)	(35,435)
Inter-segment purchases	796	521	1,317
Total consolidated costs	(17,130)	(16,988)	(34,118)
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 costs (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)	65,285	38,857	104,142
Goodwill on purchase of additional ownership interest in Eurotel Praha, spol. s r.o.	–	13,320	13,320
Non-current assets held for sale	203	–	203
Total assets	**65,488**	**52,177**	**117,665**
Trade and other payables	(5,568)	(5,349)	(10,917)
Other liabilities	(15,719)	(2,548)	(18,267)
Total liabilities	**(21,287)**	**(7,897)**	**(29,184)**
Capital expenditure	**3,209**	**3,291**	**6,500**

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 issue of IFRS 8 Operating segments and the deep integration process from the past convergence, the Group will analyse criteria for segment identification, which might lead to a change in the reported segments in the next years.

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 ČESKÝ TELECOM, a.s. and Eurotel Praha, spol. s r.o. or based on a decision of the Czech Telecommunication Office (CTO, Český telekomunikační úřad). The rates applied in 2007 and 2006 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 Eurotel Praha, spol. s r.o. became irrelevant since 2006, however are still monitored for regulatory purposes. After the transfer of assets and liabilities, effectively as of 1 January 2006, all inter-company transactions between fixed segment (ČESKÝ TELECOM, a.s.) and mobile segment (Eurotel Praha, spol. s r.o.) became inter-segments.

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

2 Revenue and Internal expenses capitalized in fixed assets

Revenue **In CZK million**	**31 December 2007**	**31 December 2006**
Voice	23,147	23,462
Interconnection	10,625	9,444
Subscription charges	8,849	9,841
Connection charges	783	669
SMS & MMS & Value Added Services	4,998	4,813
Leased lines	2,051	2,330
Data services	1,910	1,839
Internet	5,828	5,051
IT and business solutions	1,950	751
Equipment and Activation Fee	2,058	2,172
Other Telco Revenues	437	457
Other revenues	560	439
Total revenues	**63,196**	**61,268**

Revenues from related parties are disclosed in Note 26.

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

In CZK million	**31 December 2007**
No later than 1 year	244
Later than 1 year and not later than 5 years	868
Later than 5 years	237
Total	**1,349**

Internal expenses capitalized in fixed assets **In CZK million**	**31 December 2007**	**31 December 2006**
Material	138	593
Labour	415	318
Total	**553**	**911**

3 Operating expenses

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

In CZK million	31 December 2007	31 December 2006**
Wages and salaries*	4,891	4,766
Redundancy payments	209	247
Social security contributions (Note 18)	1,678	1,649
Staff welfare costs	331	389
Total staff costs	**7,109**	**7,051**
Interconnection and roaming	11,012	10,010
Cost of goods sold	3,499	3,065
Contents	160	118
Customer Loyalty Program	446	399
Sub-deliveries	1,217	500
Commissions	1,203	893
Other cost of sales	261	268
Purchases	645	1,210
Billing and Collection	386	444
Marketing	2,237	2,175
Call centres	245	109
Network & IT repairs and maintenance	2,603	2,701
Rentals, buildings and vehicles	1,897	1,657
Utilities supplies	807	746
Consultancy and professional fees	338	483
Other external services	1,043	959
Provision for bad and doubtful debts and inventories	225	639
Taxes (other than income tax)	375	409
Other operating expenses	45	282
Total operating expenses	**35,753**	**34,118**

* 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 7 million in relation to such non-competition clauses in 2007 (2006: CZK 6 million).

** 2006 figures may be different as more detailed structure of costs was introduced in 2007.

Purchases from related parties are disclosed in Note 26.

4 Interest and other finance income

In CZK million	31 December 2007	31 December 2006
Financial income		
Interest income	403	149
Other financial income	749	692
Total financial income	1,152	841
Financial expenses		
Interest expenses	(446)	(430)
(Gain)/loss for derivatives of fair value hedges	(26)	(29)
Other financial expenses	(768)	(602)
Total financial expenses	(1,240)	(1,061)
Net financial (cost)/income	**(88)**	**(220)**

5 Tax

In CZK million	31 December 2007	31 December 2006
Total income tax expense is made up of:		
Current income tax charge	4,240	4,171
Deferred income tax credit (Note 17)	(1,116)	(1,251)
Taxes on income	**3,124**	**2,920**

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:

In CZK million	31 December 2007	31 December 2006
Profit before tax	13,510	10,940
Income tax charge calculated at the statutory rate of 24% (2006: 24%)	3,242	2,626
Income not subjected to tax	(9)	(1)
Expenses not deductible for tax purposes	299	385
Impact of change in income tax rate	(798)	–
Tax related to prior periods	54	12
Unrecognised tax losses	336	26
Other	–	(128)
Taxes on income	**3,124**	**2,920**
Effective tax rate	23%	27%

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.

	31 December 2007	31 December 2006
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	10,386	8,020
Basic earnings per share (CZK)	32	25

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

7 Dividends

In CZK million	2007	2006
Dividends declared (including withholding tax)	16,104	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 2007. Approval of the 2007 profit and the decision regarding the amount of any dividend payment for the 2007 financial year will take place at the Annual General Shareholders Meeting scheduled for 21 April 2008.

8 Property, plant and equipment

In CZK million	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress	Total
At 31 December 2007						
Opening net book amount	14,219	43,395	17,292	1,814	2,035	78,755
Additions	691	576	2,634	1,190	5,700	10,791
Disposals and other movements	(37)	(1)	(55)	(12)	(4,927)	(5,032)
Assets classified as held for sale	(132)	(10)	–	–	–	(142)
Depreciation charge	(656)	(4,250)	(6,664)	(989)	(4)	(12,563)
Impairment charge	(5)	–	–	–	5	–
Closing net book amount	**14,080**	**39,710**	**13,207**	**2,003**	**2,809**	**71,809**
At 31 December 2007						
Cost	22,838	99,696	93,126	10,557	2,839	229,056
Accumulated depreciation and impairment allowance	(8,758)	(59,986)	(79,919)	(8,554)	(30)	(157,247)
Net book amount	**14,080**	**39,710**	**13,207**	**2,003**	**2,809**	**71,809**

	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress	Total
At 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**

As at 31 December 2007, the carrying value of non-depreciated assets amounted to CZK 472 million (2006: CZK 460 million).

Land and buildings in the carrying value of CZK 8,280 million as of 31 December 2007 were pledged in respect of execution relating to the T-Mobile Interconnect dispute as described in Note 21.

No borrowing costs were capitalized during the years 2007 and 2006.

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
At 31 December 2007				
Opening net book amount	202	1	–	203
Disposals and other movements	(12)	–	–	(12)
Impairment charge	(5)	–	–	(5)
Assets re-classified as held for sale	142	–	–	142
Closing net book amount	**327**	**1**	**–**	**328**
At 31 December 2007				
Cost	1,282	199	10	1,491
Accumulated depreciation and impairment allowance	(955)	(198)	(10)	(1,163)
Net book amount	**327**	**1**	**–**	**328**

	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
At 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**

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.

The impairment charge recorded in 2007 represents mainly correction of value of special constructions, which were idle.

In 2007, the Group achieved a total gain from the sale of the above fixed assets amounting to CZK 42 million and total losses in amount CZK 35 million. The total net sales were CZK 35 million and the carrying amount was CZK 28 million.

Cost of fully depreciated property, plant and equipment was CZK 62,165 million as at 31 December 2007 (2006: CZK 47,061 million).

9 Intangible assets

In CZK million	Goodwill	Licences	Software	Other	Total
At 31 December 2007					
Opening net book amount	13,320	5,210	3,098	–	21,628
Additions	–	16	2,034	–	2,050
Disposals and other movements	–	–	(1)	–	(1)
Amortisation charge	–	(410)	(1,462)	–	(1,872)
Impairment charge	–	–	–	–	–
Closing net book amount	**13,320**	**4,816**	**3,669**	**–**	**21,805**
At 31 December 2007					
Cost	13,320	6,209	22,955	2,829	45,313
Accumulated amortisation and impairment allowance	–	(1,393)	(19,286)	(2,829)	(23,508)
Net book amount	**13,320**	**4,816**	**3,669**	**–**	**21,805**
At 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**

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, Eurotel Praha, spol. s r.o. 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 nine years.

In 2002, Eurotel Praha, spol. s r.o. 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 NMT license is currently valid for the remaining period of four years.

In December 2001, Eurotel Praha, spol. s r.o. acquired the UMTS license, which has been granted for a period of twenty years. Under the license, Eurotel Praha, spol. s r.o. was provided with deferred payment terms by the Czech Telecommunication Office (CTU) to finance the license acquisition. In December 2003, Eurotel Praha, spol. s r.o. 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, Eurotel Praha, spol. s r.o. 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. 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 was awarded to Telefónica O2 Slovakia on 7 September 2006 for SKK 150 million (EUR 4.1 million).

Carrying value of licences as at 31 December 2007:

In CZK million	31 December 2007	31 December 2006
GSM 900 licence	619	695
GSM 1800 licence	499	559
NMT 450 licence	50	65
UMTS licence	3,518	3,771
GSM a UMTS licence – Slovakia	130	120

No borrowing costs were capitalized during the years 2007 and 2006.

Cost of fully amortised intangible assets was CZK 17,252 million as at 31 December 2007 (2006: CZK 13,874 million).

The caption Other includes brand names acquired through business combination in 2003 by the purchase of the remaining share in Eurotel Praha, spol. s r.o. 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 Eurotel Praha, spol. s r.o. 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 were acquired through business combination in 2003 with Eurotel Praha, spol. s r.o. 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.

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 Eurotel Praha, spol. s r.o. 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 2007, 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 2007.

11 Inventories

In CZK million	31 December 2007	31 December 2006
Construction material	66	81
Cables	47	28
Other inventory including goods for resale	736	642
Finished products and work in progress	4	236
Total	**853**	**987**

The inventories noted above are stated net of an allowance of CZK 96 million (2006: CZK 179 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 43 million (2006: CZK 9 million). The amount of inventories recognised as an expense is CZK 4,245 million (2006: CZK 4,212 million).

12 Receivables and prepayments

In CZK million	31 December 2007	31 December 2006
Domestic trade receivables (net)	6,895	5,853
Foreign currency trade receivables (net)	572	710
Other debtors (net)	373	880
Prepayments	716	681
Other financial assets – short-term	17	10
Derivative instruments	4	–
Total	**8,577**	**8,134**

Trade receivables are stated net of an allowance for impaired receivables of CZK 3,291 million (2006: CZK 3,312 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 26.

			Not impaired but overdue			
				Between		
Trade receivables In CZK million	**Carrying amount**	**Neither impaired nor overdue**	**Less than 90 days**	**90 and 180 days**	**180 and 360 days**	**More than 360 days**
At 31 December 2007	8,577	4,491	321	50	–	–
At 31 December 2006	8,134	4,742	329	87	–	–

Bad debt provisions In CZK million	
Bad debt provisions at 1 January 2006	3,218
Additions	393
Retirements/amount paid	(299)
Bad debt provision at 31 December 2006	**3,312**
Additions	117
Retirements/amount paid	(138)
Bad debt provision at 31 December 2007	**3,291**

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 2007 and 2006 the Group has the following non-current balances, which are classified as other financial assets:

In CZK million	31 December 2007	31 December 2006
Long-term credits	112	156
Advance payments for long-term expenses	247	221
Other financial investment	207	–
Total	**566**	**377**

Long-term trade credits include interest bearing credit (interest 5.9%) amounting to CZK 71 million (2006: CZK 78 million).

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

Available-for-sale investments In CZK million	31 December 2007	31 December 2006
At beginning of year	56	58
Revaluation deficit	–	(2)
Additions	3	3
Disposals	(59)	(3)
At end of year	**–**	**56**
Non-current	–	–
Current	–	56
Total	**–**	**56**

Held-to-maturity investments In CZK million	31 December 2007	31 December 2006
At beginning of year	27	29
Exchange differences	–	(1)
Additions	1	1
Matured	(1)	(2)
At end of year	**27**	**27**
Non-current	–	27
Current	27	–
Total	**27**	**27**

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

In CZK million	31 December 2007	31 December 2006	Interest rate
Cash at current bank accounts	4,130	334	Floating
Cash at cash-pooling structures	5,107	3,605	Floating
Short-term bank deposits	321	3,512	Fixed
Other cash equivalents	18	10	n/a
Total	**9,576**	**7,461**	
Financial investments (held to maturity/available-for-sale)	27	83	Fixed

As at 31 December 2007 and 2006, 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.

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 conditions are based on the arm's length principle.

At 31 December 2007, the Group had available equivalent of CZK 12,344 million (2006: CZK 8,404 million) of undrawn committed facilities.

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

In CZK million	31 December 2007	31 December 2006
Cash and cash equivalents	9,576	7,461
Bank overdrafts and other short-term borrowings (Note 16)	–	–
Balance at the end of period	**9,576**	**7,461**

The amount of CZK 3,902 million kept on bank accounts was pledged as of 31 December 2007 in respect of execution relating to the T-Mobile Interconnect dispute as described in Note 21. The market interest rate deposit conditions are applicable for the pledged amount.

15 Trade and other payables

In CZK million	31 December 2007	31 December 2006
Trade creditors in local currency (net)	4,575	4,292
Trade creditors in foreign currencies (net)	1,924	855
Related party loans	794	–
Other taxes and social security	518	196
Deferred revenue	1,254	2,026
Employee wages and benefits	703	559
VAT payable	162	445
Other creditors	656	72
Accruals	3,179	2,472
Total payables	**13,765**	**10,917**
Other non-current liabilities	452	807

Payables to related parties are disclosed in Note 26.

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

In CZK million	31 December 2007	31 December 2006
Bank loans in foreign currencies (a)	3,062	3,163
Bonds in local currency (b)	5,998	5,993
Total borrowings	9,060	9,156
Accrued interest including commitment fees	185	189
Derivatives	24	18
Other financial debt	209	207
Total financial debt	**9,269**	**9,363**
Repayable:		
Within one year	6,207	207
Between one and two years	–	5,993
Between two and five years	3,062	–
After five years	–	3,163
Total non-current	3,062	9,156
Total financial debt	**9,269**	**9,363**

(a) No bank overdrafts are included.

Short-term borrowings as at 31 December 2006 consisted of loans drawn under bilateral short-term facilities.

In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity date on 30 July 2012. As at 31 December 2007, the outstanding amount of the foreign currency loan amounts to EUR 115 million.

(b) 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.

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:

In CZK million	31 December 2007	31 December 2006
At fixed rate	9,060	9,156
At floating rate	–	–
Total	**9,060**	**9,156**

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 In CZK million	31 December 2007	31 December 2006
Bank loans 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.

Loans are not secured.

The table below summarizes the maturity profile of the Group's financial liabilities at 31 December 2007 based on contractual undiscounted payments.

At 31 December 2007 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	–	6,413	3,875	–
Trade and other payables (except for deferred revenue)	10,655	1,856	–	–
Other financial liabilities	3	8	–	–
Derivatives fair value	22	2	–	–
Total	**10,680**	**8,279**	**3,875**	**–**

At 31 December 2006 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	–	–	7,050	3,373
Trade and other payables (except for deferred revenue)	8,614	277	–	–
Other financial liabilities	3	9	11	–
Derivatives fair value	11	7	–	–
Total	**8,628**	**293**	**7,061**	**3,373**

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements.

	Carrying amount		Fair value	
In CZK million	**2007**	**2006**	**2007**	**2006**
Financial assets				
Cash and cash equivalents	9,576	7,461	9,576	7,461
Financial investments (held to maturity/ available-for-sale)	27	83	27	83
Derivatives	4	–	4	–
Other financial assets	566	377	566	377

	Carrying amount		Fair value	
In CZK million	**2007**	**2006**	**2007**	**2006**
Financial liabilities				
Interest bearing loans and borrowings				
Floating rate related party borrowings	794	–	794	–
Fixed rate borrowings	3,148	3,248	3,348	3,557
Issued Bonds	6,097	6,097	6,049	6,135
Derivatives	24	18	24	18

Market values have been used to determine the fair value of the above mentioned issued CZK bonds. The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Financial risk analysis

The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange and interest rates.

In CZK million	Effect on profit before tax	Effect on equity
FX risk		
Value at Risk*	(95)	n/a
Stress testing*	(26)	(20)
IR risk		
Stress testing*	(183)	–

* The Value at Risk (VaR) Model enables the Group estimate the probability of maximum possible loss to the portfolio value in the given time frame which will not be exceeded given the defined reliability level. For conducting a VaR calculation, the Group uses the risk variance and covariance method using the normal distribution (e.g. parametric method). The time frame used is one month with a 95% reliability rate. Considering the importance of net open positions resulting from financial assets and financial liabilities of the Group in individual foreign currencies, the Group models VaR from a position of translation and transaction in EUR and USD.

FX risk used stress scenario represents immediate one-off change in the foreign exchange rates vs. CZK by 1% in a negative direction (in the case of short open foreign currency position, this will result in a depreciation of the foreign exchange rate and vice versa).

IR risk used stress scenario represents immediate one-off change of interest rates along the whole yield curve by 1% in an unfavorable direction. The calculation of unfavorable impact on Group cash flows (due to an increase in interest expense or drop in interest received relating to financial assets and financial liabilities) is made each month on the floating basis within a time frame of 12 months.

Hedging

The following nominal value of foreign exchange forwards was used by the Group to hedge the EUR/CZK risk:

	Nominal value In EUR million		Fair value In CZK million	
	2007	**2006**	**2007**	**2006**
Forward exchange contracts	36	36	(20)	(18)

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.

Short-term deferred taxes were calculated at 21% and long-term deferred taxes were calculated at 20% and 19% depending on the period of its expected realisation (24% in 2006).

In CZK million	2007	2006
At 1 January	4,469	5,721
Income statement tax credit (Note 5)	(1,116)	(1,251)
Tax impact on changes in equity	–	(1)
At 31 December	3,353	4,469

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:

In CZK million	31 December 2007	31 December 2006
Deferred tax assets	(1,143)	(1,509)
Deferred tax liabilities	4,496	5,978
Total	**3,353**	**4,469**

The deferred tax asset includes CZK 655 million (2006: CZK 444 million) recoverable in less than twelve months and CZK 488 million (2006: CZK 1,065 million) recoverable after more than twelve months. The deferred tax liability includes CZK 584 million (2006: CZK 724 million) payable in less than twelve months and CZK 3,912 million (2006: CZK 5,254 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Consolidated balance sheet		Consolidated income statement	
In CZK million	**2007**	**2006**	**2007**	**2006**
Amount relating to the origination and reversal of temporary differences from:				
– property, plant and equipment and intangible assets	4,496	5,978	(575)	(1,026)
– trade receivables, inventories and other differences	(1,139)	(1,479)	231	(225)
Revaluations of cash flow hedges	(4)	(4)	–	–
Amount relating to unrecognised tax loss	–	(26)	26	–
Amount relating to changes in tax rates	–	–	(798)	–
Total	**3,353**	**4,469**	**(1,116)**	**(1,251)**

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

In CZK million	**31 December 2007**	**31 December 2006**
Revaluation of cash flow hedges	–	(1)
Total	**–**	**(1)**

Reduction of the corporate income tax rate resulted in a positive impact on deferred tax liability of CZK 798 million in 2007.

18 Government social security and pension schemes

The Group is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2007 and 2006, 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 1,678 million in 2007 (2006: CZK 1,649 million). Employees contribute 12.5% (2006: 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 58 million (2006: CZK 53 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 2007 relating to employee retirement amounted to CZK 0.2 million (2006: 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

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee-Related costs	Benefit loyalty provision	Other	Total
At 1 January 2007	1,973	19	255	564	61	2,872
Additions during the year	164	81	296	599	4	1,144
Utilised during the year	(27)	(97)	(248)	(536)	(57)	(965)
At 31 December 2007	**2,110**	**3**	**303**	**627**	**8**	**3,051**
Short-term Provisions 2007	–	3	263	627	8	901
Long-term Provisions 2007	2,110	–	40	–	–	2,150
Short-term Provisions 2006	14	19	183	564	55	835
Long-term Provisions 2006	1,959	–	72	–	6	2,037
At 31 December 2006	**1,973**	**19**	**255**	**564**	**61**	**2,872**

With the exception of the regulatory and court decisions, benefit loyalty provision 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 347 million (2006: CZK 290 million) within one year and CZK 280 million (2006: CZK 274 million) from one year up to three years.

The future obligation of the expenditures expected to be required amounting to CZK 657 million (2006: CZK 580 million) is fully covered by the amount of the provision in its present value.

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:

Forward foreign exchange contracts In CZK million	**31 December 2007**	**31 December 2006**
Cash flow hedges		
– with positive fair value	4	–
– with negative fair value	(24)	(18)
Total (Note 16)	**(20)**	**(18)**

21 Contingencies

The Company is involved in several court proceedings which have arisen from the ordinary course of business. Significant legal matters involving the Company are listed below:

Legal proceedings

I. The Company has not yet agreed a 2001 price amendment to an agreement with T-Mobile Czech Republic a.s. governing interconnect arrangements. Despite the fact that 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 has subsequently brought a legal action against the decision and obtained the suspension of the executability of the decision. Based on the legal environment in the Czech Republic, the 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.

Meanwhile the question of jurisdiction between the civil courts and the administrative courts has arisen. As a result of this the case is now before the special panel of judges, which shall decide which court has the authority to decide the dispute. The question of jurisdiction also caused the temporary expiration of the suspension of the executability of the CTO decision. T-Mobile Czech Republic initiated the execution and seeks the remuneration of the litigable amount (see Note 8 and 14). The Company does not agree with the execution and uses all its legal instruments to the termination of the execution. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

II. On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) brought a legal action 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.

Court issued the decision which was delivered in January 2008 that the proceeding is terminated with reference to the lack of authority and delegated the case to the CTO. This decision will be the matter of the appeal proceeding at the High court in Prague though. The management is confident that all risks, which may arise as a result of the litigation, are adequately provided for in the financial statements.

Office for the Protection of Economic Competition proceedings

The Company was subject to administrative proceeding before the Office for the Protection of Economic Competition (UOHS) relating to the alleged abuse of the dominant position by 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 a legal action in January 2006 and while the suspension of the executability was not granted the fine was paid. The Regional court in Brno refused the legal action and therefore the Company lodged a cassation complaint to the Supreme Administrative Court on 19 October 2006.

Other legal matters

I. The Company is a defendant in a case filed by TELE 2 s.r.o. on 3 February 2005 asserting causes for alleged breach of act on protection of the competition by the Company in connection by offering certain pricing plans from September 2002 to December 2004. The amount of the claim is CZK 2,142 million with appurtenances.

The Company provided to the court extensive defense 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.

As a consequence of the sale of the TELE 2´s enterprise there currently takes place an appeal proceeding, in which the question of succession is dealt with.

II. 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 (totaling approximately additional CZK 257 million as of the end of 2007) 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 (total cca CZK 139 million). Both parties subsequently filed an extraordinary appeal against the court judgment. 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.

III. 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 act on protection of the competition by Eurotel Praha, spol. s r.o. (damages amounting to CZK 1,043 million). Both parties filed their expert opinions to the court. The management believes that all risks, which may arise as a result of Vodafone litigations, are adequately provided for in the financial statements. Decision of the Office for the Protection of Economic Competition (UOHS) on which Vodafone based its claim was on 11 July 2007 cancelled by the Constitutional court. 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. The total amount of those individual cases exceeding CZK 5 million amounts to CZK 135 million. The management believes that the risk of losing 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:

In CZK million	31 December 2007	31 December 2006
No later than 1 year	1,287	1,052
Later than 1 year and not later than 5 years	4,112	3,136
Later than 5 years	3,208	2,518
Total	**8,607**	**6,706**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2007 were CZK 1,201 million (2006: CZK 1,102 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 2007 were CZK 458 million (2006: CZK 368 million).

Capital commitments In CZK million	31 December 2007	31 December 2006
Capital expenditure contracted but not provided for in the financial statements	1,877	673

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

23 Service concession arrangements

The Company performs communication activities as defined under the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunication Office num. 516 as amended by later changes num. 516/1, 516/2 and 516/3.

The communication activities include (territory of the Czech Republic):

a public fixed network of electronic communications,
b public mobile network of electronic communications,
c public network for the transfer of radio and TV signal,
d public fixed telephone network,
e public mobile telephone network,
f publicly accessible telephone services,
g other voice services – service is provided as publicly available,
h rent of circuits – service is provided as publicly available,
i transmission of radio and TV signal – service is provided as publicly available,
j transfers of data – service is provided as publicly available,
k internet access services – service is provided as publicly available,
l other voice services – service is not provided as publicly available,
m rent of circuits – service is not provided as publicly available,
n transmission of radio and TV signal – service is not provided as publicly available,
o transfers of data – service is not provided as publicly available,
p internet access services – service is not provided as publicly available.

The Company provides mobile services of electronic communications in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (GSM) standard on the basis of radio frequency assignment from CTO valid until 7 February 2016, in the 2100 MHz frequency band under the Universal Mobile Telecommunications System (UMTS) standard on the basis of radio frequency assignment from CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access – CDMA), where on the basis of radio frequency assignment from CTO valid until 7 February 2011 is provided broadband mobile access to Internet.

Validity of radio frequency assignment is possible to prolong for next period on the basis of application submitted to CTO in accordance with the Act on Electronic Communications. 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 radio frequency assignments in the future.

No additional expenses or any limitations connected with renewal of the radio frequency assignments are expected in accordance with the existing interpretation of regulatory provisions.

Imposition of obligations related to provision of universal service

During the whole year 2007, the Company provided the partial services within CTO imposed obligations to provide universal service:

a periodic issuance of telephone directories with numbers of participants of the publicly accessible telephone service and access of end users to these directories;

b information service on the numbers of participants of the publicly accessible telephone service;

c public pay telephones services;

d access for disabled to the public telephone;

e supplementary services to 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:
- phased payment of the price for the establishment of connection to the public telephone network for consumer,
- free selective barring of outgoing calls for the subscribers, and
- free itemised billing of the price for consumer,

f special price schemes, which are different from the price schemes used under normal business conditions, for low income persons, persons with special social needs and disabled persons.

Provision of electronic communications services in Slovakia

On 7 September 2006, Telefónica O2 Slovakia was granted a licence for providing of electronic communications services by the means of the public electronic communications network – GSM and UMTS mobile telephone network within the area of the Slovak Republic. The licence has been granted for 20 years, i.e. until September 2026.

The following obligations were part of the licence:

a putting into operation the own GSM network within 6 months (i.e. until 7 March 2007),

b putting into operation the UMTS network within 12 months (i.e. until 7 September 2007),

c putting into operation 400 GSM base stations and to cover 12% of population by the own network within 12 months.

These obligations were fulfilled in year 2007.

24 Share capital and reserves

	31 December 2007	31 December 2006
Nominal value per ordinary bearer share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares (in CZK million)	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.

Shareholdings in the Company were as follows:

	31 December 2007	31 December 2006
Telefónica, S.A.	69.4%	69.4%
Other shareholders	30.6%	30.6%

Funds include a statutory reserve fund of CZK 6,443 million (2006: CZK 6,262 million) that is not distributable under ruling legislation.

Capital management

The Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing its capital are:

a to safeguard the Company's ability to continue as a going concern so that it can provide value for its shareholders, and
b to comply with all relevant legal requirements.

The investment strategy in the light of managing capital of the Company is to focus investment activities on pro-growth areas, i.e. broadband internet, IPTV, mobile services and corporate ICT solutions and the launch of mobile services in Slovakia.

At present, the approach that the Company follows is not to retain surplus cash.

In the following periods, the Board of Directors will continue to evaluate and carry out an in-depth analysis of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation and will establish the most adequate capital structure for accomplishment of the plans.

There is no other specific objective.

No changes were made in the objectives, policies or processes during the years 2007 and 2006.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2007	31 December 2006
Capital	82,812	88,499
Net unrealized gains reserve (cash flow hedge)	(20)	(18)
Total equity	**82,792**	**88,481**

25 Hedging reserve

In CZK million	
Balance at 1 January 2006	(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)**
Fair value losses in period	(17)
Fair value losses transfer to net profit	15
Balance at 31 December 2007	**(20)**

26 Related party transactions

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 was incurred.

The following transactions were carried out with related parties:

I. Parent company

In CZK million	31 December 2007	31 December 2006
a) Dividend paid Telefónica, S.A.	11,179	10,061

II. Other related parties – Telefónica Group

In CZK million	31 December 2007	31 December 2006
a) Sales of services and goods	651	520
b) Purchases of services and goods	443	351
c) Capital purchases	1	18
d) Receivables	45	131
e) Payables	838	74
f) Short-term receivables (interest)	17	8
g) Interest income	315	15
h) Cash equivalents	5,107	3,605

The list of the Telefónica companies with which the Group had any transaction in 2007 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 Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Manx Telecom Ltd., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A, Telefónica Móviles Columbia, S.A., Telefónica S. de Informática y Comunicaciones de Espana, S.A.U., Telefónica Investigación y Desrrollo, S.A., Médi Telecom, S.A., 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

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:

In CZK million	31 December 2007	31 December 2006
Salaries and other short-term benefits	153	86
Personal indemnification insurance	9	12
Total	**162**	**98**

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2007 and 2006.

No other loan was provided to related parties by the Group.

27 Principal subsidiary undertakings

Subsidiary	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 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., v likvidaci	100%	Czech Republic	E-business company providing market place services
Associate			
7. První certifikační autorita, a.s.	23%	Czech Republic	Rendering of certification services
8. AUGUSTUS spol. s r.o.	40%	Czech Republic	Sales by auctions and advisory services

DELTAX Systems a.s. financial results will be fully included in the Group financial statements from the effective date of 1 January 2008. As of that date, all inter-company transactions will be fully eliminated.

As of 1 January 2007, CenTrade, a.s., in liquidation commenced the process of voluntary liquidation. During 2007, the Company increased its investment and paid in capital which would aim to the smooth liquidation process. The liquidation process was effectively terminated on 30 November 2007 resulting in a liquidation surplus of CZK 32 million received by the Company. At the beginning of January 2008, the liquidator submitted a proposal of registration of the termination of the Company liquidation and cancellation of the registration from the Commercial Register.

During the fourth quarter 2007, SPT TELECOM Finance B.V. commenced preparatory steps for the process of voluntary liquidation. The process is still in progress and will probably be finalised during next year.

28 Post balance sheet events

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 2007.

06 FINANCIAL STATEMENTS

In the Taurus constellation in the open star cluster Pleiades, there are several white dwarfs, which are stars in the final stages of their life cycle. A white dwarf is a burnt-out star which emits only its previously accumulated energy into the outer space. Once all the heat is gone, the star will turn into a black dwarf. Scientists estimate it takes a billion of billions of years for a star to cool down completely – significantly much longer than the age of our universe.

Financial statements for the year ended 31 December 2007

(Prepared in accordance with International Financial Reporting Standards)

Content

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 Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

The Company is 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 four suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Company amounted in average to 9,004 in 2007 (2006: 9,816).

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

These financial statements were approved for issue by the Company's Board of Directors on 20 February 2008.

Acquisition of DELTAX Systems a.s.

In September 2007, Telefónica O2 Czech Republic, a.s. announced the conclusion of an agreement for the purchase of 100% of the shares in DELTAX Systems a.s. DELTAX Systems a.s. is a system integrator company operating on the market since 1993 and, at present, its yearly turnover exceeds CZK 300 million. The main business activities include IT/ICT consulting, application development, outsourcing services and capacities in system integration. Key clients include top Czech companies and government agencies. The acquired company has a long-term track record of a successful co-operation with the Company in several projects. Acquisition of DELTAX Systems a.s. fits in the Company's current growth plan being a leader in integrated ICT solutions.

In December 2007, the transaction was approved by the Office for the Protection of Competition. The acquisition will be effective as of 1 January 2008. The total cost of the acquisition was agreed to be up to CZK 200 million and costs directly attributable to the acquisition were CZK 7 million.

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.

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 2007 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 as adopted by the European Union. 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 and implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the 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 2007, 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 European Union.

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

20 February 2008
Prague, Czech Republic

Income statement

For the year ended 31 December 2007

In CZK million	Notes	31 December 2007	31 December 2006
Revenue	2	63,035	61,264
Gains from sale of non-current assets		43	98
Internal expenses capitalized in fixed assets	2	470	879
Operating expenses	3	(34,158)	(33,911)
Impairment loss	8, 9, 10	(5)	(253)
Depreciation and amortisation	8, 9	(14,375)	(16,726)
Operating profit		15,010	11,351
Interest income	4	402	148
Interest expense	4	(438)	(431)
Other finance income (net)	4	3	26
Profit before income tax		14,977	11,094
Taxes on income	5	(3,083)	(2,772)
Profit for the year		**11,894**	**8,322**
Earnings per share (CZK) – basic*	6	37	26

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

Balance sheet

As at 31 December 2007

In CZK million	Notes	31 December 2007	31 December 2006
ASSETS			
Property, plant and equipment	8	70,799	78,686
Intangible assets	9	21,467	21,508
Held-to-maturity investments	13	–	27
Investment in subsidiaries and associate	27	1,300	77
Other financial assets	12	565	376
Non-current assets		**94,131**	**100,674**
Inventories	11	743	987
Receivables and prepayments	12	8,387	8,367
Available-for-sale investments/Held-to-maturity investments	13	27	56
Cash and cash equivalents	14	9,521	7,298
Current assets		**18,678**	**16,708**
Non-current assets classified as held for sale	8	**328**	**203**
Total assets		**113,137**	**117,585**
EQUITY AND LIABILITIES			
Ordinary shares	24	32,209	32,209
Share premium		30,816	30,816
Retained earnings, funds and reserves		21,400	25,590
Total equity		**84,425**	**88,615**
Long-term financial debts	16	3,062	9,156
Deferred taxes	17	3,353	4,494
Non-current provisions for liabilities and charges	19	2,146	2,037
Non-current other liabilities	15	452	805
Non-current liabilities		**9,013**	**16,492**
Short-term financial debts	16	6,207	207
Trade and other payables	15	11,732	10,708
Income tax liability		859	728
Provisions for liabilities and charges	19	901	835
Current liabilities		**19,699**	**12,478**
Total liabilities		**28,712**	**28,970**
Total equity and liabilities		**113,137**	**117,585**

These financial statements were approved by the Board of Directors on 20 February 2008 and were signed on its behalf by:

Salvador Anglada Gonzalez

Chairman of the Board of Directors and Chief Executive Officer

Ramón Ros Bigeriego

Member of the Board of Directors and Chief Financial Officer

Statement of changes in shareholders' equity

For the year ended 31 December 2007

In CZK million	Notes	Share capital	Share premium	Hedging reserve	Foreign exchange translation reserve	Funds*	Retained earnings	Total
At 1 January 2006		**32,209**	**30,816**	**(11)**	**–**	**5,911**	**25,875**	**94,800**
Fair value gains (net of tax)								
– cash flow hedges		–	–	(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
At 31 December 2006		**32,209**	**30,816**	**(18)**	**(5)**	**6,269**	**19,344**	**88,615**
At 1 January 2007		**32,209**	**30,816**	**(18)**	**(5)**	**6,269**	**19,344**	**88,615**
Fair value gains (net of tax)								
– cash flow hedges		–	–	(2)	–	–	–	(2)
Currency translation differences								
– amount arising in year		–	–	–	5	–	–	5
Changes in statutory reserves and other movements		–	–	–	–	181	(164)	17
Net income/(expense) recognised directly in equity		–	–	(2)	5	181	(164)	20
Dividends declared in 2007	7	–	–	–	–	–	(16,104)	(16,104)
Net profit		–	–	–	–	–	11,894	11,894
At 31 December 2007		**32,209**	**30,816**	**(20)**	**–**	**6,450**	**14,970**	**84,425**

* Refer Note 24 regarding amounts not available for distribution.

Movement of gains and losses recognised in equity

In CZK million	Gains/(losses) proceeding from cash flow hedges	Translation differences	Tax effect	Total
At 1 January 2006	**(14)**	**–**	**3**	**(11)**
Gains/(losses) arisen in the fiscal year	(19)	(5)	1	(23)
Gains/(losses) re-classified to the profit and loss account	11	–	–	11
At 31 December 2006	**(22)**	**(5)**	**4**	**(23)**
Gains/(losses) arisen in the fiscal year	(17)	5	–	(12)
Gains/(losses) re-classified to the profit and loss account	15	–	–	15
At 31 December 2007	**(24)**	**–**	**4**	**(20)**

Cash flow statement

For the year ended 31 December 2007

In CZK million	Notes	31 December 2007	31 December 2006
Net profit		11,894	8,322
Non-cash adjustments for:			
Income tax	5	3,083	2,772
Depreciation	8	12,522	14,018
Amortisation	9	1,853	2,708
Impairment loss	8, 9, 10	5	253
Disposals of obsolete assets		37	49
Profit on sale of property, plant and equipment		(52)	(96)
Net interest and other charges		36	245
Foreign exchange (gains)/losses (net)		(131)	(203)
Fair value changes		–	29
Increase in provisions		(1,258)	62
Operating cash flow before working capital changes		27,989	28,159
Working capital adjustments:			
Decrease/(increase) in trade and other receivables		100	(98)
Decrease/(increase) in inventories		14	(753)
(Decrease)/increase in trade and other payables		55	868
Cash flows from operating activities		28,158	28,176
Interest paid		(428)	(429)
Interest received		375	186
Income tax paid		(4,074)	(3,562)
Net cash from operating activities		**24,031**	**24,371**
Cash flows from investing activities			
Purchase of property, plant and equipment		(3,688)	(4,710)
Purchase of intangible assets		(1,505)	(1,323)
Proceeds from sales of property, plant and equipment		71	214
Proceeds from marketable securities		53	–
Proceeds from discontinued operations		32	–
Cash purchase of financial investments		(836)	(40)
Dividends received		7	–
Grant of loan		(1,426)	(3,446)
Repayment of loan		1,583	3,253
Net cash used in investing activities		(5,709)	(6,052)
Cash flows from financing activities			
Dividends – paid		(16,083)	(14,494)
Net cash used in financing activities		(16,083)	(14,494)
Net increase/(decrease) in cash and cash equivalents		**2,239**	**3,825**
Cash and cash equivalents at beginning of year		7,298	3,471
Effects of exchange rate changes		(16)	2
Cash and cash equivalents at the year end	14	**9,521**	**7,298**

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 the year-end, 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 20 February 2008.

The financial statements were prepared under the historical cost convention except for non-current assets held for sale, inventory held at net realizable value, financial derivatives, 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 new or revised IFRS standards and interpretations

In 2007, the Company applied the below stated new or revised IFRS standards and interpretations, which are relevant to its operations. Adoption of these new or revised standards and interpretations did not have any effect on the financial performance or position of the Company, however they resulted in presenting additional disclosures:

IAS 1 Amendment – (issued 2005, effective date 1 January 2007) Presentation of financial statements, Capital disclosures

The amendment requires the Company to make new disclosures to enable users of the financial statements to evaluate the Company's objectives, policies and processes for managing capital. This new information is shown in Note 24.

IFRS 7 (issued in 2005, effective date 1 January 2007) Financial Instruments: Disclosures

The standard requires disclosures that enable users of the financial statements to evaluate the significance of the Company's financial instruments and the nature and the extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results, comparative disclosures information has been revised where needed.

IFRIC 8 (issued in 2006, effective date 1 May 2006) Scope of IFRS 2

This interpretation requires IFRS 2 to be applied to any arrangements in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. As the Company can identify specifically services received in the share based transactions granted to the employees, the interpretation had no impact on the financial position or performance of the Company.

IFRIC 9 (issued in 2006, effective date 1 June 2006) Reassessment of Embedded Derivatives

IFRIC 9 states that the date to assess the existence of an embedded derivative is the date that an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. As the Company has no embedded derivative requiring separation from the host contract, the interpretation had no impact on the financial position or performance of the Company.

IFRIC 10 Interim Financial Reporting and Impairment (issued 2006, effective date 1 November 2006)

The interpretation limits the Company in reversing the impairment loss recognised in previous interim periods in respect of goodwill or an investment. This adoption had no material effect on the financial position or presenting figures of the Company.

Standards and interpretations issued and endorsed by the European Union but not early adopted by the Company

IFRS 8 Operating Segments (issued 2006, effective date 1 January 2009)

The standard requires entities to disclose segment information based on the information reviewed by the entity's chief operating decision maker.

The impact of this standard is still to be determined, i.e. whether the Company will define new segments replacing current fixed/mobile.

IFRIC 11 IFRS 2 Company and Treasury Share Transactions (effective date 1 March 2007)

This adoption will affect certain disclosures in the notes to the financial statements.

Standards and interpretations issued but not endorsed by the European Union and neither early adopted by the Company nor effective.

IAS 1 Amendment – (issued 2007, effective date 1 January 2009) Presentation of financial statements, Comprehensive revision including requiring a statement of comprehensive income

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 financial statements.

IAS 23 Borrowing costs (issued 2007, effective date 1 January 2009)

The amendment requires the Company to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Since the Company has already applied this policy as an allowed alternative treatment before, no impact is expected on the financial position of the Company.

Revised IFRS 3 Business combinations (issued January 2008, effective date 1 July 2009) – the Company has not yet considered impacts of the adoption of this revision.

Amendments to IAS 27 (issued January 2008, effective date 1 July 2009) – the Company has not yet considered impacts of the adoption of this amendment.

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 13 Customer Loyalty programmes (effective date 1 July 2008)

This interpretation addresses the accounting by entities that provide their customers with incentives to buy goods or services by providing awards as part of the sale transaction. The interpretation requires the entity that grants the awards to account for the sales transaction that gives rise to the award credits as a multiple element transaction and allocate the fair value of the consideration received or receivable between the award credits granted and the other components of the revenue transaction.

This adoption will affect current accounting policy in respect of change of the fair value awards measurement and change in the presentation in the financial statements. This will also affect certain disclosures in the notes to the financial statements and will be classified as a change of accounting policy. The impact on the financial position is being analysed by the Company. This change will impact the financial results in 2009.

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

B Foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company 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 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 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.

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.

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).

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 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 the corresponding accumulated amortisation (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).

Impairment losses are recognised in the expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised as a reduction in the expenses in the period in which the reversal occurs.

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 2007 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.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible or sold.

(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

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of specific asset or assets and the arrangement conveys a right to use the assets.

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 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 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 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 in the relevant country.

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 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 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. 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 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 the 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 2007, 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 binominal 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 2007, 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 a selected price based on a 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 are 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:

a the Company is the primary obligor in the arrangement,
b the Company has general inventory risk,
c the Company has price latitude,
d the Company changes the product or performs part of the service,
e the Company has discretion in supplier selection,
f the Company is involved in the determination of product or service specifications,
g the Company has credit risk,
h the Company has the ability to set the terms of the transaction,
i 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.

(1) Fixed line business 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.

- Universal service

The Company is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications where the Company receives the contributions from the other operators in respect of the above mentioned Act and the approval and decision by Czech Telecommunication Office. The Company recognises such contributions when the consideration is received.

- 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 business 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 recognised 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, IPTV and data services

The Company earns revenue from providing Internet services, IPTV and other data 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. Detailed figures are described in Note 16.

Financial risk management

The Company's is exposed to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates as a result of ordinary business, debt taken on to finance its business and net investment in foreign operations. The Company's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Company. The Company uses either derivative financial instruments (such as forward and swap contracts) or non--derivative instruments (such as cash instruments) 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 of Directors 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, liquidity risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign currency risk

The Company is exposed to foreign currency risk arising from various currency exposures, primarily with respect to the Euro, partially to US Dollar:

a balance sheet items (such as debt, receivables, payables) denominated in foreign currency,
b probable forecasted transactions or firm commitments (such as purchases or sales) denominated in foreign currency,
c net investment in Slovak subsidiary (functional currency differs from CZK).

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 Company primarily hedges the balance sheet foreign currency exposure, mainly long term debt denominated in EUR and net payables in EUR or USD. Non-derivative instruments are currently used for hedging this kind of exposure.

Additionally, the Company uses to a certain extent derivative hedging via short term forwards to buy respective foreign currency for highly probable or committed purchase transactions, primarily up to 6 months horizon.

(ii) Interest rate risk

The Company is exposed to interest rate risk arising from:

a floating interest rate bearing cash investments and debt instruments,
b fair value of debt on fixed interest rate.

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The cash assets and short term debt are currently maintained on floating rates while long term debt instruments are on fixed rates. The Company may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable rate debts.

(iii) Liquidity risk

The Company's essential objective of liquidity risk management is to have ready access to cash resources sufficient to meet all its cash payment obligations as they fall due, allowing some flexibility. The cash resources consist of cash instruments, marketable securities and available committed credit facilities.

The Company is particularly focusing on the liquidity profile within the time horizon of the next 12 months considering projected cash flow from operations and maturity structure of both debt obligations and financial investments. The balance between funding continuity and flexibility is managed through maintaining the possible use of bank overdrafts or bilateral credit lines.

(iv) 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.

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 12. There are no significant concentrations of credit risk within the Company.

With respect to credit risk arising from the financial assets of the Company, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Credit Risk is managed by the Credit Management Department and is based on three main activities:

a monitoring of accounts receivables: regular monitoring of payment moral of existing customers and monitoring and analyzing of the receivable aging structure (internal and external indicators of any potential bad debts),
b prevention: scoring of new customers – checking procedures (Black Lists, External Debtors Register, other information), set up the limits or/and collection of the deposit according to customer segments, products and set up the credit limits for indirect sales partners (dealers, distributors, retailers) for purchase of our products, „securing“ of credit limits (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc.). Guarantees are either in cash (deposits) or there are special procedures to collect cash for the other securing tools (insurance etc.),
c collection: reasonable, effective and continual collection process is the additional tool of bad debts decrease and prevention as well.

New credit management activities during last two years

During the last two years, the Company introduced new credit management activities such as:

a implementation of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),
b implementation of the credit management best practice from the merge of the fixed and mobile business in all company activities,
c checking of the new activation by using of fixed and mobile Black Lists,
d implementation of tight activation rules for all distribution channels.

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:

a hedge of the fair value of a recognised asset or liability (fair value hedge), or
b 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 4,148 million, advances paid for income taxes amount to CZK 3,289 million and the net deferred tax liability is CZK 3,353 million.

In October 2007, the Czech government enacted legislation, by which the corporate income tax rate will be reduced from 24% to 21%, 20% and 19% for the fiscal years ending in 2008, 2009 and 2010, respectively. The positive impact on deferred tax liability amounts to CZK 798 million in 2007 (see Note 5).

(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. 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 no longer exist, 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 calculated, there is 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 2007 (see Note 8 and 10).

(6) Operating lease commitments – Company as lessee

The Company changed its headquarters and moved to the new premises, where the Company has entered into the commercial property leases. The Company has determined, based on an evaluation of the terms and conditions of the arrangements, that the lessor retains all the significant risks and rewards of the ownership and accounts for the contract as an operating lease. The original premises that have become temporarily idle are currently under consideration of the next usage.

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 an 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

No substantial changes in accounting policies were applied in 2007.

W Real estate portfolio optimisation

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.

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 financial statements

1 Segment information

Business segments recognised by the Company are as follows:

- Fixed – network communications services using a fixed network,
- Mobile – mobile communications services.

Year ended 31 December 2007 In CZK million	Fixed	Mobile	Company
Revenues	30,490	33,783	64,273
Inter-segment sales	(455)	(783)	(1,238)
Total revenues	30,035	33,000	63,035
Gains from sale of non-current assets	43	–	43
Work performed by the Company and capitalized	448	22	470
Costs	(16,990)	(18,406)	(35,396)
Inter-segment purchases	783	455	1,238
Total costs	(16,207)	(17,951)	(34,158)
Impairment charge	(5)	–	(5)
Depreciation	(8,515)	(4,007)	(12,522)
Amortisation	(683)	(1,170)	(1,853)
Total depreciation and amortization	(9,198)	(5,177)	(14,375)
Operating profit	5,116	9,894	15,010
Interest and other financial costs (net)			(33)
Profit before tax			14,977
Tax			(3,083)
Net profit			**11,894**
Assets (excluding Goodwill and non-current assets held for sale)	47,689	51,800	99,489
Goodwill on purchase of additional ownership interest in former Eurotel	–	13,320	13,320
Non-current assets held for sale	328	–	328
Total assets	**48,017**	**65,120**	**113,137**
Trade and other payables	(5,631)	(6,101)	(11,732)
Other liabilities	(8,150)	(8,830)	(16,980)
Total liabilities	**(13,781)**	**(14,931)**	**(28,712)**
Capital expenditure	**4,255**	**2,331**	**6,586**

Year ended 31 December 2006 In CZK million	Fixed	Mobile	Company
Revenues	30,891	31,690	62,581
Inter-segment sales	(521)	(796)	(1,317)
Total revenues	30,370	30,894	61,264
Gains from sale of non-current assets	96	2	98
Work performed by the Company and capitalized	694	185	879
Costs	(17,988)	(17,240)	(35,228)
Inter-segment purchases	796	521	1,317
Total costs	(17,192)	(16,719)	(33,911)
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 costs (net)			(257)
Profit before tax			11,094
Tax			(2,772)
Net profit			**8,322**
Assets (excluding Goodwill and non-current assets held for sale)	65,200	38,862	104,062
Goodwill on purchase of additional ownership interest in former Eurotel	–	13,320	13,320
Non-current assets held for sale	203	–	203
Total assets	**65,403**	**52,182**	**117,585**
Trade and other payables	(5,569)	(5,139)	(10,708)
Other liabilities	(15,714)	(2,548)	(18,262)
Total liabilities	**(21,283)**	**(7,687)**	**(28,970)**
Capital expenditure	**3,149**	**3,170**	**6,319**

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 issue of IFRS 8 Operating segments and the deep integration process from the past convergence, the Company will analyse criteria for segment identification, which might lead to a change in the reported segments in the next years.

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 (CTO, Český telekomunikační úřad). The rates applied in 2007 and 2006 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 since 2006, however are still monitored for regulatory purposes. After the transfer of assets and liabilities, effectively as of 1 January 2006, all inter-company transactions between fixed segment (former ČESKÝ TELECOM, a.s.) and mobile segment (former Eurotel) became inter-segments.

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

2 Revenue and Internal expenses capitalized in fixed assets

Revenue In CZK million	31 December 2007	31 December 2006
Voice	22,839	23,463
Interconnection	10,625	9,444
Subscription charges	8,849	9,841
Connection charges	783	669
SMS & MMS & Value Added Services	4,934	4,813
Leased lines	2,051	2,330
Data services	1,910	1,839
Internet	5,824	5,051
IT and business solutions	1,934	740
Equipment and Activation Fee	2,070	2,163
Other Telco Revenues	436	468
Other revenues	780	443
Total revenues	**63,035**	**61,264**

Revenues from related parties are disclosed in Note 26.

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

In CZK million	31 December 2007
No later than 1 year	244
Later than 1 year and not later than 5 years	868
Later than 5 years	237
Total	**1,349**

Internal expenses capitalized in fixed assets In CZK million	31 December 2007	31 December 2006
Material	138	593
Labour	332	286
Total	**470**	**879**

3 Operating expenses

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

In CZK million	31 December 2007	31 December 2006**
Wages and salaries*	4,621	4,757
Redundancy payments	208	247
Social security contributions (Note 18)	1,612	1,630
Staff welfare costs	323	388
Total staff costs	**6,764**	**7,022**
Interconnection and roaming	10,649	10,010
Cost of goods sold	3,225	3,055
Contents	160	118
Customer Loyalty Program	446	399
Sub-deliveries	1,401	499
Commissions	1,179	893
Other cost of sales	258	325
Purchases	672	1,214
Billing and Collection	386	444
Marketing	1,818	2,149
Call centres	231	107
Network & IT repairs and maintenance	2,608	2,722
Rentals, buildings and vehicles	1,802	1,650
Utilities supplies	790	746
Consultancy and professional fees	337	347
Other external services	854	848
Provision for bad and doubtful debts and inventories	171	672
Taxes (other than income tax)	362	409
Other operating expenses	45	282
Total operating expenses	**34,158**	**33,911**

* 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 7 million in relation to such non-competition clauses in 2007 (2006: CZK 6 million).

** 2006 figures may be different as more detailed structure of costs was introduced in 2007

Purchases from related parties are disclosed in Note 26.

4 Interest and other finance income

In CZK million	31 December 2007	31 December 2006
Financial income		
Interest income	402	148
Other financial income	753	694
Total financial income	1,155	842
Financial expenses		
Interest expenses	(438)	(431)
(Gain)/loss for derivatives of fair value hedges	(26)	(29)
Other financial expenses	(724)	(639)
Total financial expenses	(1,188)	(1,099)
Net financial cost/(income)	**(33)**	**(257)**

5 Tax

In CZK million	31 December 2007	31 December 2006
Total income tax expense is made up of:		
Current income tax charge	4,224	3,700
Deferred income tax credit (Note 17.)	(1,141)	(928)
Taxes on income	**3,083**	**2,772**

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:

In CZK million	31 December 2007	31 December 2006
Profit before tax	14,977	11,094
Income tax charge calculated at the statutory rate of 24% (2006: 24%)	3,594	2,663
Income not subjected to tax	(9)	1
Expenses not deductible for tax purposes	242	223
Impact of change in income tax rate	(798)	–
Tax related to prior periods	54	12
Other	–	(127)
Taxes on income	**3,083**	**2,772**
Effective tax rate	21%	25%

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.

	31 December 2007	31 December 2006
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	11,894	8,322
Basic earnings per share (CZK)	37	26

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

7 Dividends

In CZK million	2007	2006
Dividends declared (including withholding tax)	16,104	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 2007. Approval of the 2007 profit and the decision regarding the amount of any dividend payment for the 2007 financial year will take place at the Annual General Shareholders Meeting scheduled for 21 April 2008.

8 Property, plant and equipment

In CZK million	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress	Total
At 31 December 2007						
Opening net book amount	14,219	43,395	17,283	1,803	1,986	78,686
Additions	622	576	2,124	1,112	4,738	9,172
Disposals and other movements	(37)	(1)	(58)	(8)	(4,291)	(4,395)
Assets classified as held for sale	(132)	(10)	–	–	–	(142)
Depreciation charge	(654)	(4,250)	(6,638)	(976)	(4)	(12,522)
Impairment charge	(5)	–	–	–	5	–
Closing net book amount	**14,013**	**39,710**	**12,711**	**1,931**	**2,434**	**70,799**
At 31 December 2007						
Cost	22,769	99,696	92,541	10,470	2,464	227,940
Accumulated depreciation and impairment allowance	(8,756)	(59,986)	(79,830)	(8,539)	(30)	(157,141)
Net book amount	**14,013**	**39,710**	**12,711**	**1,931**	**2,434**	**70,799**

	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress	Total
At 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**

As at 31 December 2007, the carrying value of non-depreciated assets amounted to CZK 472 million (2006: CZK 460 million).

Land and buildings in the carrying value of CZK 8,280 million as of 31 December 2007 were pledged in respect of execution relating to the T-Mobile Interconnect dispute as described in Note 21.

No borrowing costs were capitalized during the years 2007 and 2006.

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
At 31 December 2007				
Opening net book amount	202	1	–	203
Disposals and other movements	(12)	–	–	(12)
Impairment charge	(5)	–	–	(5)
Assets re-classified as held for sale	142	–	–	142
Closing net book amount	**327**	**1**	**–**	**328**
At 31 December 2007				
Cost	1,282	199	10	1,491
Accumulated depreciation and impairment allowance	(955)	(198)	(10)	(1,163)
Net book amount	**327**	**1**	**–**	**328**

	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
At 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**

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.

The impairment charge recorded in 2007 represents mainly correction of value of special constructions, which were idle.

In 2007, the Company achieved a total gain from the sale of the above fixed assets amounting to CZK 43 million and total losses in amount CZK 34 million. The total net sales were CZK 37 million and the carrying amount was CZK 28 million.

Cost of fully depreciated property, plant and equipment was CZK 62,143 million as at 31 December 2007 (2006: CZK 47,049 million).

9 Intangible assets

In CZK million	Goodwill	Licences	Software	Other	Total
At 31 December 2007					
Opening net book amount	13,320	5,090	3,098	–	21,508
Additions	–	–	1,814	–	1,814
Disposals and other movements	–	–	(2)	–	(2)
Amortisation charge	–	(404)	(1,449)	–	(1,853)
Impairment charge	–	–	–	–	–
Closing net book amount	**13,320**	**4,686**	**3,461**	**–**	**21,467**
At 31 December 2007					
Cost	13,320	6,073	22,734	2,829	44,956
Accumulated amortisation and impairment allowance	–	(1,387)	(19,273)	(2,829)	(23,489)
Net book amount	**13,320**	**4,686**	**3,461**	**–**	**21,467**
At 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**

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 nine years.

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 NMT license is currently valid for the remaining period of four 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 Czech Telecommunication Office (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. UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

Carrying value of licences of as at 31 December 2007:

In CZK million	31 December 2007	31 December 2006
GSM 900 license	619	695
GSM 1800 license	499	559
NMT 450 license	50	65
UMTS license	3,518	3,771

No borrowing costs were capitalized during the years 2007 and 2006.

Cost of fully amortised intangible assets was CZK 16,947 million as at 31 December 2007 (2006: CZK 13,569 million).

The caption Other includes brand names acquired through business combination in 2003 by the purchase of the remaining share in Eurotel Praha, spol. s r.o. 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 were 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.

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 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 2007, 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 2007.

11 Inventories

In CZK million	31 December 2007	31 December 2006
Construction material	66	81
Cables	47	28
Other inventory including goods for resale	626	642
Finished products and work in progress	4	236
Total	**743**	**987**

The inventories noted above are stated net of an allowance of CZK 89 million (2006: CZK 179 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 18 million (2006: CZK 9 million). The amount of inventories recognised as an expense is CZK 4,130 million (2006: CZK 4,197 million).

12 Receivables and prepayments

In CZK million	31 December 2007	31 December 2006
Domestic trade receivables (net)	6,782	5,937
Foreign currency trade receivables (net)	618	710
Other debtors (net)	300	873
Prepayments	666	671
Other financial assets – short-term	17	176
Derivative instruments	4	–
Total	**8,387**	**8,367**

Trade receivables are stated net of an allowance for impaired receivables of CZK 3,277 million (2006: CZK 3,345 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 26.

Trade receivables In CZK million	Carrying amount	Neither impaired nor overdue	Not impaired but overdue Less than 90 days	Not impaired but overdue Between 90 and 180 days	Not impaired but overdue Between 180 and 360 days	Not impaired but overdue More than 360 days
At 31 December 2007	8,387	4,491	321	50	–	–
At 31 December 2006	8,367	4,742	329	87	–	–

Bad debt provisions In CZK million	
Bad debt provisions at 1 January 2006	3,218
Additions	426
Retirements/amount paid	(299)
Bad debt provision at 31 December 2006	**3,345**
Additions	103
Retirements/amount paid	(171)
Bad debt provision at 31 December 2007	**3,277**

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 2007 and 2006 the Company has the following non-current balances, which are classified as other financial assets:

In CZK million	31 December 2007	31 December 2006
Long-term credits	112	156
Advance payments for long-term expenses	246	220
Other financial investment	207	–
Total	**565**	**376**

Long-term trade credits include interest bearing credit (interest 5.9%) amounting to CZK 71 million (2006: CZK 78 million).

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

Available-for-sale investments In CZK million	31 December 2007	31 December 2006
At beginning of year	56	58
Revaluation deficit	–	(2)
Additions	3	3
Disposals	(59)	(3)
At end of year	**–**	**56**
Non-current	–	–
Current	–	56
Total	**–**	**56**

Held-to-maturity investments In CZK million	31 December 2007	31 December 2006
At beginning of year	27	29
Exchange differences	–	(1)
Revaluation deficit	–	–
Additions	1	1
Matured	(1)	(2)
At end of year	**27**	**27**
Non-current	–	27
Current	27	–
Total	**27**	**27**

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

In CZK million	31 December 2007	31 December 2006	Interest rate
Cash at current bank accounts	4 076	178	Floating
Cash at cash-pooling structures	5 107	3 605	Floating
Short-term bank deposits	321	3 512	Fixed
Other cash equivalents	17	3	n/a
Total	**9,521**	**7,298**	
Financial investments (held to maturity/available-for-sale)	27	83	Fixed

As at 31 December 2007 and 2006, 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.

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 conditions are based on the arm's length principle.

At 31 December 2007, the Company had available equivalent of CZK 11,453 million (2006: CZK 8,290 million) of undrawn committed facilities.

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

In CZK million	31 December 2007	31 December 2006
Cash and cash equivalents	9,521	7,298
Bank overdrafts and other short-term borrowings (Note 16)	–	–
Balance at the end of period	**9,521**	**7,298**

The amount of CZK 3,902 million kept on bank accounts was pledged as of 31 December 2007 in respect of execution relating to the T-Mobile Interconnect dispute as described in Note 21. The market interest rate deposit conditions are applicable for the pledged amount.

15 Trade and other payables

In CZK million	31 December 2007	31 December 2006
Trade creditors in local currency (net)	4,724	4,323
Trade creditors in foreign currencies (net)	1,235	638
Other taxes and social security	516	192
Deferred revenue	1,195	2,026
Employee wages and benefits	657	554
VAT payable	154	442
Other creditors	654	70
Accruals	2,597	2,463
Total payables	**11,732**	**10,708**
Other non-current liabilities	452	805

Payables to related parties are disclosed in Note 26.

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

In CZK million	31 December 2007	31 December 2006
Bank loans in foreign currencies (a)	3,062	3,163
Bonds in local currency (b)	5,998	5,993
Total borrowings	9,060	9,156
Accrued interest including commitment fees	185	189
Derivatives	24	18
Other financial debt	209	207
Total financial debt	**9,269**	**9,363**
Repayable:		
Within one year	6,207	207
Between one and two years	–	5,993
Between two and five years	3,062	–
After five years	–	3,163
Total non-current	3,062	9,156
Total financial debt	**9,269**	**9,363**

(a) No bank overdrafts are included.

Short-term borrowings as at 31 December 2006 consisted of loans drawn under bilateral short-term facilities.

In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity date on 30 July 2012. As at 31 December 2007, the outstanding amount of the foreign currency loan amounts to EUR 115 million.

(b) 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.

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:

In CZK million	31 December 2007	31 December 2006
At fixed rate	9,060	9,156
At floating rate	–	–
Total	**9,060**	**9,156**

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 In CZK million	31 December 2007	31 December 2006
Bank loans 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 total net borrowings, EBITDA and tangible net worth) required by the creditors.

Loans are not secured.

The table below summarizes the maturity profile of the Company's financial liabilities at 31 December 2007 based on contractual undiscounted payments.

At 31 December 2007 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	–	6,413	3,875	–
Trade and other payables (excluding deferred revenue)	9,236	1,301	–	–
Other financial liabilities	3	8	–	–
Derivatives fair value	22	2	–	–
Total	**9,261**	**7,724**	**3,875**	**–**

At 31 December 2006 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	–	–	7,050	3,373
Trade and other payables (excluding deferred revenue)	8,466	216	–	–
Other financial liabilities	3	9	11	–
Derivatives fair value	11	7	–	–
Total	**8,480**	**232**	**7,061**	**3,373**

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the financial statements.

	Carrying amount		Fair value	
In CZK million	**2007**	**2006**	**2007**	**2006**
Financial assets				
Cash and cash equivalents	9,521	7,298	9,521	7,298
Financial investments (held to maturity/ available-for-sale)	27	83	27	83
Derivatives	4	–	4	–
Other financial assets	565	376	565	376

	Carrying amount		Fair value	
In CZK million	**2007**	**2006**	**2007**	**2006**
Financial liabilities				
Interest bearing loans and borrowings				
Floating rate borrowings	–	–	–	–
Fixed rate borrowings	3,148	3,248	3,348	3,557
Issued Bonds	6,097	6,097	6,049	6,135
Derivatives	24	18	24	18

Market values have been used to determine the fair value of the above mentioned issued CZK bonds. The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Financial risk analysis

The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange and interest rates.

In CZK million	Effect on profit before tax	Effect on equity
FX risk		
Value at Risk*	(95)	n/a
Stress testing*	(26)	(20)
IR risk		
Stress testing*	(176)	–

* The Value at Risk (VaR) Model enables the Company estimate the probability of maximum possible loss to the portfolio value in the given time frame which will not be exceeded given the defined reliability level. For conducting a VaR calculation, the Company uses the risk variance and covariance method using the normal distribution (e.g. parametric method). The time frame used is one month with a 95% reliability rate. Considering the importance of net open positions resulting from financial assets and financial liabilities of the Company in individual foreign currencies, the Company models VaR from a position of translation and transaction in EUR and USD.

FX risk used stress scenario represents immediate one-off change in the foreign exchange rates vs. CZK by 1% in a negative direction (in the case of short open foreign currency position, this will result in a depreciation of the foreign exchange rate and vice versa).

IR risk used stress scenario represents immediate one-off change of interest rates along the whole yield curve by 1% in an unfavorable direction. The calculation of unfavorable impact on Company cash flows (due to an increase in interest expense or drop in interest received relating to financial assets and financial liabilities) is made each month on the floating basis within a time frame of 12 months.

Hedging

The following nominal value of foreign exchange forwards was used by the Company to hedge the EUR/CZK risk:

	Nominal value In EUR million		Fair value In CZK million	
	2007	**2006**	**2007**	**2006**
Forward exchange contracts	36	36	(20)	(18)

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.

Short-term deferred taxes were calculated at 21% and long-term deferred taxes were calculated at 20% and 19% depending on the period of its expected realisation (24% in 2006).

In CZK million	2007	2006
At 1 January	4,494	5,423
Income statement tax credit (Note 5)	(1,141)	(928)
Tax on fair value gains	–	(1)
At 31 December	3,353	4,494

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:

In CZK million	31 December 2007	31 December 2006
Deferred tax assets	(1,143)	(1,483)
Deferred tax liabilities	4,496	5,977
Total	**3,353**	**4,494**

The deferred tax asset includes CZK 655 million (2006: CZK 444 million) recoverable in less than twelve months and CZK 488 million (2006: CZK 1,039 million) recoverable after more than twelve months. The deferred tax liability includes CZK 584 million (2006: CZK 723 million) payable in less than twelve months and CZK 3,912 million (2006: CZK 5,254 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Balance sheet		Income statement	
In CZK million	**2007**	**2006**	**2007**	**2006**
Amount relating to the origination and reversal of temporary differences from:				
– property, plant and equipment and intangible assets	4,496	5,977	(574)	(1,026)
– trade receivables, inventories and other differences	(1,139)	(1,479)	231	98
Revaluations of cash flow hedges	(4)	(4)	–	–
Amount relating to changes in tax rates	–	–	(798)	–
Total	**3,353**	**4,494**	**(1,141)**	**(928)**

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

In CZK million	2007	2006
Revaluation of cash flow hedges	–	(1)
Total	**–**	**(1)**

Reduction of the corporate income tax rate resulted in a positive impact on deferred tax liability of CZK 798 million in 2007.

18 Government social security and pension schemes

The Company is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2007 and 2006, 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 1,612 million in 2007 (2006: CZK 1,630 million). Employees contribute 12.5% (2006: 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 58 million (2006: CZK 53 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 2007 relating to employee retirement amounted to CZK 0.2 million (2006: 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

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee-Related costs	Benefit loyalty provision	Other	Total
At 1 January 2007	1,973	19	255	564	61	2,872
Additions during the year	164	81	292	599	4	1,140
Utilised during the year	(27)	(97)	(249)	(536)	(56)	(965)
At 31 December 2007	**2,110**	**3**	**298**	**627**	**9**	**3,047**
Short-term Provisions 2007	–	3	262	627	9	901
Long-term Provisions 2007	2,110	–	36	–	–	2,146
Short-term Provisions 2006	14	19	183	564	55	835
Long-term Provisions 2006	1,959	–	72	–	6	2,037
At 31 December 2006	**1,973**	**19**	**255**	**564**	**61**	**2,872**

With the exception of the regulatory and court decisions, benefit loyalty provision 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 347 million (2006: CZK 290 million) within one year and CZK 280 million (2006: CZK 274 million) from one year up to three years.

The future obligation of the expenditures expected to be required amounting to CZK 657 million (2006: CZK 580 million) is fully covered by the amount of the provision in its present value.

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:

Forward foreign exchange contracts In CZK million	31 December 2007	31 December 2006
Cash flow hedges		
– with positive fair value	4	–
– with negative fair value	(24)	(18)
Total (Note 16)	**(20)**	**(18)**

21 Contingencies

The Company is involved in several court proceedings which have arisen from the ordinary course of business. Significant legal matters involving the Company are listed below:

Legal proceedings

I. The Company has not yet agreed a 2001 price amendment to an agreement with T-Mobile Czech Republic a.s. governing interconnect arrangements. Despite the fact that in December 2003 the Czech Telecommunication Office (CTO) effectively ruled in favor 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 has subsequently brought a legal action against the decision and obtained the suspension of the executability of the decision. Based on the legal environment in the Czech Republic, the 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.

Meanwhile the question of jurisdiction between the civil courts and the administrative courts has arisen. As a result of this the case is now before the special panel of judges, which shall decide which court has the authority to decide the dispute. The question of jurisdiction also caused the temporary expiration of the suspension of the executability of the CTO decision. T-Mobile Czech Republic initiated the execution and seeks the remuneration of the litigable amount (see Note 8 and 14). The Company does not agree with the execution and uses all its legal instruments to the termination of the execution. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

II. On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) brought a legal action 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.

Court issued the decision which was delivered in January 2008 that the proceeding is terminated with reference to the lack of authority and delegated the case to the CTO. This decision will be the matter of the appeal proceeding at the High court in Prague though. The management is confident that all risks, which may arise as a result of the litigation, are adequately provided for in the financial statements.

Office for the Protection of Economic Competition proceedings

The Company was subject to administrative proceeding before the Office for the Protection of Economic Competition (UOHS) relating to the alleged abuse of the dominant position by 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 a legal action in January 2006 and while the suspension of the executability was not granted the fine was paid. The Regional court in Brno refused the legal action and therefore the Company lodged a cassation complaint to the Supreme Administrative Court on 19 October 2006.

Other legal matters

I. The Company is a defendant in a case filed by TELE 2 s.r.o. on 3 February 2005 asserting causes for alleged breach of act on protection of the competition by the Company in connection by offering certain pricing plans from September 2002 to December 2004. The amount of the claim is CZK 2,142 million with appurtenances.

The Company provided to the court extensive defense 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.

As a consequence of the sale of the TELE 2´s enterprise there currently takes place an appeal proceeding, in which the question of succession is dealt with.

II. 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 (totaling approximately additional CZK 257 million as of the end of 2007) 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 (total cca CZK 139 million). Both parties subsequently filed an extraordinary appeal against the court judgment. 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.

III. 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 act on protection of the competition by former Eurotel (damages amounting to CZK 1,043 million). Both parties filed their expert opinions to the court. The management believes that all risks, which may arise as a result of Vodafone litigations, are adequately provided for in the financial statements. Decision of the Office for the Protection of Economic Competition (UOHS) on which Vodafone based its claim was on 11 July 2007 cancelled by the Constitutional court. 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. The total amount of those individual cases exceeding CZK 5 million amounts to CZK 135 million. The management believes that the risk of losing 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:

In CZK million	31 December 2007	31 December 2006
No later than 1 year	1,196	1,026
Later than 1 year and not later than 5 years	3,809	3,052
Later than 5 years	2,976	2,431
Total	**7,981**	**6,509**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2007 were CZK 1,112 million (2006: CZK 1,102 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 2007 were CZK 458 million (2006: CZK 368 million).

Capital commitments In CZK million	31 December 2007	31 December 2006
Capital expenditure contracted but not provided for in the financial statements	1,671	622

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

23 Service concession arrangements

The Company performs communication activities as defined under the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunication Office num. 516 as amended by later changes num. 516/1, 516/2 and 516/3.

The communication activities include (territory of the Czech Republic):

a public fixed network of electronic communications,
b public mobile network of electronic communications,
c public network for the transfer of radio and TV signal,
d public fixed telephone network,
e public mobile telephone network,
f publicly accessible telephone services,
g other voice services – service is provided as publicly available,
h rent of circuits – service is provided as publicly available,
i transmission of radio and TV signal – service is provided as publicly available,
j transfers of data – service is provided as publicly available,
k internet access services – service is provided as publicly available,
l other voice services – service is not provided as publicly available,
m rent of circuits – service is not provided as publicly available,
n transmission of radio and TV signal – service is not provided as publicly available,
o transfers of data – service is not provided as publicly available,
p internet access services – service is not provided as publicly available.

The Company provides mobile services of electronic communications in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (GSM) standard on the basis of radio frequency assignment from CTO valid until 7 February 2016, in the 2100 MHz frequency band under the Universal Mobile Telecommunications System (UMTS) standard on the basis of radio frequency assignment from CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access – CDMA), where on the basis of radio frequency assignment from CTO valid until 7 February 2011 is provided broadband mobile access to Internet.

Validity of radio frequency assignment is possible to prolong for next period on the basis of application submitted to CTO in accordance with the Act on Electronic Communications. 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 radio frequency assignments in the future.

No additional expenses or any limitations connected with renewal of the radio frequency assignments are expected in accordance with the existing interpretation of regulatory provisions.

Imposition of obligations related to provision of universal service

During the whole year 2007, the Company provided the partial services within CTO imposed obligations to provide universal service:

a periodic issuance of telephone directories with numbers of participants of the publicly accessible telephone service and access of end users to these directories,

b information service on the numbers of participants of the publicly accessible telephone service,

c public pay telephones services,

d access for disabled to the public telephone,

e supplementary services to 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:

- phased payment of the price for the establishment of connection to the public telephone network for consumer,
- free selective barring of outgoing calls for the subscribers, and
- free itemised billing of the price for consumer,

f special price schemes, which are different from the price schemes used under normal business conditions, for low income persons, persons with special social needs and disabled persons.

24 Share capital and reserves

	31 December 2007	31 December 2006
Nominal value per ordinary bearer share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares (in CZK million)	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.

Shareholdings in the Company were as follows:

	31 December 2007	31 December 2006
Telefónica, S.A.	69.4%	69.4%
Other shareholders	30.6%	30.6%

Funds include a statutory reserve fund of CZK 6,443 million (2006: CZK 6,261 million) that is not distributable under ruling legislation.

Capital management

The Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing its capital are:

a to safeguard the Company's ability to continue as a going concern so that it can provide value for its shareholders, and
b to comply with all relevant legal requirements.

The investment strategy in the light of managing capital of the Company is to focus investment activities on pro-growth areas, i.e. broadband internet, IPTV, mobile services and corporate ICT solutions and the launch of mobile services in Slovakia.

At present, the approach that the Company follows is not to retain surplus cash. In the following periods, the Board of Directors will continue to evaluate and carry out an in-depth analysis of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation and will establish the most adequate capital structure for accomplishment of the plans.

There is no other specific objective.

No changes were made in the objectives, policies or processes during the years 2007 and 2006.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2007	31 December 2006
Capital	84,445	88,633
Net unrealized gains reserve (cash flow hedge)	(20)	(18)
Total equity	**84,425**	**88,615**

25 Hedging reserve

In CZK million	
Balance at 1 January 2006	(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)**
Fair value losses in period	(17)
Fair value losses transfer to net profit	15
Balance at 31 December 2007	**(20)**

26 Related party transactions

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 was incurred.

The following transactions were carried out with related parties:

I. Parent company:

In CZK million	31 December 2007	31 December 2006
a) Dividend paid Telefónica, S.A.	11,179	10,061

II. Other related parties – Telefónica Group:

In CZK million	31 December 2007	31 December 2006
a) Sales of services and goods	982	597
b) Purchases of services and goods	817	564
c) Capital purchases	1	18
d) Receivables	159	195
e) Payables	1,001	117
f) Short-term receivables (interest)	17	10
g) Interest income	330	18
h) Cash equivalents	5,107	3,605

The list of the Telefónica companies with which the Company had any transaction in 2007 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 Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Manx Telecom Ltd., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A, Telefónica Móviles Columbia, S.A., Telefónica S. de Informática y Comunicaciones de Espana, S.A.U., Telefónica Investigación y Desrrollo, S.A., Médi Telecom, S.A., 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., 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., in liquidation.

III. 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:

In CZK million	31 December 2007	31 December 2006
Salaries and other short-term benefits	153	86
Personal indemnification insurance	9	12
Total	**162**	**98**

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2007 and 2006.

No other loan was provided to related parties by the Company.

27 Principal subsidiary undertakings

Subsidiary	Company's interest	Cost of investment In CZK million	Country of incorporation	Activity
1. Telefónica O2 Services, spol. s r.o.	100%	30	Czech Republic	Network and consultancy services in telecommunications
2. SPT TELECOM Finance B.V.	100%	1	Netherlands	Financing other entities in the Company
3. CZECH TELECOM Germany GmbH	100%	29	Germany	Data transmission services
4. CZECH TELECOM Austria GmbH	100%	11	Austria	Data transmission services
5. Telefónica O2 Slovakia, s.r.o.	100%	1,219	Slovakia	Mobile telephony, internet and data transmission services
6. CenTrade, a.s., v likvidaci	100%	–	Czech Republic	E-business company providing market place services
Associate				
7. První certifikační autorita, a.s.	23%	10	Czech Republic	Rendering of certification services
8. AUGUSTUS spol. s r.o.	40%	–	Czech Republic	Sales by auctions and advisory services

As of 1 January 2007, CenTrade, a.s., in liquidation commenced the process of voluntary liquidation. During 2007, the Company increased its investment and paid in capital which would aim to the smooth liquidation process. The liquidation process was effectively terminated on 30 November 2007 resulting in a liquidation surplus of CZK 32 million received by the Company. At the beginning of January 2008, the liquidator submitted a proposal of registration of the termination of the Company liquidation and cancellation of the registration from the Commercial Register.

During the fourth quarter 2007, SPT TELECOM Finance B.V. commenced preparatory steps for the process of voluntary liquidation. The process is still in progress and will probably be finalised during next year.

28 Post balance sheet events

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 2007.

07 INFORMATION ON THE LISTED SECURITY ISSUER

M 13 in the constellation of Hercules is the most conspicuous globular cluster. The cluster is formed by hundreds of thousands of stars, and its intensity equals that of three hundred thousands of Suns. In 1974, the cluster was selected as target of the coded radio message, one of humankind's first attempts to contact extraterrestrial civilisations. The project is however rather symbolic as the signal will reach the M 13 globular cluster in no less than 25,000 years.

Information on the listed security issuer

Note: This section of the Annual Report contains information for the year 2007 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:	Za Brumlovkou 266/2, 140 22 Praha 4
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 issuer 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

Effective from 1 August 2007, the registered address of Telefónica O2 changed from formerly Olšanská 5/55, Praha 3, 130 34 to Za Brumlovkou 266/2, Praha 4, Michle, 140 22.

Details on the Company's dependency on patents or licenses, industrial, commercial or financial contracts which have a significant bearing on the Company's business

1) Patents and licenses

Company has licence agreements for the following software products: application middleware (BEA), database environment (Oracle), operating systems (Hewlett--Packard, SUN and Microsoft), workstation software (Microsoft), CRM using Siebel SW (Oracle), customer care and billing software (Amdocs and LHS) and enterprise resource planning software (SAP).

2) Industrial and commercial contracts

The Company maintains a diverse portfolio of technology suppliers. The main objective of the issuer 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 issuer are IBM Česká republika, Alcatel Czech, AutoCont CZ, Vegacom, Siemens, Accenture Central Europe B.V., DNS, NextiraOne Czech, Amdocs Development Limited, LHS, Hewlett--Packard and Huawei Technologies Co.

3) Financial contracts

See Section Financial debts which forms a part of the Financial Statements for the year ended 31 December 2006 on page 202 of the Annual Report.

Investments

Main investments made by Telefónica O2 in the last two accounting periods (in CZK million):

	2007	2006
Network & Operations	3,497	4,363
Customer Solutions	524	347
IT and Products	1,506	1,313
Real Estate & Logistics	522	134
Point of Sale Redesign & Re-branding	193	69
Investments related to Telefónica O2 Slovakia made in the Czech Republic	344	93
Total	**6,586**	**6,319**

All major investments were made in the Czech Republic and were financed from own capital and from borrowings.

In 2007, the Company continued to implement the standard investment policy, which clearly favours the development of progressive, customer-oriented technologies and emphasises the internal integration of the Company. The structure of investment expenditure reflected the existing customer demands for new trends in telecommunications services with a high standard of execution, and the efforts to complete the integration process and strengthen the primacy of the converged operator. The focus on greater customer orientation was reflected in the more than 50% higher volume of investment in the customer solutions segment, with two major projects of hosting centres. In the area of data services, the focus was on improving the quality of the service portfolio and on customer experience, in particular with regard to the leadership in the market of converged services. The attention paid to the integration process was manifested in the increased investment in the information systems; customer experience was the common motto of all investment activities. The trend was also apparent in investments related to the integration of the Company's points of sale. The new headquarters also played a major role in the cultural alignment process.

The successful entry to the Slovak telecommunications market and the need to exploit synergies of having existing technical capacity in the Czech Republic initiated an investment amounting to 5% of all CAPEX. 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 issuer in the last two accounting periods

in CZK million	2007	2006
Financial investments	1,426	40

Financial investments amounting to CZK 1,426 million in 2007 represent an increase of equity in Telefónica O2 Slovakia, s.r.o., and the acquisition cost of a 100% stake in DELTAX Systems a.s., including all acquisition-related costs.

Principal future investments

In the period 2008–2010, the Company will continue to implement the standard investment policy for the telecommunications sector, which favours performance increases and the implementation of progressive technologies and customer approaches, aimed at achieving the key strategic goal – to confirm the leadership on the Czech telecommunications market and to increase the market share on the Slovak telecommunications market. 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.

Employees

(as at 31 December)

Organisation unit	**2007**	**2006**
Business Customers Division	1,065	1,083
Residential Customers Division	2,403	2,453
Operations	4,077	4,459
Wholesale	48	49
Regulation and Interconnect	29	22
Strategy and Product Development	116	114
Human Resources and Support Services	424	483
Finance	425	466
Transformation and Convergence	–	52
Legal Affairs	38	38
Internal Audit and Risk Management	19	20
Public Affairs	33	23
CEO Office	4	3
Branding & Customer Experience	14	–
Total	**8,695**	**9,265**

Financial debts

Financial debts broken down to short and long term:

in CZK million	**As at 31 December 2007**
Short-term (maturing within 1 year)	6,207
Long-term	3,062
Total	**9,269**

Loans and bonds issued:

	Currency	**Total loan in the currency**	**Outstanding in the currency as at 31 December 2007**	**Outstanding in CZK as at 31 December 2007**	**Redemption**
Private Placement – debt instrument	EUR	115,040,673	115,040,673	3,062,382,722	2012
Bond issue (Dluhopisy 3,50% / 2008)[1]	CZK	6,000,000,000	5,992,483,042	5,997,415,930	2008
	EUR	145,273,206	–	–	2008
Syndicated loan[2]	CZK	3,360,000,000	–	–	
Other financial debt				209,119,433	

EUR/CZK exchange used in the table for conversion purposes (as at 31 December 2007) is CZK 26.620/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 2007, Telefónica O2 had no overdue loan obligations.

Commercial undertakings in which the Company directly owns more than 10% of the registered/share capital

(as at 31 December 2007)

Corporate name	Registered address	Object	Identification number	Registered/share capital	Share of the issuer in the registered/share capital in %
COMPANIES INCORPORATED IN THE CZECH REPUBLIC					
AUGUSTUS spol. s r.o.	Prague 10 Na zájezdu 5, 100 00	Consulting and brokerage activity in non--telecommunication disciplines	49356160	CZK 166,000	39.76%
CenTrade, a.s. v likvidaci	Prague 3 Olšanská 55/5, 130 00	E-business and electronic marketplace services	26513731	CZK 42,000,000	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 Kodaňská 1392/97, 101 00	Data services and telecommunications consulting	45797111	CZK 10,000,000	100%
DELTAX Systems a.s.	Prague 7 Jankovcova 1569/2c, 170 00	Services in the field of management systems, information systems and information technology	49241451	CZK 3,006,000	100%
COMPANIES INCORPORATED IN OTHER COUNTRIES					
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.	Viedenská cesta 5, Bratislava, 851 01, Slovakia	Operation of a public telecommunications network; provision of a public telecommunications service and the service of leased lines	35848863	SKK 1,500,000,000	100%

Changes in 2007

After the process of liquidation of CenTrade, a.s. v likvidaci, Telefónica O2, being the sole shareholder, approved on 30 November 2007 the Liquidator's Report form the process of liquidation, which contained also a proposal for the distribution of the remaining assets. After the remaining assets were distributed, the liquidator applied for deletion of the company from the Commercial Register; the company was deleted in 2008.

Acting on resolution of the Board of Directors of Telefónica O2 from 10 September 2007, Telefónica O2 signed an agreement on purchase of 100% shares of DELTAX Systems a.s. The transaction came into effect in December 2007.

Based on the decision of Telefónica O2, the sole member in Telefónica O2 Slovakia, the share capital of Telefónica O2 Slovakia was increased to SKK 1,500,000,000 (formerly SKK 200,000), effective from 24 September 2007. Effective from 10 November 2007, the corporate name of the company was changed to Telefónica O2 Slovakia, s.r.o. (formerly Telefónica O2 Slovakia s.r.o.).

Based on a resolution by the Board of Directors of Telefónica O2 from 17 July 2007, the process of liquidation of SPT TELECOM (Czech Republic) Finance B.V., commenced in the fourth quarter. The process is presently underway and its finish is projected some time in 2008.

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	143,721	–	5,254
– due to membership in the Board of Directors	1,842	–	3,501
Supervisory Board total	18,306	–	6,056
– due to membership in the Supervisory Board	6,822	–	5,691
Management[1]	31,904	–	975

[1] The Management category includes income of managers whose positions are included in the Executive Management of Telefónica O2 sub-section in section 7.6. of the Annual Report. 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 2007, 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	–
Supervisory Board	250
Management[1]	440

[1] The Management category includes income of managers whose positions are included in the Executive Management of Telefónica O2 sub-section in section 7.6. of the Annual Report. 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.

Principles of remuneration of executive managers of the issuer 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 held on 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 26 April 2007. The same aggregate amount is applicable also to 2008 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. These targets represent the key performance indicators of both financial and non-financial nature (e.g. reaching the projected operating profit, reaching the revenues targets, higher customer satisfaction). The performance against these targets is evaluated by the Board of Directors and discussed by the Nomination and Remuneration Committee; the audited financial results and, in the case of customer experience, independent (external) surveys form the basis for the discussion. The performance-related bonus may, in aggregate for the calendar year, reach 44% of the total annual income 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).

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), unless such business is done in another member of the Group. 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 persons who in 2007 were 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 Telefónica O2 Czech Republic Supervisory Board (Rules) which were amended by the Extraordinary General Meeting held on 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 2007 could total a maximum (for the whole Supervisory Board) of CZK 8.5 million, an amount approved by the Ordinary General Meeting held on 26 April 2007. The same aggregate amount is applicable also to 2008 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), unless such business is done in another member of the Group. 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:

- 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 persons who in 2007 were 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 held on 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, and
  – the total number of Supervisory Board members, and it is multiplied by two.
- 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 2007.

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.

4. **Other persons in the management** (titled as Executive Management or Management in the Annual Report)

Remuneration to which persons in the Company's management (not applicable to members of the Board of Directors and to the Chief Executive Officer) are also entitled consists of two components. The components comprise the basic gross salary on the one hand, and a performance-related bonus which is granted upon meeting annual targets, on the other. The method of target setting, as well as performance evaluation and control are governed by the same rules and procedures as for the Chief Executive Officer. The performance-related bonus may, in aggregate for the calendar year, reach 33% of the total annual income, if the targets are reached to a standard level. The evaluation of performance of these persons also comprises personal review by the Chief Executive Officer.

Information on work contracts and similar contracts concluded between members of the Board of Directors and of the Supervisory Board with the Company

In 2007, all members of the Board of Directors and of the Supervisory Board (except replacement members Vivek Dev and Maria Pilar López Álvarez who were appointed (co-opted) as members of the Supervisory Board in the second half of 2007), had a valid agreement for discharge of the office of a member, which stipulates the eligibility to compensation for members who had committed to the non--competition covenant after the termination of their office.

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 2007:

Type of service	Fees (in CZK thousands)
Audit	18,400
Other audit-related advisory services	–
Other services	–
Total	**18,400**

Costs incurred by Telefónica O2 Group in connection with activities of Ernst & Young, the external auditor, in 2007:

Type of service	Fees (in CZK thousands)
Audit	21,650
Other audit-related advisory services	–
Other services	–
Total	**21,650**

Information on persons responsible for the Annual Report and for verification of the financial statements

Salvador Anglada Gonzalez, Chairman of the Board of Directors and Chief Executive Officer of Telefónica O2 Czech Republic, a.s.

Ramón Ros Bigeriego, 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 registered security issuer were omitted.

Salvador Anglada Gonzalez
Chairman of the Board of Directors and Chief Executive Officer

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

08 INFORMATION FOR SHAREHOLDERS

The constellation Aquila lies in the Milky Way – a clearly visible star field across the night sky. An observer from the Earth would often not realise that the Milky Way is in fact the arms of a gigantic spiral galaxy which is our home. If we sent the fastest courier – the ray of light – through the Milky Way, it would take 100 thousand years to travel across.

Information for shareholders

The main shareholders of Telefónica O2 Czech Republic, a.s.

(as at 31 December 2007)

	Shareholder	Address	% of share capital
1	Telefónica, S.A.	Gran Vía 28, 28013 Madrid, the Kingdom of Spain	69.41%
2	Investment funds and individual shareholders	–	30.59%

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 69.41% 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 69.41%.

Shares

(as at 31 December 2007)

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 security issuer.

Bonds

(as at 31 December 2007)

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:	CZ 0003501355
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
Issuer'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 security issuer. The agreement with the administrator is available at the above address of the administrator.

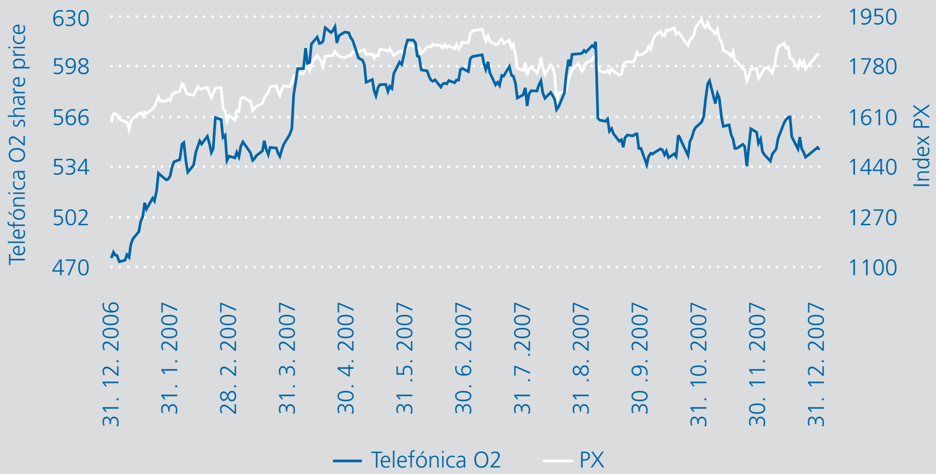
	2007	2006
Number of shares (in millions)	322.1	322.1
Net profit/(loss) per share (in CZK)[1]	36.9	25.8
Highest share price (in CZK)[2]	622.8	547.6
Lowest share price (in CZK)[2]	473.7	417.2
Share price at the end of period (in CZK)[2]	544.8	476.0
Market capitalisation (in CZK billions)[2]	175.5	153.3

1 Unconsolidated net profit under IFRS.
2 Source: Prague Stock Exchange.

In 2007, 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 2007 was CZK 101.8 billion compared to CZK 98.7 billion in 2006. Trading in Telefónica O2 Czech Republic shares, as measured by the total volume of shares, made up 10% of all trades on the PSE stock market. Telefónica O2 shares were the fifth most traded issue on the PSE in 2007, after ČEZ, Komerční banka, Zentiva and Erste Bank. The average daily volume of trades in company shares in 2007 was CZK 407.03 million.

As at 28 December 2007 (the last trading day on the PSE in 2007), the market capitalisation reached CZK 175.5 billion, ranking Telefónica O2 the third on the PSE stock market. The share price of Telefónica O2 on the last PSE trading day in 2007 reached CZK 544.8. The share price reached its maximum of CZK 622.80 on 25 April 2007, and its minimum of CZK 473.7 on 5 January 2007. The average share price in 2007 was CZK 564.9, compared to CZK 485.91 in 2006.

Development of Telefónica O2 share price and PX index in 2007



Dividend

The company did not pay any dividend in 2005.

At the Ordinary General Meeting held on 27 April 2006 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.

At the Ordinary General Meeting held on 27 April 2007 in Prague, the shareholders approved a dividend payment from the 2006 net profit and part of the retained earnings from previous years, in the total amount of CZK 16.104 billion, i.e. CZK 50 per share of nominal value of CZK 100 and CZK 500 per share of nominal value CZK 1,000, before tax. The record day for the payment of dividends was 10 September 2007 and the disbursement date 3 October 2007.

Dividend policy

The Company does not have any official long-term dividend policy at present. The Company has indicated several times that it did not intend to retain surplus cash. In the following periods, the Board of Directors will make annual proposals for the payment of dividend, based on a diligent analysis of the current and future performance of the Company, including the projected future cash flows and investments, development costs and acquisitions. This approach is in line with the investment strategy of directing investment into pro-growth areas, such as high-speed internet access, mobile services, ICT solutions for the corporate segment and the development of the mobile operation in Slovakia.

General Meeting

The Ordinary General Meeting of shareholders of Telefónica O2 will be held on 21 April 2008 in Prague.

Financial calendar

Dates of release of the current financial results

For the first quarter of 2008	21 April 2008
For the first half of 2008	24 July 2008*
For three quarters of 2008	23 October 2008*
For the year 2008	28 February 2009 at the latest

* Tentative date

Institutional investors and shareholders may contact

Investor Relations

Tel.: +420 271 462 076, +420 271 482 472

Fax: +420 271 463 566

E-mail: investor.relations@o2.com

URL: http://www.cz.o2.com/home/cz/aboutUs/investorRelations/index.html

Address: Telefónica O2 Czech Republic, a.s.
Za Brumlovkou 266/2
140 22 Prague 4

09 GLOSSARY OF TERMS AND ACRONYMS

The nebula NGC 6992 reminds us of a supernova explosion that took place several thousand years ago in the Cygnus constellation. The star's death, however, does not just bring about destruction. The matter propelled into space by the explosion becomes the foundation for new stars. We also owe our life to supernovas, which are the main, often the only source of all chemical elements heavier than oxygen. Indeed, the calcium in our bones or iron in haemoglobin in our blood was created in explosions of supernovas somewhere in deep space, billions of years ago.

Glossary of terms and acronyms

ADSL Asymmetric Digital Subscriber Line

ARPU an indicator – average monthly revenues from services per user, excluding roaming visitors

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

EDGE Enhanced Data Rates for GSM Evolution, a mobile digital technology with a faster and more reliable data transmission

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

ICT information and communication technology

IFRS International Financial Reporting Standards

IPTV Internet Protocol Television

IP VPN Internet Protocol Virtual Private Network, a service of intra-corporate data or voice over IP communication

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

O_2 Business new postpaid tariffs for business customers of Telefónica O2

O_2 Duo a converged service of Telefónica O2 combining unlimited free calls to fixed networks in the Czech Republic and O_2 Internet ADSL, or O2 TV, for one monthly fee

O_2 Duo Mobil a converged service of Telefónica O2 combining O2 Internet ADSL and a mobile voice tariff in one monthly fee, which already includes the fixed line rental fee

O_2 Eurotarif a mobile tariff of Telefónica O2, which was created to accommodate the requirements of the European Commission in the area of roaming charges in the European Union

O_2 Internet ADSL a high-speed internet service of Telefónica O2, formerly branded as O_2 Internet Expres

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 Moje firma an integrated solution by Telefónica O2, with economical rates on intra-company communication; for a fixed fee, the service offer unlimited calls between two to five O2 mobile numbers registered to one company

O_2 karta a SIM card with prepaid credit from Telefónica O2

O_2 Simple mobile tariffs of Telefónica O2, which let the customer choose the billed amount according to their anticipated need for mobile communication

O_2 Smart Roaming a special roaming tariff, with up to 82% cheaper calls from fourteen holiday destinations (the so-called O2 Smart zone) compared to the regular roaming prices

O_2 Smart zóna fourteen popular holiday destinations where special roaming prices offered as part of O2 Smart Roaming apply: Croatia, Slovakia, France, Italy, Spain, Cyprus, Malta, Bulgaria, Greece, Egypt, Tunisia, Turkey, Malaysia and Thailand

O_2 Trio a converged service of Telefónica O2 combining O_2 Internet ADSL, O_2 TV and unlimited calls to fixed networks in the Czech republic, all for one monthly fee

O_2 TV an IPTV service of Telefónica O2; digital television over a fixed line

OIBDA Operating Income before Depreciation and Amortisation

TCTV 112 an emergency call centre for the 112 emergency number

UMTS Universal Mobile Telecommunications System; a standard for the so-called 3rd generation mobile networks

VoIP Voice over Internet Protocol

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

10 APPENDIX

Draco constellation is the home of one of the better-researched planetary nebulae NGC 6543 with a poetic name of Cat's Eye. Planetary nebula is a term for a terminal stage in the life of small and medium-sized stars. In the middle of the Cat's Eye, we find a star that is ten thousand times brighter than our Sun; every second the star sheds 20 billion of its mass in the form of hot gasses, which form a cloud with the temperature of up to 15,000°C, expanding at the speed of 2,000 km/s.

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 2007 (pursuant to provisions of Section 66a of Act No. 513/1991 Coll., the Commercial Code, as amended)

Table of Contents

Schedules

No. 1 List of companies controlled by Telefónica S.A., with a share interest of the Telefónica Group of 40–100% in the period from 1 January 2007 to 31 December 2007;

No. 2 List of companies controlled by Telefónica O2 Czech Republic, a.s. with a share interest of the Telefónica Group of 40–100% in the period from 1 January 2007 to 31 December 2007;

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 2007 and ended on 31 December 2007.

Part B – Entities forming the holding

Section I. – Identification details of the controlled entity – Telefónica O2 Czech Republic, a.s. (hereinafter referred to as "Company")

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: Za Brumlovkou 266/2, 140 22 Prague 4 – Michle
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 2007:

With effect from 1 August 2007, the registered office of the Company changed from the previous registered address at Prague 3, Olšanská 55/5, post code 130 34 to the new registered address at Prague 4, Michle, Za Brumlovkou 266/2, post code 140 22.

After the termination of the liquidation process of CenTrade, a.s., the Company's Board of Directors – discharging the office of the sole shareholder – approved on 30 November 2007 the liquidator's report on the liquidation process containing a proposal to distribute the liquidation balance. After distribution of the liquidation balance, the liquidator filed a proposal to cancel the registration of the firm in the commercial register.

Based on the resolution of the Company's Board of Directors dated 10 September 2007, the Company concluded Purchase Agreement of 100% shares of DELTAX Systems a.s. The transaction came into effect in December 2007.

Based on the resolution of the Company Board of Directors dated 17 July 2007 adopted by virtue of the exercise of rights of the sole member, Q 4 2007 saw start of the liquidation process of SPT TELECOM (Czech Republic) Finance, B.V. This process continues; the process termination is expected in the course of 2008.

Section II. – Identification details of the controlling entity

Controlling entity:	**Telefónica S.A.**
Registered address:	Gran Vía, 28, 28013 Madrid, Spanish Kingdom
Identification number:	A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 69.41% of the registered 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 Telefónica S.A.:

(a) The list of entities controlled by Telefónica S.A. forms 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 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 and counter-performance provided thereunder

In the applicable period, contracts for the provision of services were concluded with the controlling entity and with interconnected entities.

The contracts were concluded with Telefónica S.A., the controlling entity, and with Telefónica de España, S.A.U., Telefónica O2 Services, spol. s r.o., O2 Germany GmbH, CZECH TELECOM Austria GmbH, CZECH TELECOM Germany GmbH, Telefónica International Wholesale Services, S.A., CenTrade, a.s. v likvidaci, Telefónica Investigación y Desarollo, S.A., 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 2007 between the controlled entity and controlling entity and between 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 2007 under contracts and agreements concluded prior to 1 January 2007. Performance provided in 2007 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 2007

In accounting period 2007, 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 2007

In accounting period 2007, 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 18 March 2008.

(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 2007 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 18 March 2008

Telefónica O2 Czech Republic, a.s. – controlled entity

Board of Directors

Salvador Anglada Gonzalez
Chairman of the Board of Directors

Jakub Chytil
Member of the Board of Directors

Schedule No. 1

List of companies controlled by Telefónica S.A. With a ownership interest of the Telefónica group of 40–100% In the period of 1 january 2007 until 31 december 2007

Telefónica Group

	Telefónica, S.A. in %
Telefónica de España	100
Telefónica Móviles	100
Telefónica Latinoamérica	100
Telefónica de Contenidos	100
Grupo Atento	91.35
Telefónica O2 Europe	100

Telefónica de España Group

Telyco	100
Telefónica Telecomunic. Públicas	100
Telefónica Soluciones Sectoriales	100
Telefónica de Informatica y Comunicaciones de España	100

Telefónica O2 Europe

O2 UK	100
O2 Germany	100
O2 Ireland	100
Manx	100
Be	100
Telefónica O2 Czech Republic	69.41

Telefónica Latinoamérica Group

Telesp	87.95
Telefónica del Perú	98.18
Telefónica de Argentina	98.03
TLD Puerto Rico	98
Telefónica Chile	44.89
Telefónica Telecom	52.03
Telefónica USA	100
T. Intem. Wholesale Serv. (TIWS)	100
Terra Networks Perú	99.99
Terra Networks México	99.99
Terra Networks USA	100
Terra Networks Guatemala	100
Terra Networks Venezuela	100
Terra Networks Brasil	100
Terra Networks Argentina	99.99
Terra Networks Chile	100
Terra Networks Colombia	99.99
Telefónica Data Argentina	97.92

Telefónica Móviles Group

Telefónica Móviles España	100
Brasilcel	50
Telefónica Móviles Argentina	100
Telefónica Móviles Perú	98.53
Telefónica Móviles México	100
TM Chile	100
Telefónica Móviles El Salvador	99.08
Telefónica Móviles Guatemala	100
Telcel (Venezuela)	100
Telefónica Móviles Colombia	100
Otecel (Ecuador)	100
Telefónica Móviles Panamá	99.99
Telefónica Móviles Uruguay	100
Telefónía Celular Nicaragua	100
Telefónica Móviles Chile	100
Group 3G	57.20
IPSE 2000	45.59
3G Mobile AG	100
Mobipay Internacional	50
Telefónica Móviles Soluciones y Aplicac. (Chile)	100
Tempos 21	43.69

Atento Group

Atento Teleservicios España	100
Atento Brasil	100
Atento Argentina	100
Atento de Guatemala	100
Atento Mexicana	100
Woknal (Uruguay)	100
Centro de Contacto Salta	100
Mar de Plata Gest y Contactos	100
Atento Perú	99.46
Atento Chile	77.95
Atento Maroc	100
Atento El Salvador	100

Telefónica de contenidos Group

Telefé	100
Endemol	99.7
Telefónica Servicios de Música	100
Telefónica Servicios Audiovisuales	100

Schedule No. 2

List of companies controlled by Telefónica O2 Czech Republic, a.s. with a ownership interest of the Telefónica Group of 40–100% in the period of 1 January 2007 until 31 December 2007

Telefónica O2 Czech Republic

	in %
Telefónica O2 Services	100
Telefónica O2 Slovakia	100
CenTrade v likvidaci	100
CZECH TELECOM Germany	100
CZECH TELECOM Austria	100
SPT TELECOM (Czech Republic) Finance v likvidaci	100
DELTAX Systems	100
GITUS*	
Internet Information Services*	

* Companies fully controlled through DELTAX Systems

Telefónica O2 Czech Republic, a.s.
Za Brumlovkou 266/2, 140 22 Prague 4, Czech Republic
Tel.: +420 271 411 111
Fax: +420 271 469 868
Telephone Service Centre: 800 02 02 02
CIN: 60193336
www.cz.o2.com

Annual Report 2007

Published by: Telefónica O2 Czech Republic, a.s.
Concept, design, production and print realisation: Ogilvy CID, s.r.o.
Photographs of Company management: Lukáš Vrtílek and archive of Telefónica O2 Czech Republic, a.s.
Constellation images are for illustrative purposes only.

Telefónica O2 Czech Republic, a.s., member of the Telefónica Group